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Costs to Recall and Dispose of Adulterated Products Supplied by an Insured Is Not a Covered "Occurrence"

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Recently, in *Sage Products LLC v. Federal Insurance Company*, 19-cv-5308 (N.D. Ill. Oct. 25, 2023), the District Court for the Northern District of Illinois (applying Wisconsin law) addressed whether costs to recall an adulterated product containing a defective component supplied by the insured were covered under a commercial general liability policy. The District Court granted summary judgment in favor of the insurance company holding that coverage was not owed where damage and loss of use that resulted from the recall was not the result of an "occurrence" as defined by the policy.

The underlying dispute in *Sage* was a breach of contract claim brought by Sage Products LLC against ChemRite CoPac, Inc. after ChemRite provided Sage with adulterated products for oral hygiene kits. Sage manufactures and supplies oral hygiene products for patients in hospitals, including kits containing a toothbrush, swab, and one of several oral rinse solutions. ChemRite, one of the manufacturers of the oral rinse solution, received notice from the FDA that their oral rinse solution did not conform with federal standards. ChemRite informed Sage, who then recalled and stopped distribution of all products with ChemRite's solution. Sage sued ChemRite and later reached a settlement, the terms of which included ChemRite assigning Sage its claims against its insurer, Federal Insurance Company. Sage then stepped into ChemRite's shoes and sued Federal for $6 million, the maximum under ChemRite's policy.

In assessing coverage, the District Court focused on a single dispositive point, namely, whether there was an "occurrence" within the meaning of the policy. Federal's policy defined "occurrence" as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." The policy did not define "accident." However, to determine if an act was accidental the Court attempted to determine whether the occurrence giving rise to the claims was "an unintentional act in the sense that it was not volitional."

Sage identified two events that it argued caused "property damage" under the policy: the incorporation of ChemRite's tainted rinse solutions into Sage's kits and the physical removal of the rinse packets from the kits. As to the incorporation of the tainted rinse packets, the Court denied that this was an occurrence. First, the Court reasoned that Wisconsin law recognizes "installation" as part of workmanship. Thus, faulty installation, like faulty workmanship, does not constitute an "accident" or "occurrence" unless it results in property damage to other property. Thus, ChemRite providing Sage with tainted rinse packets, and Sage incorporating those packets into its kits, is analogous to a third party incorporating an insured's faulty workmanship into construction of a defective building. Neither of those events, according to the District Court, constitute an "occurrence."

Second, the District Court reasoned that even assuming incorporation of ChemRite's rinse solutions into Sage's kits could be construed as an "occurrence," it did not help Sage because that incorporation was intentional, not accidental. In other words, Sage and ChemRite intended that the rinse solution packets would be incorporated with the other kit components and sealed—that was the purpose of their contract. But, the policy only provided coverage for losses resulting from an "accident." According to the District Court, the incorporation of the rinse solutions did not "occur by chance" nor was it "unforeseen and unintended." Similarly, arguing that no one anticipated that ChemRite would provide a tainted product did not transform the act into an "accident." Put another way, an unexpected result alone does not constitute an accident; "the means or cause must be accidental." Accordingly, Sage's incorporation of ChemRite's adulterated oral rinse solution was not an accident or an "occurrence" under the policy.

The District Court also rejected Sage's argument that removing the rinse solution from the kits constituted an "occurrence." Similar to the Court's prior reasoning, the District Court held that such acts were "intentional and volitional" and once Sage was informed of the tainted rinse solution, it was expected that the rinse would need to be removed and Sage would incur losses. Therefore, removing the defective rinse solution was not an accident.

Ultimately, the District Court held because any damage or loss of use that resulted from Sage's recall of the kits and removal of solution was not caused by an "occurrence" within the meaning of the policy, there was no initial grant of coverage and Sage could not recover against Federal. While the FDA's finding that the rinse solutions did not comply with regulations was unforeseen and unintentional, the insured's actions that led to this finding were both foreseeable and intentional because the contract between Sage and ChemRite itself called for such actions to be taken. Moreover, once the recall was set into motion, the Court reasoned that Sage took purposeful actions to remove the rinse solutions, as was required by law. According to the Court, the damage and losses incurred as a result of the recall were then in no way an accident.