Food Safety and Spoilage: Courts Favor Reasonable Expectations of Food Companies for Product Loss

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INTRODUCTION

Reasonable expectations can make a difference in insurance coverage litigation

Wakefern Food Corp. v. Liberty Mutual Insurance Co., 406 N.J. Super. 524 (App.Div. 2009) and *HoneyBaked Foods, Inc. v. Affiliated FM Insurance Co.* Case No. 3:08-cv-01686 (N.D. Ohio Dec. 2, 2010) share some crucial facts. Both concerned food companies; Wakefern is a supermarket, and HoneyBaked a manufacturer of hams. In both cases, the company bought an all-risk first party property insurance policy. Similarly, the court in both cases found that the company, in purchasing all-risk insurance, was most concerned about the risk of food spoilage. Also in both cases, the company suffered a major food spoilage loss that, after a close reading of the insurance policy, the lower court found was not covered under the policy.

In Wakefern, the New Jersey Appellate Division then reversed the trial court decision denying coverage and found coverage based on the reasonable expectations doctrine. In HoneyBaked, the Ohio Federal District Court certified to the Ohio Supreme Court the question of whether the reasonable expectations doctrine applied, so that there would be coverage despite the policy's clear language.

The Wakefern and HoneyBaked takeaways are as follows:

- An all-risk policy provides coverage for all risks that are not excluded, but the exclusions devour a great deal of the coverage that the insured might expect.
- Despite policy language, courts are willing to find coverage when the exclusions cut to the heart of the insurance protection that the insured would reasonably expect.

CASE STUDY #1

Wakefern Food Corp. v. Liberty Mutual Insurance Co.

Wakefern concerned a supermarket that had an all-risk policy. The court found that spoilage was the biggest risk that the supermarket faced and for which it bought insurance coverage. During the blackout of 2003, the supermarket was without electricity for four days, and a large amount of its food spoiled. Wakefern turned to its all-risk policy for coverage. The insurer disclaimed.

Wakefern's policy covered loss of electrical power, but that coverage was triggered only if the loss was caused by physical damage to the off-site electrical plant. The 2003 blackout, however, was not due to an accident that caused property damage and shut down the power system. Rather, the electrical grid was shut down to prevent damage from occurring. As the insurer's expert explained, the cause of the blackout was "the de-energizing of transmission lines by the proper operation of protective relay devices." *Id*. at 535. The trial court granted summary judgment to the insurer.

On appeal, the Appellate Division found that "based on the highly technical analysis in the *Final Report*, one could certainly argue that the system was not physically damaged." *Id.* at 541. However, the court found that the term 'physical damage' was ambiguous in the context of the case before it. Applying the basic rules of insurance policy construction,

the court found that an insured would consider that the events surrounding the blackout involved physical damage. The court also relied heavily on the doctrine of reasonable expectations. The court cited the testimony of the insured's risk manager to the effect that protection from spoilage caused by electrical failure was precisely the coverage that he thought that he was buying.

CASE STUDY #2

HoneyBaked Foods, Inc. v. Affiliated FM Insurance Co.

In HoneyBaked, the insured was seeking to purchase an all-risk policy, and its broker suggested Affiliated FM. Affiliated FM conducted a site visit and prepared a report that stated that "the most significant and common hazards exposing the food industry are centered on the susceptibility of food products to spoilage and contamination." Based on this report, HoneyBaked purchased an all-risk insurance policy from Affiliated FM.

In November 2006, HoneyBaked discovered that its products contained bacteria that cause listeriosis, "an uncommon but potentially fatal disease." The bacterial contamination occurred because of an accumulation of sludge in a hollow roller on a conveyor belt. As a result of the bacteria, HoneyBaked had to destroy almost one million pounds of product. HoneyBaked then sought coverage under its all-risk policy. Affiliated FM disclaimed coverage on the basis of 'ensuing loss' exclusions. Such exclusions state: "This policy does not insure against loss or damages caused by the following; however, if direct physical loss or damage insured by this policy results, then that resulting direct physical loss or damage is covered." As demonstrated by the court's discussion of the issue, the ensuing loss provision is extremely difficult to construe and often results in coverage litigation.

The exclusions at issue were "manufacturing and processing operations" and "contamination" exclusions. The court found that the first exclusion was ambiguous and therefore did not bar coverage. The court did find, however, that the contamination exclusion applied. To that end, the court noted:

"[w]hile a close reading of the policy excludes the loss of HoneyBaked's food products caused by *Listeria*, a jury could find that HoneyBaked reasonably believed its all-risk policy covered its biggest risk—spoilation during processing of its product. The record indicates that HoneyBaked believed the policy covered this type of loss, and this belief, a jury could find, was reasonable."

The court found it unclear whether Ohio had adopted the reasonable expectations doctrine, and certified the question to the Ohio Supreme Court.

Another case, *SeaSpecialties, Inc. v. Westport Insurance Corp.,* 2008 U.S. Dist. 90836 (S.D.Fla. 2008), presents a different twist on similar facts. SeaSpecialties also concerned coverage for *Listeria* contamination under an all-risk policy. The insurer brought a motion to dismiss SeaSpecialties' coverage complaint, arguing that the policy's pollution exclusion applied.

Generally, provisions such as this are designed to address environmental contamination. Westport's reliance on the pollution exclusion in this context demonstrates how insurers can overreach in disclaiming coverage. The court did not address the scope of the exclusion, however. Rather, the court noted that the policy also contained a provision entitled "Pollutant Cleanup and Removal," which provided coverage for the expense of cleanup and remediation of pollution. As a result of the conflict between the exclusion and this provision, the court denied the insurer's motion to dismiss.

CONCLUSIONS

In obtaining property insurance, a company should work carefully with its insurance broker or consultant to identify its risks and to make sure that the company's insurance needs are communicated to the insurer. It should try to create a written record to the degree possible to document the insurance that it expects to acquire.

However, even with every precaution, all-risk policies frequently provide far less coverage than policyholders expect, and an insurer's close reading of a policy frequently results in a coverage disclaimer. These cases demonstrate that policyholders should not accept such disclaimers, because many courts are willing to enforce a policyholder's reasonable expectation that an 'all-risk' policy provides broad coverage.

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