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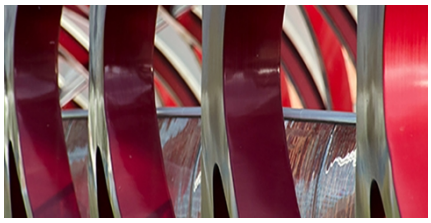

News & Types: Commercial, Competition & Trade Update

Manufacturer Loses Big Time Twice – to its Customer and to its Insurance Company

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Practices: Commercial, Competition & Trade, Corporate, Finance & Acquisitions, Litigation

Berry Plastics Corporation (now known as Berry Global, Inc.) is a manufacturer of primarily plastic packaging products. It encountered some difficulties with one of its products, resulting in two major litigation defeats. In the first, a jury in Maine awarded Berry's customer, Packgen, $7.2 million for breach of contract and breach of warranty. Then, when Berry tried to recover against its insurance carrier, Berry lost again. (*Berry Plastics Corporation, n/k/a Berry Global, Inc. v. Illinois National Insurance Company*, 7th Circuit Court of Appeals, No. 17-1815, September 10, 2018) Judge Rovner's complex opinion discusses at length the interplay between contract losses, generally not recoverable through insurance, and losses that can be recovered through insurance. It is a complicated, fact-based analysis.

Packgen manufactured specialized containers for bulk quantities of industrial chemicals and other materials. Packgen worked with one of its customers, CRI Catalyst Company, to develop a new type of intermediate bulk container ("IBC") that could be used to store and ship a chemical catalyst that CRI produced. This innovative IBC used a polypropylene fabric rather than metal. So the IBC would be collapsible, saving storage space, weight and money.

But there were hazards. The catalyst that CRI produced was a self-heating material that could ignite when exposed to oxygen. So the safety of the IBC was critical. To make the IBC safer, Packgen engaged Berry to manufacture a laminated product comprised of a woven polypropylene chemically bonded to a layer of aluminum foil. After extensive testing, Packgen began to manufacture and ship the IBCs to CRI in October 2007. At first, the IBC was very successful. By April 2008, Packgen was selling an average of 1,261 IBCs per month to CRI. Packgen was anticipating an increase in sales and profits from the IBC, not just to CRI but also to other customers.

In April 2008, there was a failure. CRI personnel were lifting an IBC. The foil layer on the exterior surface separated from the polypropylene causing the outer portion to come apart, exposing the interior lining. Similar failures followed, some resulting in fires when the catalyst was exposed to air. Packgen determined that the large roll of foil laminate Berry delivered to Packgen in January 2008 was defective. While Packgen thought the problem was correctable, either by Berry or by another vendor, CRI lost confidence in the innovative IBC. CRI cancelled all pending orders for the IBCs, destroyed the IBCs that it had received, and refused to pay for any of them.

Packgen sued Berry in Maine based on breach of contract and breach of express and implied warranties. The jury's verdict mirrored the $7.2 million damages calculated by Packgen's expert, representing unpaid invoices and out-of-pocket costs of $643,039.30 and a staggering future lost profits assessment of $6,563,607 based on a 10-year projection. The jury verdict was upheld on appeal.

As an aside, the 7th Circuit opinion did not discuss the basis for such a high verdict and questions abound. Did Berry exclude consequential damages in its agreement, and, if so, did the jury refuse to apply the limitation? Did Berry indemnify Packgen? Was the agreement silent on these types of consequential damages? This costly jury verdict represented Berry's first major defeat from the IBC failure.

Berry recovered $1 million from its primary liability carrier. It sought the remaining $6.2 million from Illinois National, its commercial liability carrier. Illinois National denied coverage. The district court granted summary judgment to Illinois National and Berry appealed. Applying Indiana law, Judge Rovner wrote a 36-page opinion affirming the district court judgment.

The opinion is complex with many subtle points about the obligation of insurance companies to indemnify in this situation. But two elements are critical – the language in the policy and the facts.

The insurance policy covered damages that Berry was required to pay "because of . . . Property Damage." Judge Rovner acknowledged that "some portion of the lost profits theoretically might be attributable to property damage [but] Berry has neither undertaken to make that showing nor demanded the opportunity to do so." What did Berry do wrong?

There was no Indiana case law directly on point, so the court had to predict how the Indiana Supreme Court would resolve the issue. The district court determined that Indiana would conclude that lost profits are not covered as "damages because of . . . Property Damage" unless they are a measure of the actual physical injury to tangible property or for the loss of use of that property. Profits on future sales would not be damages because of property damage.

Judge Rovner affirmed, but took the analysis in a different, more nuanced, direction. She noted that lost profits are a form of business loss and are not the type of injury insured by commercial general liability policies.

> "A manufacturer's liability insurer is not insuring against the risk that a particular product may not perform as promised or may not meet the commercial expectations of the manufacturer's customers. Especially when a manufacturer has designed a product to meet the particular needs of one customer, the specifications the manufacturer has undertaken to meet, and the purposes its product are intended to serve, are matters of negotiation between the manufacturer and its customer; and the manufacturer's liability insurer stands at a remove from that relationship. [citations omitted] An insurance policy intended to backstop a manufacturer's warranties and contractual agreements would look quite different from a commercial general liability policy."

Judge Rovner described Berry's position as arguing that, since the foil laminate failed in a way to cause property damage, all damages occurred because of property damage. Judge Rovner described Illinois National's position as limiting recoverable damages only to property damage caused by the defective product. Said Judge Rovner, "In our view, the correct answer (and the one we believe the Indiana Supreme Court would

likely adopt) lies somewhere between these positions and depends on a fact-sensitive inquiry with which Berry has not engaged."

Judge Rovner discussed several cases that represented a "narrow understanding of the losses that can be said to occur "because of" property damage to the extent they exclude any anticipated losses on products not yet sold and produced. . . . Once the assessment of consequential losses extends beyond the profits lost on existing goods and sales already made to an estimate of the profits lost on future anticipated sales, it is arguably enforcing the commercial expectations of the injured party more so than remediating property damage." This was consistent with Illinois National's position.

But then Judge Rovner went back to the policy language. The policy insured against damages "because of . . . Property Damage." Said Judge Rovner, "An ordinary understanding of the phrase "because of" would include a broad array of consequential damages, not simply those that constitute a measure of the injury to the property itself." Judge Rovner cited cases and treatises that took an expansive view of damages "because of" property damage. For example,

- "As in tort law, so in liability-insurance law[:] once there is damage to property[,] the victim can recover the nonproperty, including business, losses resulting from that damage and not just the diminution in the value of the property."
- "Liability policies cover not only damages *for* property damage, but damages *because of*, *on account of*, or *by reason of* property damage. Accordingly, once covered property damages exists, all consequential damages are covered."

So this broader interpretation of damages "because of" property damage would seem to support Berry's position that Illinois National should indemnify Berry for all its losses, not just direct property damage.

Not so, said Judge Rovner. The answer "depends on whether those losses were specifically due to property damage or instead to the failure of Berry's foil laminate product to function as expected and warranted." The jury verdict did not make this distinction – it did not need to. The jury was just required to assess damages. But the distinction was critical to Berry's claim for indemnification.

Judge Rovner then explored two hypothetical scenarios. In the first, CRI inspected the IBC and found it defective. There was little or no property damage. The same types of damages could occur as in the actual case – cancelled orders, destroyed products, loss of future profits, etc. But without the hook of property damage, Berry would have no claim for indemnification from Illinois National.

In the second scenario, the catastrophe is even worse than the actual case. Property damage in the form of a major fire occurs. In this scenario, Berry might have a stronger position that its damages of lost future sales resulted from the catastrophic property damage and were not just the result of the failure of the products to perform as expected.

Berry's failure was to ignore this distinction in making its claim. It assumed that since property damage occurred, all the damages of lost sales and lost profits were "because of" property damage. This failure doomed Berry's claim.

> "Whether and to what extent Packgen's losses were due to property damage, as opposed to the failure of Berry's product to perform as promised, are the questions dispositive of Illinois National's duty to indemnify Berry . . .
>
> . . . Berry has not outlined a case for the notion that some or all of the lost profits awarded by the *Packgen* jury were the result of property damage, nor has it asked for the opportunity to present such a case . . . Berry implicitly presumes that because its product failed in such a way as to cause property damage . . . *all* damages resulting from the failure of its component were necessarily "because" of property damage."

At this point, Berry may have felt it lost its opportunity to recover its losses of over $6 million. But Judge Rovner provided some consolation, suggesting Berry would have had difficulty in recovering much, if any, of the $6 million. Recall that Packgen's expert calculated damages based on a 10-year projection. Judge Rovner noted,

> "Part of Berry's burden . . . is to show that the full 10 years of projected losses were attributable to such damage. That task becomes more difficult the further one projects out from the April 2008 failure of Berry's product. It might be reasonable to attribute a shorter period of Packgen's business losses to the property damage inflicted by Berry's bad run of laminate. But to retroactively guarantee Packgen's profits for such a lengthy period of time – particularly for a new product without a record of reliable service and sales – looks much more like the policy is being used to insure the commercial expectations Packgen harbored based on Berry's representations and warranties . . . . Absent proof that the property damage itself was so egregious as to ruin Packgen's reputation in the industry, such a result would be inconsistent with the scope, terms, and purpose of the policy."

Illinois National won, but Judge Rovner rejected Illinois National's position that its policy covered only property damage caused by the defective product. Berry lost, but Judge Rovner agreed with Berry's position that damages "because of" property damage were not limited to property damage caused by the defective product, but could include consequential damages, such as lost sales and lost profits. Berry's failure, according to Judge Rovner, was its failure to make the intense fact-based analysis to distinguish between the types of damages recoverable and not recoverable under its insurance policy.

So, as Judge Rovner repeatedly emphasized in the opinion, in insurance indemnification cases the focus is on the policy language and a detailed analysis of the background and facts of the loss triggering the indemnification claim