RISK & INSURANCE

The Law

Legal Spotlight

A look at the latest decisions impacting the industry.

By: Anne Freedman | December 14, 2015 • 5 min read
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Insurer Must Pay $25 Million

In October 2011, floods in Thailand caused $39.4 million in property damage to a Rojana Industrial Park facility owned by Federal-Mogul Corp. The flooding also resulted in a “time element loss” of $25.1 million.

Federal-Mogul submitted claims to Insurance Co. of the State of Pennsylvania and the insurer paid the company $30 million under a “high hazard flood zone provision” sublimit in the $200 million flood policy. It rejected the time-element claim, stating the sublimit restricted the amount of money it owed to a total of $30 million.

On May 3, 2012, the auto parts company filed suit against the insurer, claiming both that the facility was not in a high hazard zone (100-year floodplain) and that even if it was, the high hazard sublimit applied only to physical loss or damage, not to losses of earnings and profit, extra expenses, contingent losses or service interruption time.

The court never reached a conclusion on whether the facility was in a high hazard zone, but concluded the sublimit did not apply to time-element losses. It ruled the policy “makes no mention of time element loss” in its high hazard zone sublimit, and that other sublimits did mention such an exclusion.

“Where insurance policies expressly include certain types of loss in some sublimits, courts have found that sublimits without reference to such loss do not include that type of loss,” the court ruled on Oct. 8.

Scorecard: Insurance Co. of the State of Pennsylvania must pay its insured $25.1 million.

Takeaway: There is no time-element exclusion in the policy unless the policy “clearly and unambiguously” limited that liability in the high hazard provision.

The Meaning of ‘Renewal’

In December 2001, Indian Harbor Insurance Co. and F&M Equipment Ltd., also known as Furnival Machinery Co., agreed to a 10-year pollution and remediation legal liability policy that offered $10 million in liability protection for 12 Furnival locations.

Furnival paid $520,498 in premium for the policy, later adding an endorsement that increased the policy's limit to $14 million for an additional premium of $55,798.

One of the policy's original endorsements stated that Indian Harbor "shall not cancel nor non-renew this policy" except for five reasons listed in an endorsement, according to court documents.

"It is undisputed that none of the listed reasons for non-renewal occurred," according to the Oct. 15 opinion filed by the U.S. 3rd Circuit Court of Appeals.

After a request for renewal from Furnival, Indian Harbor sent Furnival's insurance broker a renewal offer in January 2012 that provided $5 million of coverage for a one-year term, and omitted coverage for the Elizabethtown landfill site, which was subject to a clean-up consent decree with the federal government and for which claims had been made.

Furnival rejected those terms, ultimately sending Indian Harbor a notice that it was accepting the renewal extension contained in the original policy, and sending a premium check for $520,498.

On March 23, 2012, Indian Harbor filed a complaint in the U.S. District Court for the Eastern District of Pennsylvania seeking a judgment that it had "no obligation to offer to renew the policy under the same terms and conditions as the expiring policy," among other reasons. Furnival filed a counterclaim for breach of contract.

The district court ruled in the insurer's favor.

On appeal to the U.S. 3rd Circuit Court of Appeals, a three-judge panel reversed that decision, rejecting Indian Harbor's argument that being unable to change the terms and conditions "would lock it into the same contract for eternity."

The court ruled that the insurer's "change in terms is so drastic as to render it effectively a nonrenewal. … There is no difference between what Indian Harbor proposed and what it had every right to do without a prior promise to renew. If any new offer counts as a renewal, the promise of a renewal is illusory."

Scorecard: Indian Harbor "must offer a contract that can be considered a renewal, and then the parties can negotiate the details," the court ruled.

Takeaway: Agreeing with a U.S. 8th Circuit Court of Appeals ruling, the 3rd Circuit ruled that "a renewal requires 'continuation of coverage on the same, or nearly the same terms as the policy being renewed.' "

Recall Expenses Must Be Covered

On Oct. 7, 2013, the U.S. Department of Agriculture Food Safety and Inspection Service (FSIS) issued a Notice of Intended Enforcement to Foster Poultry Farms Inc. The FSIS said the assignment of inspectors at the plant would be suspended and marks of product inspection would be withheld.

At the time, more than 200 people in 15 states had been hospitalized for salmonella illness. About 80 percent of them reported they had eaten Foster's products, according to court documents. The number later reached 278 illnesses in 18 states.

The FSIS delayed the suspension to allow Foster to take corrective actions, but on Dec. 6, the FSIS issued a letter noting "live cockroach sightings" at the facility and the company's failure to remedy "the high incidence of salmonella."

On Jan. 8, 2014, three out of eight chicken samples at the facility tested positive for salmonella, and the FSIS suspended the assignment of inspectors and withheld marks of inspection. Foster ceased production from Jan. 8 to Jan. 21 to fumigate the facility and take corrective measures.

In all, 1.3 million pounds of chicken were ineligible for sale, and Foster submitted a claim for more than $12 million to a group of three Lloyd's of London syndicates under a product contamination insurance policy.

The insurers rejected the "accidental contamination" and "governmental recall" claims. For the accidental contamination claim, the insurers said, "a mere possibility that Foster's chicken product is contaminated is insufficient to trigger coverage."

They rejected the governmental recall claim because, they said, a recall applies only to products that left Foster's control, not to poultry destroyed at the facility.

Foster argued the term “recall” also meant “cancel” or “revoke” and thus, encompassed voluntary destruction of product, as opposed to the insurers’ contention that it applied to products that had left the facility.

On Oct. 2, the U.S. District Court for the Eastern District of California noted the policy defined accidental contamination as “an error” in the production process that “has led to or would lead to bodily injury, sickness, disease or death.”

The court said that Foster’s incorrect or mistaken implementation of sanitary measures was an error in the production process, and that the chicken products could cause injury. “It would … be unreasonable to imply that a product must first be put into commerce and injure somebody before the policy will provide coverage,” the court ruled.

The court also noted the term “recall” could be interpreted differently, and since it was ambiguous, it must be interpreted in favor of the insured.

Scorecard: The insurers must pay more than $12 million to settle the claim.

Takeaway: Any ambiguous terms in an insurance contract must be interpreted in favor of the insured.

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