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Calif. Odor Case Stinks For Businesses With CGL Policies


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Law360, New York (April 11, 2014, 3:53 PM ET) -- The U.S. District Court for the Northern District of California recently confirmed that purely economic loss is not a "loss of use" of tangible property and therefore does not constitute property damage under a commercial general liability policy. The district court determined that a restaurant's reduced profits from loss of customers due to bad odors emanating from an adjacent restaurant is merely economic loss and is not covered property damage.

Facts

In Travelers Property Casualty Company of America v. Mixt Greens Inc. (2014), Mixt Greens and Murphy's Deli both operated restaurants inside a commercial building in San Francisco. Mixt Greens operated a grill inside its restaurant that shared an air duct with Murphy's Deli. Murphy's Deli alleged that the ventilation system was not properly installed, which resulted in the odor of cooking oil emanating from Mixt Greens through the ducts and into Murphy's Deli. Murphy's Deli alleged that the odors coming through the ducts were offensive, which caused the restaurant to lose patrons and suffer a reduction in profits.

Murphy's Deli sued Mixt Greens alleging numerous causes of action, including fraud, negligent misrepresentation, nuisance, injunctive relief and trespass. All the causes of action were dismissed by the district court, except the nuisance claim.

Mixt Greens was insured under a CGL policy, which provided coverage for property damage for which Mixt Greens was liable. The policy defined "property damage" as "physical injury to tangible property," which included "all resulting loss of use of that property" and "loss of use of tangible property that is not physically injured." Travelers filed an action against Mixt Greens seeking a declaration from the court that it had no duty to defend Mixt Greens.

What is Property Damage?

The district court noted that current CGL forms provide that the "loss of use of tangible property" constitutes property damage, even if the property itself is not physically damaged. Further, "tangible property" typically refers to things that can be seen, touched and smelled; property having physical substance apparent to the senses. Citing to numerous California cases, the court observed that general liability policies do not cover purely economic losses. It confirmed that under the plain meaning of "loss

of use", the insured must be deprived of the use of its tangible property.

Travelers asserted that it had no duty to defend the claim of nuisance against Mixt Greens because the underlying action did not expose Mixt Greens to liability for property damage. Travelers asserted that the loss of customers did not constitute the loss of use of tangible property, because Murphy's Deli was never forced to close its restaurant and only claimed a loss of revenue. Murphy's Deli did not contend that Mixt Greens caused any physical damage to its property, or that the odors caused physical damage, but rather only claimed that the odors caused customers to stay away. Murphy's Deli did not claim that Mixt Greens was liable to pay for physical damage to the air ducts; it only claimed loss of sales, earnings and profits resulting from the odor.

In its analysis, the district court distinguished three cases. First, the court discussed Borg v. Transamerica Insurance Co. (1996), where a third party brought suit against an insured for alleged damages resulting from a deck encroaching on the third party's real property. In determining whether the loss had occurred within the policy period, the court assumed, without deciding, that the physical encroachment of the deck on to the third party's real property constituted a loss of use of the real property.

The district court in the Mixt Greens case distinguished it from Borg because, in Borg, the deck physically encroached on the third party's property, resulting in the third party's inability to use a portion of its real property. The inability to use its property constituted a loss of use of tangible property. No such allegation of encroachment was asserted by Murphy's Deli.

Second, the district court discussed in Hendrickson v. Zurich American Insurance Co. (1999). In Hendrickson, the underlying action stemmed from an action by strawberry growers against a nursery for negligently selling damaged plants to the growers. The nursery assured the growers that the plants would produce a normal yield, and in reliance thereon the growers did not plant different strawberry plants. The crop, however, did not produce a normal yield. The court ultimately found that the loss of strawberry production, and the related loss of use of the fields, constituted property damage.

The Mixt Greens Court emphasized that the damaged plants in Hendrickson prevented the growers from using the portion of their property on which the damaged plants were planted. Specifically, the growers were not able to plant other properly yielding plants because a portion of their land was not available. This constituted a deprivation of the use of their property.

Lastly, the Mixt Green Court distinguished Essex Insurance Co. v. Bloomsouth Flooring Corp. (2009). In Essex, the defendant subcontractor installed carpet tiles in an office building. After the subcontractor completed the work, the building occupants noticed a bad odor. Both the subcontractor and general contractor then spent more than $1.4 million in an attempt to remediate the odor. The court ultimately found that the insurer had a duty to defend and indemnify both the subcontractor and general contractor because an odor permeating a building can constitute physical injury to tangible property.

The district court in the Mixt Greens case distinguished Essex by focusing on the fact that in Essex, the odor necessitated $1.4 million worth of remediation efforts in an attempt to eliminate the odor. It was the remediation efforts that supported a claim of physical injury to the building, rather than the presence of the odor by itself.

The district court in Mixt Greens ultimately held that the cause of action for nuisance against Mixt Greens did not allege the existence of property damage as it is defined in the relevant policies. Rather, the only damages sought were purely economic losses. Further, the court specifically stated that, "The fact that [Murphy's Deli] does not seek to recover the cost of repairing or replacing any tangible

property, and that no part of its restaurant was ever closed because of the odors — not even for an hour — compels the conclusion that [Murphy's Deli's] losses, which are purely economic, are not covered under the policy ..." Therefore, Travelers did not have a duty to defend Mixt Greens.

Notably, while the district court did recognize that repairs necessitated by the odor would be physical damage sufficient to trigger the duty to defend under a CGL policy, the court seems to imply, without actually holding, that if Mixt Greens had been forced to close its doors — even if for only an hour and without incurring repair costs — there would be an argument for loss of use of tangible property sufficient to trigger the duty to defend.

The argument is supported by the decisions in Borg and Hendrickson which both found the inability of the insured to use its property was sufficient to trigger policy coverage. In both of those cases, however, there were physical items preventing the use of the property (i.e., a deck and strawberry plants), whereas in Mixt Greens was only an odor.

Therefore, the question remains to be determined, and this district court left open whether the presence of an odor so offensive as to cause a business to close its doors is sufficient to deprive an insured of the use of its tangible property for purposes of liability coverage.

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