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## WHAT IS THAT SMELL?

### UNITED STATES DISTRICT COURT FOR THE DISTRICT OF ARIZONA CONCLUDES THAT AN INSURER DID NOT ACT IN BAD FAITH BY PROVIDING INSUREDS BENEFITS UNDER AN ALL-RISK PROPERTY POLICY FOR REMEDIATION OF FOUL ODORS

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On February 21, 2008, the United States District Court for the District of Arizona concluded that an insurer, which provided its insureds with \$1.8 million in benefits under an all-risk property policy for remediation of foul odors in the insureds' house, did not act in bad faith; that a third-party adjuster hired by the insurer is not liable for breach of contract or bad faith; but that the insurer is responsible for the adjuster's actions; and that a jury could conclude that the insurer is liable for breach of contract for its failure to raze and rebuild the insureds' house. *Goldberg v. Pacific Indem. Co.*, No. CV 05-2670-PHX-JAT, 2008 U.S. Dist. LEXIS 13193 (D. Ariz. Feb. 21, 2008).

In June of 2001, the Goldbergs purchased a 14,000 square foot home in Paradise Valley, Arizona for \$5.7 million, "as is." *Goldberg*, 2008 U.S. Dist. LEXIS 13193 at \* 2. Shortly after purchasing the house, the Goldbergs began to remodel it, and after moving into the house in May of 2002, the Goldbergs continued their remodeling efforts. *Id.* In August of 2002, however, the Goldbergs began to notice foul odors, and someone advised them that the remodeling contractor's employees may have urinated in various locations throughout the house. *Id.* at \*2-3. The Goldbergs demanded that the contractor remediate the problems, and the contractor hired AIR Resources in January of 2003, to perform remediation services. *Id.* at \*3. Nonetheless, the Goldbergs claimed they could still smell urine odors after AIR Resources' remediation efforts. *Id.*

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On or about July 16, 2003, the Goldbergs notified Pacific Indemnity Company (“Pacific”), which had issued the Goldbergs an all-risk “Masterpiece Policy,” of the alleged urine damage. *Id.* Despite the fact that Pacific received notice of the claim fourteen months after the Goldbergs first smelled the odors, and seven months after the Goldbergs made a remediation claim against the contractor, Pacific accepted the claim, and Federal Insurance Company (“Federal”) adjusted the claim on Pacific’s behalf. *Id.*

Federal retained several consultants and experts, including industrial hygienists, construction specialists, and olfactory experts, to investigate the Goldbergs’ claim. *Id.* at \*3-4. Over the course of the several-month investigation, Federal adopted a “when in doubt, rip it out” approach, and removed anything the Goldbergs claimed was contaminated, including an entire room, and Pacific expended approximately \$300,000 in the process. *Id.* at \*4-12. In addition, Pacific paid the Goldbergs \$1.8 million in benefits, including “\$75,000 *a month* for additional living expenses,” but not including a \$1,000 per month charge for drapery storage or the amount paid to the Goldbergs’ daughter for an apartment. *Id.* at \*4, \*23 (emphasis in original).

Even after Federal’s remediation work, the Goldbergs maintained that the urine odor permeated their house, and, convinced that additional remediation would not solve the problem, demanded that Pacific raze the house and completely rebuild a new one. *Id.* at \*4. Federal continued to investigate, but advised the Goldbergs that the investigation did not reveal any remaining physical evidence of urine contamination. *Id.* at \*4-5. Pacific offered to pay for more construction, but refused to completely raze and rebuild the house, and the Goldbergs then filed a breach of contract and bad faith action against Pacific and Federal. *Id.* at \*5. Federal, on behalf of Pacific, offered to purchase the house from the Goldbergs at a price determined by an independent appraiser, but the Goldbergs refused the offer. *Id.*

Pacific and Federal moved for summary judgment on both of the Goldbergs’ claims. *Id.* at \*7. Because Federal was not a party to the insuring agreement, the Goldbergs conceded that Federal was not liable for breach of contract. *Id.* However, the Goldbergs argued that both Federal and Pacific were liable for bad faith. *Id.* Relying on *Meineke v. GAB Business Services, Inc.*, 991 P.2d 267 (Ariz. Ct. App. 1999), the court concluded that an adjuster does not owe the insureds a separate tort duty of good faith. *Id.* at \*9. Thus, the court held that Federal was not liable for bad faith. *Id.*

The court reasoned, however, that Federal’s handling of the claim was pertinent to whether Pacific was liable for bad faith, since Pacific was liable for Federal’s actions. *Id.* “Given the extensive and expensive nature of Federal’s investigation of the claim, its payment of extremely generous benefits to the Goldbergs (\$1.8 million dollars), and its efforts to settle the claim, a jury would be extremely hard pressed to find that Federal acted unreasonably in investigating the Goldbergs’ claim.” *Id.* at \*27. Thus, the court concluded that Pacific was also not liable for bad faith, notwithstanding the Goldbergs’ disappointment with Federal’s refusal to raze and rebuild the house. *Id.* at \*27-28.

Pacific raised late notice and failure to cooperate as defenses to the Goldbergs' breach of contract claim. *See id.* at \*28-32. Because Pacific had paid the Goldbergs over \$1 million in benefits, however, the court determined that Pacific had waived those defenses. *Id.* at \*30-32. Pacific also argued that the policy did not cover the Goldbergs' claim for "stigma" damages caused by the urine contamination. *Id.* at \*33. While the court agreed that "stigma" damages were purely economic and did not fall within the policy's definition of "physical loss," it could not, as a matter of law, find that Pacific did not breach the insurance contract by refusing to raze and rebuild the house. *Id.* at \*35-36. As a result, the court concluded that the issue of whether Pacific breached the insurance contract was to be decided by the jury, and that the Goldbergs could only recover damages for the actual physical loss to their house. *Id.* at \*36.

For a further analysis of the *Goldberg* decision and its impact on property insurers, please contact Joe Bermudez, Chris Clemenson, Jason Melichar or Suzanne Meintzer of Cozen O'Connor's Denver, Colorado office. Cozen O'Connor is a nationally recognized leader in representing the insurance industry in all coverage areas, including first party property matters.

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