

08 December 2015

Practice Group:
Insurance Coverage

This article was first published by *Law360* on 03 December 2015.

Massachusetts Court of Appeals Precludes Coverage for Dairy Products and Packaging Despite “Resulting Loss” Exception to “Faulty Workmanship” Exclusion in “All Risk” Policy

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Introduction

Manufacturers, suppliers, and distributors of food products face significant business and litigation risks associated with food contamination and recall issues. Policyholders in this chain of production should be aware that even when they believe they have purchased adequate coverage to respond and protect them in such situations, courts may not always agree and may instead deny coverage. *H.P. Hood LLC v. Allianz Global Risks U.S. Ins. Co.*, No. 14–P–1605 (Mass. Ct. App. Nov. 2, 2015), is the most recent example, in which the Court of Appeals of Massachusetts affirmed a trial court’s decision that a first party “all risks” insurance policy containing a “faulty workmanship” exclusion precluded coverage for losses arising from the policyholder’s destruction of 1.8 million bottles of a specialty drink due to alleged problems with the bottle caps, which put the product at risk of spoilage. As discussed below, notwithstanding the strong arguments demonstrating that the Court reached the wrong conclusion, the decision serves as a cautionary tale to policyholders who have not critically evaluated their coverage program and filled in potential gaps by purchasing specialized food contamination coverage.

Background Facts

HP Hood, LLC (“Hood”), a processor and distributor of dairy products throughout the United States, manufactured a dairy based liquid product known as Myoplex¹ for Abbott Laboratories (“Abbott”). Within the first month that Hood began production, several bottles of Myoplex failed contractually-required (but not FDA-required) quality assurance testing. Due to the quality assurance issue, Abbott declined to accept a production run of Myoplex, cancelled portions of upcoming production orders, and reduced the overall volume of Myoplex it would accept. Even though the product had not yet spoiled, Hood and Abbott agreed to destroy 1.8 million bottles of Myoplex on the grounds that the affected production run was no longer marketable. Ultimately, Hood discovered that the problem was due to the liner in the bottle caps becoming slippery over time, which affected the amount of optimal torque required to seal the bottles properly.

Hood sought coverage for its losses under a first party “all risks” insurance policy it had purchased from Allianz Global Risks U.S. Insurance Company (“Allianz”). Hood’s policy

¹ Myoplex is a “shelf stable” beverage designed to require refrigeration only after its bottles are opened. To ensure Myoplex does not spoil before consumers open them, it must be manufactured and bottled under strict aseptic conditions, and its bottles must stay hermetically sealed.

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provided coverage for “all risks of direct physical loss or damage to Insured Property . . . provided such physical loss or damage occurs during the Policy Period.” The policy excluded losses arising from “faulty workmanship, material, construction or design, from any cause,” but included what is commonly known as an “ensuing loss” or “resulting loss” provision, which limited the reach of the exclusion to allow coverage for physical loss or damage resulting from faulty workmanship, material, construction or design.²

On cross motions for summary judgment, the trial court held that under an “all risks” policy actual physical damage was unnecessary to trigger coverage, but ruled in Allianz’s favor that Hood’s losses fell within two policy exclusions – the “faulty workmanship exclusion” and the “latent defect” exclusion.³ Hood appealed.

The Court of Appeals Decision

In affirming, the Court’s ruling centered on the “faulty workmanship” exclusion. Specifically, the Court held that there was no coverage because the claimed losses were excluded under the “faulty workmanship” exclusion “whether that problem be viewed as one of faulty ‘material’ (the fact that the characteristics of the bottle cap liners changed as they aged), faulty ‘workmanship’ (the failure by Hood to apply the correct torque), or faulty ‘design’ (the fact that the bottling process did not take into account the changes to the liners as they aged).”⁴ Further, despite recognizing that the policy’s “ensuing loss” exception “raise[d] some interpretive challenges, and the case law reveal[ed] the frustration that judges have felt in trying to make sense of provisions that include such language”,⁵ the Court rejected Hood’s argument that the “ensuing loss” provision, if not clearly providing coverage, was at least ambiguous and, therefore, should be read to provide Hood with coverage.⁶ The Court concluded that the “problem with the bottle cap liners directly rendered the entire product unsaleable” such that the loss fell squarely within the faulty workmanship exclusion.⁷

Takeaways from Hood

The *Hood* case is subject to criticism from a policyholder’s perspective for a variety of reasons.

- First, the Court’s reading of the policy rendered the “ensuing loss” exception illusory, which the Court should have recognized as not only impermissible but also a result Hood and Allianz would not have intended.⁸

² The “ensuing loss” provision provided: “This ‘policy’ does not cover the following, but if physical loss or damage not otherwise excluded by this ‘policy’ to Insured Property at Insured Location(s) results, then only such resulting physical loss or damage is covered by this ‘policy.’”

³ *H.P. Hood LLC v. Allianz Global Risks U.S. Ins. Co.*, No. 2010-04360 (Mass. Super. Ct. June 24, 2014). The trial court held that the “recall” exclusion was inapplicable.

⁴ *H.P. Hood LLC v. Allianz Global Risks U.S. Ins. Co.*, No. 14–P–1605, at *8 (Mass. Ct. App. Nov. 2, 2015).

⁵ *Id.* at *9-*11 (citing *Lake Charles Harbor & Terminal Dist. v. Imperial Cas. & Indem. Co.*, 857 F.2d 286, 288 (5th Cir. 1988) as commenting that “[a]t first glance, the exclusion at issue here appears to be self-contradictory gibberish.”) (internal quotations omitted).

⁶ *Id.* at *11.

⁷ The Court determined it need not determine whether the losses were excluded under the separate “latent defect” exclusion or whether the “recall” exclusion was inapplicable (as found by the trial court).

⁸ *Id.* at *10 (recognizing same, but with respect to the “faulty workmanship” exclusion).

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- Second, despite recognizing the interpretative issues surrounding the policy’s “ensuing loss” exception, the Court refused to apply the rule of interpreting ambiguities in Hood’s favor. If it had done so, at the very least the Court would have found coverage for the “ensuing loss,” or loss of the dairy product itself.
- Third, if not relegated to its facts, insurers may attempt to utilize *Hood* to strip policyholder’s of their coverage in a wide variety of spoilage cases regardless of the presence of an “ensuing loss” exception that should restore coverage for at least the physical loss or damage not directly arising from faulty design or workmanship.

The net result is that *Hood*, and other similar decisions, leave policyholders in doubt as to whether their “all risks” policies are as broad as they appear. There are strong arguments in favor of coverage for Hood’s losses and in other jurisdictions, some, if not all, of Hood’s claimed losses would have been covered. In addition, under even slightly different facts, or even if the same facts were characterized differently, the *Hood* court may well have come to a different conclusion. The takeaway for policyholders is that “all risk” policies remain a potential source of coverage for product contamination and recall-related losses. That said, in order to maximize coverage for these losses, policyholders (and their coverage counsel) should carefully assess the relevant caselaw and facts surrounding their losses, and, where possible, argue for the application of law from jurisdictions which are more favorable on this subject.

It should be noted that the insurance industry also offers specialized food contamination policies which expressly cover, among other things, accidental product contamination, malicious product tampering, and product extortion demands. Although these policies should provide greater certainty of coverage for product contamination and recall related losses, they require the payment of additional premiums. Moreover, because such policies are generally unique to each insurer that writes them, it is imperative to carefully review the policy language to ensure that coverage gaps are filled. Finally, because entities involved in the chain of manufacturing and distribution are frequently added as an “Additional Insured” on each other’s policies, it is also necessary to review those policies to determine the scope of coverage provided. Therefore, companies should proactively review their coverage program, including any applicable “all risks” policies or food contamination / recall policies, with brokers or coverage counsel to guard against potentially substantial uninsured risks.

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