

Court Rules Insurer Must Defend Odor Remediation Suit

by David Governo and Bryna Rosen Misiura

The First Circuit Court of Appeals – the federal appeals court that covers most of New England – recently required an insurer to defend a claim arising out of an offensive carpet odor that permeated the building and made tenants sick.¹

Essex Insurance claimed that it did not have to defend because the CGL policy covered only physical injury to property. It also argued that, even if an odor could somehow be considered physical injury to property, two business-risk exclusions applied and relieved it from any duty to defend.

This ruling is important for those working in the indoor air quality area because it decides that odor is a physical injury to property, at least based on the facts of this case under Massachusetts law.

The case also provides basic guidance on the manner in which the common business risk exclusion operates. Indoor air quality practitioners can take one crucial message home: when in doubt about coverage, ask for it anyway and do not take “no” for the answer without exploring all remedies.

In the *Essex v. BloomSouth* case, the District Court’s ruling that the policyholder was not entitled to a defense was overturned on appeal.

Facts of the Case

Boston Financial Data Services (BFDS) hired Suffolk Construction (Suffolk) as the general contractor for a tenant improvement project. Suffolk subcontracted with BloomSouth to supply and lay the carpet. BloomSouth carried a CGL policy with Essex Insurance, with Suffolk named as an additional insured.

Shortly after the renovation was complete, BFDS employees began complaining of an odor that permeated the building. Test results were inconclusive, and everyone blamed the other person for the problem.

Ultimately, the new carpet and adhesives had to be removed and replaced twice, the

concrete floor bead-blasted, and carbon filters installed in the HVAC system – all at a cost of \$1.4 million. Suffolk paid BFDS, and then sued BloomSouth in state court for damages caused by carpet installation.

Essex then filed a lawsuit in federal court, requesting a finding that it was not required to defend or indemnify. It argued that odor did not constitute physical injury to property under the policy, and that, in any event, two business-risk exclusions in the policy applied.

First, it claimed that the “impaired property” exclusion applied because the claim for an odor problem did not constitute physical harm to the property.

Second, it claimed that the “your property”

exclusion applied because it barred coverage for property damage to the insured’s own product. The Federal District Court had ruled that both exclusions applied, and that Essex did not owe either a duty of defense or of indemnity.

BloomSouth appealed to the First Circuit Court of Appeals, arguing only that it was owed a defense.

Appellate Decision

With no appellate law on point, the Court of Appeals had to interpret what a Massachusetts court would do. Under Massachusetts law, if the allegations in a complaint are “reasonably susceptible” of an interpretation that they state a claim within policy terms, the in-

surer has a duty to defend. The Court of Appeals first found that an odor can constitute “physical injury” to property. It held:

“We are persuaded both that odor can constitute physical injury to property under Massachusetts law, and also that allegations that an unwanted odor permeated the building and resulted in a loss of use of the building are *reasonably susceptible* to an interpretation that physical injury has been claimed. Further since nothing in the Essex’s policies suggests that odor cannot constitute physical injury to property, Suffolk’s claim is *colorable* under the policies.”²

The burden then fell on Essex to show that one of the two business-risk exclusions ap-

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plied. A business risk-exclusion, by definition under the CGL policy at issue, was an exclusion designed for risks that are “a normal, foreseeable and expected incident of doing business” and which should be “reflected in the price of the product or service.”

The first business-risk exclusion Essex raised was the “impaired property” exclusion. If the property was capable of being “restored to use” by “repair, replacement, adjustment or removal of the insured’s product or work,” the “impaired property” exclusion applied to eliminate coverage.

Essex argued that because removal of the carpet ultimately solved the problem, the exclusion applied.

The court disagreed, finding that “a fair reading” of Suffolk’s complaint suggested that this was not true because it took more than just carpet replacement (i.e., carbon air filter installation and bead-blasting work) to solve the odor problem.

The second business-risk exclusion Essex raised was the “your property” exclusion, which essentially bars coverage for damage to the insured’s own product, but does not apply by its own terms to “a building and its components.” The court found that the damaged concrete subfloor over which the carpet was laid was not considered BloomSouth’s property.

Accordingly, the court found that neither business-risk exclusion relieved Essex of its duty to defend.

The court limited its decision to the duty to defend and expressly reserved any opinion on whether Essex had a duty to indemnify the loss.

“We express no opinion on the issue of whether the alleged odor damage here will ultimately require indemnification,” Judge Jeffrey Howard wrote for the court. “A Massachusetts court may conclude that odor in general, or this odor in particular, does not constitute ‘physical injury’ to the property. Moreover, exclusion (m) may serve to deny indemnification if, for example, a fact-finder determines that removing or replacing the carpet alone would have sufficed to restore the property to use.”

The appellate court then sent the case back to the federal district court for further consideration.

How This Applies to Your Business

1. Don’t take anything for granted. Even if you’re not sure you will be covered, don’t be bashful asking about it.

The policyholders in BloomSouth were successful in convincing a Federal court that a Massachusetts court would act favorably on their novel argument. The law changes over time, as novel claims are advanced.

2. There is a difference between a duty of defense and a duty of indemnity. In this case, the First Circuit awarded a defense to BloomSouth, but did not decide whether it was entitled to indemnification.

Indoor air quality cases can be very com-

plicated and costly to defend. Thus, getting an insurance company to pay for your defense may be more valuable than establishing that it has an obligation to pay a settlement or verdict.

3. Insurance is an integral part of any company’s basic business plan. But, having a policy with a \$10 million policy limit is worthless if it does not cover your loss. Negotiating the terms and conditions of your policy can be more important than the coverage limits you choose. Insurance policies for indoor air quality professionals and remediation contractors necessarily need to deal with

risks peculiar to the field, including asbestos, toxins, lead, etc.

If you are uncertain about whether certain risks are covered, ask questions and document responses. This will help, but may not be foolproof. In the end, you may discover that you have more or less coverage than you thought you had.

1. *Essex Insurance Company v. BloomSouth Flooring Corporation*, 562 F.3d 399 (1st Cir. 2009).

2. *Id.* at 403 (emphasis added).

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ing business, environmental and indoor air quality claims.

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