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## Five Tips for Recovering Insurance Coverage For HVP Recalls And Claims

*By Jonathan M. Cohen and Stephen A. Weisbrod*

On March 4, 2010, the U.S. Food and Drug Administration announced that it had identified *Salmonella Tennessee* in a commonly used food-flavoring ingredient – hydrolyzed vegetable protein (“HVP”) – made by Basic Food Flavors Inc. Although there have been no reported illnesses associated with tainted HVP, Basic Food Flavors has recalled all HVP in powder and paste form that it has produced since September 17, 2009.

HVP is a flavor enhancer commonly used in small amounts in many commercially processed foods, such as soups, chips, frozen dinners, hot dogs, salad dressings, dips, stews, and seasoned snack foods. Basic Food Flavors is one of only a small number of companies that make HVP.

Although the FDA has stated that it does not know precisely how large this recall could become, the FDA has said that the number of products potentially affected potentially could be “very large.” HVP manufactured by Basic Food Flavors reportedly may have been used in as many as 10,000 products, but the number of products affected by the recall might be significantly smaller than that. That is because many manufacturers using HVP cook their products before those products are sold, and companies that can document that their manufacturing process contains a “kill step” may not need to recall their products. Nonetheless, food manufacturers already have recalled more than 100 products in just the first days since the FDA’s announcement.

HVP-related recalls likely will be very costly, but many companies have insurance coverage in place that might pay some or all of the costs of these recalls. In pursuing insurance for HVP-related costs, companies should pay careful attention to the following lessons learned in connection with other food-related recalls:

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## **1. Identify All Policies That Might Apply**

Analyzing how to obtain insurance coverage starts with a comparison of what types of costs and losses have been incurred with what is covered under the company's various insurance policies. Immediately upon initiating a recall or otherwise suffering a loss, a company should review all of its insurance policies to determine what coverages may be available.

The costs of a product recall often are excluded from coverage under many of the most commonly held types of insurance policies, such as first-party property policies or third-party general liability policies. However, some companies' policies may provide at least limited product recall coverage, which sometimes is available subject to a separate, often smaller limit of liability. First-party property policies also may have other lines of coverage that can pay some, or all, of the costs of a recall-related loss. For instance, many property policies pay for the costs of business interruptions caused by the interruption of a supplier's ability to provide food ingredients or other product components, so long as the supply-chain interruption was caused by the supplier incurring certain types of property damage. Depending on the specific policy language used, the interruption in supply of HVP might result from property damage as required by the policy.

Companies also may have specialty insurance policies that expressly cover the costs of product recalls. Product recall policies generally are first-party policies that cover, among other things, the "reasonable and necessary" costs, expenses, losses, and liabilities that a company incurs as a result of a product recall. Product recall policies also sometimes cover lost profits resulting from the recall.

Product recall policies sometimes cover recalls only if those recalls result from specified categories of causes, which generally will include accidental contamination and forced recalls. Based on these provisions, some insurers recently have argued that product recall policies do not provide any coverage until the policyholder can demonstrate that their product actually were tainted with a dangerous pathogen. Policyholders should argue vigorously against this position, which conflicts both with the public policy encouraging voluntary recalls and the policy language triggering coverage where a recall results from a company's products potentially posing a safety risk.

## **2. Early Decisions Matter In Seeking Insurance Coverage For HVP Losses**

Immediately upon deciding that a recall may be necessary, or even before making that decision, companies have a series of important decisions that may have critical insurance consequences. That is because most insurance policies contain an array of procedural requirements that might apply.

For instance, one of the most significant early decisions companies must make is whether and when to provide its insurer with notice of the recall or the circumstances that may give rise to a future recall. To effectuate notice, companies should review all of their relevant insurance policies to determine which policies

even arguably might apply. Then, companies should consider giving notice with respect to all of those policies. Prompt notice may be particularly significant under product recall policies, under which a claim sometimes is covered only if it is made and reported to the insurer during the policy period.

Many product recall policies also require the company to provide an initial and a final statement of loss. A statement of loss generally must identify the “full particulars” of the loss and the company’s projections of the likely scope of the loss. In the first-party coverage context, disputes sometimes arise as to how to quantify the amount that the policyholder actually lost. Companies should document all of the recall costs, as well as any property damage, and keep a detailed account of all costs incurred to repair or to replace damaged property.

Because some insurance policies also cover losses from business interruptions, companies should preserve evidence to substantiate prior sales and any inability to meet expected sales resulting from the recall of tainted HVP. Companies also should be aware that they may be entitled to measure their business interruption loss based on what they would have made had there been increased demand for their goods absent the recall.

It also is important to bear in mind that product recall policies often require the policyholder to submit the initial statement of loss within a relatively short time after the company provides its initial notice – sometimes as soon as thirty or forty-five days after initial notice. Companies should pay close attention to the deadlines provided in the policy. If a company believes it is not feasible to provide an initial statement of loss in the time required, the company should work with its insurers to seek an agreed extension of these deadlines.

Other policy terms may apply if a company looks to its insurer for defense or liability payments with respect to third-party bodily injury claims resulting from exposure to a tainted product. For instance, insurers often argue that their policies give them the power to participate directly in the defense and settlement of third-party claims. Insurers also sometimes argue that the policies give insurers the right to limit the insured company’s choice of defense counsel.

In making its early insurance decisions, companies must keep a close eye on the specific requirements of the policy language. Understanding the policy terms can help companies to navigate successfully the crucial early days of a product recall.

### **3. Recognize The Role Of Insurance In Business And Defense Plans**

For companies facing an HVP-related recall, there may be a temptation to focus first on the implementation of the recall and in protecting their brands from bad publicity, and to defer insurance issues for a later date. This can be a mistake.

Seemingly innocuous decisions made in the course of a recall or in defending third-party bodily injury claims can have a significant effect on the amount of coverage ultimately available to pay for that recall or for the defense of the third-party claims. Insurers might rely on positions a company takes in its defense or

statements it makes in the course of a recall to try to reduce the insurer's own coverage obligations. Consequently, how a company describes a claim in its defensive pleadings, recall materials, or public statements or advertising might have a significant impact on how much coverage the company ultimately can recover.

The reverse also is true: Insurance policy provisions may affect how a company handles its recall and how it defends any third-party claims that might arise. For instance, many product recall policies specify details of how a company must conduct its recall. Another example is that some insurer defenses do not apply when a policyholder settles the underlying claim without making certain admissions, such as admissions regarding intent. These types of insurance considerations can affect dramatically how a company conducts its recall and its defense of any third-party claims.

#### **4. Take Steps To Work Effectively With Insurers**

Companies seeking coverage should take all appropriate steps to establish an appropriate working relationship with their insurers.

From the start, companies should seek to create a cooperative relationship with their insurers. Insurers can be a valuable resource to their policyholders. Insurers often have broad experience with the types of issues that often confront companies facing a product recall. Insurers can be an important ally in negotiations with any third-party bodily injury claimants because the insurers often are familiar with the plaintiffs' lawyers. Insurers often represent many policyholders confronting the same recall issues and addressing the same plaintiff claims, and they thus can help their policyholders understand how other companies are addressing similar recall and claims-handling issues.

However, companies also need to be aware of when the insurer's interests diverge from the company's own interests. For example, insurers often request supporting information before agreeing to make payment on claims. Frequently, though, insurers use information requests as a means to extend the claims review process and delay making payments. Companies should be alert to the difference between legitimate information requests and endless and repeated information demands that lack a good-faith basis. If an insurer meets every response to a prior information request with new and additional information requests, companies should evaluate carefully whether their insurer is acting appropriately or, instead, is simply slowing its claim-review process.

Another complication may arise where HVP-related recalls and claims potentially trigger more than one insurance policy or where multiple companies in the chain of distribution each involve one or more of their own insurers. In that situation, companies must address overlapping, and possibly contradictory, policy requirements and terms. For instance, a product recall insurer may insist that a food company make certain statements or admissions about the recalled products, while a general liability insurer may regard those very same statements or admissions as a breach of the policyholder's duties under a general liability policy.

Companies should recognize that insurers do not have the right to place their policyholders in such untenable positions, and companies should respond to contradictory insurer demands accordingly.

A related problem may arise where two or more insurers point the finger at each other, each claiming that the other should pay or, at least, should pay first. Here, again, policyholders should recognize that they have arguments to disarm this type of problem. For example, some courts have recognized that insurers cannot in good faith withhold coverage solely because they dispute whether they, or another insurer, should pay first. That result is particularly compelling when the coverage at issue obligates the insurer to defend the policyholder and to pay the policyholder's defense costs.

## **5. Understand Your Rights As A Policyholder**

Even where an insurance policy may appear at first blush to cover HVP-related recalls or claims, insurers may point to arguably ambiguous policy language or to a policy's exclusions to attempt to evade what otherwise would be their clear coverage obligation. Policyholders, though, should not be daunted by an insurer's efforts to avoid payment under its policies. There often are strong counterarguments to the insurers' positions, and many insurer arguments depend on legal positions that policyholders in other contexts already have litigated successfully.

For instance, insurers have argued that claims alleging bodily injury resulting from exposure to tainted foods fall under the provision in many policies that excludes coverage for pollution claims. In the spinach cases, insurance-company lawyers argued that the E. coli contamination resulted from manure, which they claimed was a "pollutant" that triggers a pollution exclusion. Some courts, however, have held that E. coli itself does not constitute a pollutant. Insurers might make similar arguments regarding the salmonella at issue in the HVP context, and policyholders should be prepared to respond. Moreover, insurers generally bear the burden of proving the applicability of coverage exclusions, and insurers may be hard-pressed to meet this burden where government officials have not yet traced the contamination to a specific cause, as may be the case with the HVP recall.

Similarly, insurers have asserted that damages from a pathogen in a food product are not covered under property policies. Insurers have argued that at least some tainted products did not suffer the "physical" damage covered by property policies, but instead sustained only a "diminution of value" that they assert is not covered. Some courts have found, however, that food that no longer complies with Food and Drug Administration regulations has been physically damaged.

Insurers also often point to provisions in general liability policies that exclude claims for the recall of the policyholder's products, sometimes called "sistership" exclusions. These exclusions, however, might not apply where the claim against the policyholder arises from damage to another company's product from the incorporation of a contaminated or recalled product.

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In sum, companies ensnared in HVP-related recalls must fight the temptation to focus solely or first on conducting the recall and defending against third-party bodily injury claims that might later arise. Instead, they should immediately and proactively develop an effective insurance strategy. Failure to do so could reduce precipitously the coverage available to pay a company's recall and liability costs.

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