Products Liability Law Daily Wrap Up, TOP STORY—SUPPLY CHAIN LIABILITY ISSUES—Wis. Sup. Ct.: CGL policies didn't cover use of defective ingredient in probiotic health tablets, (Mar. 2, 2016)

Products Liability Law Daily

By Susan Engstrom.

The commercial general liability insurers for two companies in a chain of pharmaceutical manufacturers/suppliers were not required to cover damages arising from the incorporation of the wrong type of beneficial bacteria into a probiotic health supplement, Wisconsin's highest court ruled, reversing the appellate panel's decision to the contrary. The blending of the wrong component into the tablets did not constitute property damage caused by an occurrence under the policies' terms and, even if it did, the policies' "impaired property" exclusions would apply to bar coverage (*Wisconsin Pharmacal Co., LLC v. Nebraska Cultures of California, Inc.*, March 1, 2016, Roggensack, P.).

Wisconsin Pharmacal Co. contracted to supply a feminine health probiotic supplement to a major retailer. The supplement was in the form of a chewable tablet and contained the beneficial bacteria *Lactobacillus rhamnosus* (LRA). Pharmacal contacted Nutritional Manufacturing Services, LLC (NMS) to locate a supplier of the bacteria and to manufacture the tablets. NMS purchased the bacteria from Nebraska Cultures of California, Inc., which had acquired it from Jeneil Biotech, Inc. Pharmacal ultimately provided the probiotic supplement tablets pursuant to the contract, but the retailer later determined through independent testing that the tablets contained *Lactobacillus acidophilus* (LA) rather than LRA. It notified Pharmacal of the error and ultimately ended up recalling and discarding the adulterated supplement.

Pharmacal (on its own behalf and as NMS's assignee) filed suit against Nebraska Cultures, Jeneil, and their respective CGL insurers, alleging various causes of action sounding in tort and contract. The trial court dismissed all of Pharmacal's claims against Nebraska Cultures and Jeneil, leaving only NMS's contract claims against Nebraska Cultures and the two suppliers' cross-claims against their insurers for contribution or indemnification. The insurers successfully moved to bifurcate and stay the proceedings pending a coverage decision, followed by a motion for summary judgment on the coverage issue.

Jeneil's policy. Jeneil's CGL policy, which was issued by The Netherlands Insurance Co., provided coverage for losses arising out of "bodily injury" or "property damage" caused by an "occurrence." The term "property damage" was defined as:

(a) Physical injury to tangible property, including all resulting loss of use of that property[;] or
(b) Loss of use of tangible property that is not physical injured.

To fall within definition (a), the incorporation of the LA—the defective ingredient Jeneil had provided—into the tablets had to constitute physical injury to tangible property other than the LA itself. To make that determination, the court had to analyze whether a supplement tablet was an integrated system. If it was, then damage to the system would be considered damage to the product itself, and not to other property.

In the court's view, combining a defective ingredient with other ingredients and incorporating them into supplement tablets formed an integrated system. Pharmacal could not separate out the LA from the other ingredients or the other ingredients from each other. Accordingly, the court concluded that the alleged injury was sustained by the integrated system itself, i.e., the tablets, and that no other property was injured.

Moreover, there was no physical injury to tangible property caused by LA. There was no evidence showing that creating tablets using LA physically altered other ingredients in a way that would not have occurred if LRA had been used in the same tableting process.

With respect to definition (b), Jeneil argued that the incorporation of a defective ingredient rendered the tablets and other ingredients useless, thereby constituting loss of use. However, the court has previously determined that diminution in value—even to the point of worthlessness—is not the same as "loss of use," which contemplates some sort of loss of use in fact, and not a reduction in value. In this case, Pharmacal did not actually lose *use* of the tablets but, rather, permanently lost the entire value of the tablets.

Accordingly, the incorporation of LA into the tablets did not constitute property damage under either definition.

For the sake of completeness, the court also determined that Jeneil's accidental provision of a defective ingredient did not constitute an "occurrence" in and of itself. Therefore, there was no property damage caused by an occurrence, precluding an initial grant of coverage under Jeneil's policy.

Nebraska Cultures' policy. The CGL policy held by Nebraska Cultures was issued by Evanston Insurance Co. and was governed by California law. It similarly provided coverage for losses arising out of "bodily injury" or "property damage" caused by an "occurrence," and defined "property damage" as:

> [1] physical injury to or destruction of tangible property including, consequential loss of use thereof; o[r] [2] loss of use of tangible property which has not been physically injured or destroyed.

When considering whether a defective product has caused property damage, California courts examine whether the product is hazardous. If it is, there is immediate property damage to other property caused by the defective product. In this case, however, there was no evidence suggesting that the defective probiotic ingredient, LA, was hazardous. Although a defective ingredient rendered the tablets inadequate for their contracted purpose, the mere presence of a defective ingredient did not make them hazardous. Therefore, there was no property damage under the first definition.

Nor was there property damage under the second. Under California law, "loss of use" damages refer to the rental value of temporary replacement property rather than the value of replacing the property itself. Here, Pharmacal's underlying claims were not for loss of use damages because they related to the permanent uselessness of the tablets and not to the value of temporary replacement property.

In addition, the provision of a defective ingredient could not be said to constitute an occurrence under the policy. Accordingly, there was no initial grant of coverage under this policy either.

Exclusions. Finally, even if there had been an initial grant of coverage, the plain meaning of the policies' "impaired property" exclusions would bar coverage. These exclusions specifically precluded coverage for the insured's failure to perform its contractual obligations.

The case is No. 2013AP613.

Attorneys: Philip J. Dahlberg, IV (Dahlberg Law Group, LLC) for Wisconsin Pharmacal Co., LLC. Terry E. Johnson (Peterson Johnson Murray) for Nebraska Cultures of California, Inc. Mark F. Wolfe (Traub Lieberman Straus & Shrewsberry LLP) for Evanston Insurance Co. James A. Baxter (James A. Baxter, Attorney at Law) for Jeneil Biotech, Inc. Thomas R. Schrimpf (Hinshaw & Culbertson LLP) for The Netherlands Insurance Co.

Companies: Wisconsin Pharmacal Co., LLC; Nebraska Cultures of California, Inc.; Evanston Insurance Co.; Jeneil Biotech, Inc.; The Netherlands Insurance Co.

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