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United States District Court, D. Oregon.

COLUMBIAKNIT, INC., an
Oregon Corporation, Plaintiff,
v.
AFFILIATED FM INSURANCE CO.,
a Deleware Corporation, Defendant.

No. Civ. 98–434–HU.
|
Aug. 4, 1999.

Attorneys and Law Firms

David B. Markowitz, Peter H. Glade Markowitz, Herbold, Glad & Mehlhaf, PC, Portland, Oregon 97204, for Plaintiff.

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OPINION AND ORDER

HUBEL.

***1** Plaintiff insured disputes defendant insurer's denial of coverage for alleged losses under an "all-risks" property and business interruption insurance contract. Before the court is defendant's motion (# 16) for partial summary judgment. For the reasons set out below, defendant's motion is denied in part and granted in part.

BACKGROUND

Plaintiff, a clothing manufacturer, is owned by Jakob Kryszek and his sons, Jerry and Al. Plaintiff held an insurance policy, dated August 8, 1996, issued by defendant for its warehouse (the White Stag Building) and the garments and fabric it stored there. The policy insured against "all risks of direct physical loss of or damage to the property insured except as hereinafter excluded." Pl.'s Ex. A, at 13. On September 14, 1996, rainwater entered the White Stag Building and saturated some of the fabric and garments. The remaining contents of the building were exposed to high humidity for a prolonged period while salvage crews hired by defendant worked to dry out the building. Pl. resp. to def.'s mot. for sum. jdmt. at 3.

Defendant hired Maxson Young Associates, Inc. ("Maxson Young") to assist the cleanup. Pl.'s SMF at 2. Maxson Young hired MF Bank, a salvage company, to separate wet goods from dry goods. MF Bank employees went through the building and pulled out goods that appeared to be wet or damp. Def.'s SMF at 2. These wet or damp goods were removed from the building. *Id.* The dry goods were repackaged and remained in the building. *Id.* Plaintiff maintains that MF Bank employees may have mixed wet goods with dry goods during the repackaging process. Exam. J. Kryszek at 114.

Maxson Young also hired Dow Columbia to dry out and clean up the building. McDonald depo. at 32. During the drying out process, Dow Columbia applied antimicrobial agents throughout the building, to reduce the possibility of mold or mildew. Dow depo. at 30. In response to plaintiff's concerns regarding the possibility of elevated microbial levels in the building, Maxson Young hired Clayton Environmental Consultants ("CEC") to conduct a "microbial evaluation" of the White Stag Building, which CEC completed in October, 1996. The evaluation sought to "distinguish between building related sources of microorganisms and microorganism growth related to flood damage." Def.'s Ex. 4, at 4. The microbial evaluation revealed higher than normal concentrations of penicillium inside the building. Keeth depo. at 28. Sampling of boxes remaining in the building indicated elevated fungal concentrations (compared to outdoor air), with a few exceptions. *Id.* At 7. However, the evaluation was inconclusive as to whether the elevated fungal concentrations resulted from exposure to other wet items or from the ambient air. Keeth depo. at 42. CEC's report also noted that because all of the dry goods were moved to the second floor after repackaging, it was impossible to determine which goods came from what part of the building and which, boxes, if any, contained both wet and dry goods. *Id.* The report concluded that microbial concentrations in several areas not directly affected by the September, 1996, rainwater intrusion were higher than some areas that were directly affected. Def.'s Ex. 4 at 7. The report noted evidence of a long history of water intrusion to the White Stag Building prior to September 14, 1996. *Id.* at 4, 7–8. The report stated:

> ***2** It is thought that several factors affected the amplification of mold in this building. First, water leaks in this building prior to September, 1996 are likely to have resulted in microbial reservoirs and microbial amplification in this building. Second, after the September, 1996 water leak, five days passed prior to beginning clean up efforts. Following initial cleaning and removal of carpeting, it took an additional week to separate the wet items from the dry items."

Id. at 8.

On May 1, 1997, Bruce McDonald, the adjuster for Maxson Young, Al Kryszek and others toured the White Stag Building and randomly opened boxes of repackaged goods. They found no indication of mold or mildew in any of the boxes. Def.'s SMF at 2. They did not open all boxes owing to the sheer number of boxes. *Id.* Plaintiff submitted a proof of loss to defendant on June 18, 1997, including a claim for all goods stored in the building. Pl.'s Ex. 2. On January 26 1999, plaintiff discovered mold on approximately one dozen pieces of clothing that were previously thought to be dry and undamaged and therefore had not been removed from the building. Bennett Aff. at 2. Defendant has paid plaintiff for damage to the building and the loss of saturated garments and fabrics. Def.'s SMF at 7. Defendant admitted at oral argument that it will pay, as covered by the policy, for additional losses to moldy goods discovered during a January, 1999 visit to the warehouse.

STANDARD FOR SUMMARY JUDGMENT

Summary judgment is appropriate if the court finds that no genuine issue of material fact exists, and the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(c). There is no genuine issue of material fact where the non-moving party fails "to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." *Celotex Corp. v. Catrett,* 477 U.S. 317, 323, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); *Harper v. Wallingford,* 877 F.2d 728, 731 (9th Cir.1989). A scintilla of evidence, or evidence that is merely colorable or not significantly probative, does not present a genuine issue of material fact. *United Steelworkers of America v. Phelps Dodge,* 865 F.2d 1539, 1542 (9th Cir.), *cert. denied,* 493 U.S. 809, 110 S.Ct. 51, 107 L.Ed.2d 20 (1989).

All reasonable doubts as to the existence of genuine issues of fact must be resolved against the moving party. *Hector v. Weins,* 533 F.2d 429, 432 (9th Cir.1976). The inferences drawn from underlying facts must be viewed in the light most favorable to the party opposing the motion. *Valadingham v. Bojorquez,* 866 F.2d 1135, 1137 (9th Cir.1989). Where different ultimate inferences can be drawn, summary judgment is inappropriate. *Sankovich v. Insurance company of North America,* 638 F.2d 136, 140 (9th Cir.1981).

***3** To avoid summary judgment, the non-moving party must do more than simply show that there is some metaphysical doubt as to the material facts. *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.,* 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). The mere existence of a scintilla of evidence in support of the non-mover's position will be insufficient; there must be evidence upon which the jury could reasonably find for the non-moving party. *Anderson v. Liberty Lobby, Inc.,* 477 U.S. 242, 250–51, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). "Summary judgment is not precluded simply because there is a dispute of some facts in a case." *School Dist. No. 1J, Multnomah Co., v. AcandS, Inc.,* 5 F.3d 1255, 1264 (9th Cir.1993), *cert. denied,* 512 U.S. 1236, 114 S.Ct. 2742, 129 L.Ed.2d 861 (1994).

DISCUSSION

Defendant seeks partial summary judgment in its favor on the grounds that there is no genuine issue as to any material fact that plaintiff's claim for damages to property, stored in the warehouse and not subjected to direct water intrusion, is not covered under the property insurance policy issued by defendant to plaintiff. Defendant's motion requires the court to determine who bears the burden of proof of loss, and what constitutes physical damage under the policy.

I. Coverage Under "All–Risks" Property Insurance

" 'All-risks' insurance is intended to provide coverage for any physical loss or damage to covered property from any external cause except as otherwise excluded." Kingman, Donald, L., 28 Gonz.L.Rev. 449, 453 (1993) (citing 13A Couch on Insurance 2D § 48:141 (1982 and supp. 1992). This constitutes a kind of special coverage extending to risks not usually contemplated, and coverage is usually found unless expressly excluded by the policy. *Id.* While it is true that "all-risks" policies are generally construed liberally in favor of coverage, the general requirement of any property policy that there be "physical loss or damage" is not ignored. Kingman, *supra,* at 462.

The term "all-risk" is essentially a misnomer as the questions of loss and risk are separate and distinct. *Intermetal Mexicana, S.A. v. Ins. Co. of North America,* 866 F.2d 71, 75 (3d Cir.1989). " 'All-risk' is not synonymous with 'all-loss.' " *Id.* (citing *Hampton Foods, Inc. v. Aetna Cas. & Sur. Co.,* 787 F.2d 349, 352 (8th Cir.1986)). "All-risks" property insurance indemnifies the insured against physical losses resulting from "perils" not excluded under the policy. Kingman, *supra,* at 498, n. 69. Perils are active physical forces which cause the loss of or damage to the insured property. *Garvey v. State Farm Fire & Cas. Co.,* 48 Cal.3d 395, 257 Cal.Rptr. 292, 770 P.2d 704, 710 (Cal.1989).

> ***4** The requirement that the loss be 'physical,' given the ordinary definition of that term, is widely held to exclude alleged losses that are intangible or incorporeal, and, thereby, to preclude any claim against the property insurer when the insured merely suffers a detrimental economic impact unaccompanied by a distinct, demonstrable, physical alteration of the property."

10 Couch on Ins. § 148:46 (3d ed.) (West 1998). *Cf. Wyoming Sawmills, Inc. v. Transp. Ins. Co.,* 282 Or. 401, 578 P.2d 1253 (1978) (inclusion of the word "physical" in a liability insurance policy negated any possibility that the policy was intended to cover consequential or intangible damage). Under an "all-risks" insurance policy, the insured's burden is limited. The insured need only show that a physical loss occurred to covered property. *Atlantic Lines, Ltd. v. American Motorists Ins. Co.,* 547 F.2d 11, 12 (2d Cir.1976). There is no dispute that the property in the White Stag Building is insured by the policy. Def.'s sum. jdgt. memo. at 4. To avoid summary judgment, plaintiff here must show that there is a material question of fact whether a "direct physical loss of or damage to" its covered property has occurred.

II. Ambiguity

Plaintiff contends that the policy language "direct physical loss of or damage to" is ambiguous, in that it raises a question of whether damages must be "physical" or "direct." Under plaintiff's theory, if damages need only be direct and not physical, loss in value to covered goods and other economic damages could be recovered under the policy. In asserting that the policy language is ambiguous, plaintiff urges the court to follow the rule of *Linnton Plywood Ass'n. v. Protection Mut. Ins. Co.,* 760 F.Supp. 170 (D.Or.1991) which instructs that any reasonable ambiguities in the policy be resolved against the insurer. [1]

Because the court finds the policy language to be unambiguous, it is not necessary to resort to rules governing interpretations of ambiguous policy language. Although the Oregon Supreme Court has not spoken directly to the issue, Oregon appears to be among the majority of states that views the term "direct," when used in insurance policies, as a synonym for "proximate" or "dominant." *Fred Meyer, Inc. v. Central Mut. Ins. Co.,* 235 F.Supp. 540, 543 (D.Or.1964); *Kunniholm v. Portland Elec. Power Co.,* 133 Or. 246, 252, 289 P. 1055, 1057 (1930). *See also* 10 Couch on Ins. § 148:60.

In *Wyoming Sawmills,* the Oregon Supreme Court interpreted liability insurance language requiring an insurance company to indemnify an insured for damages from "physical injury to or destruction of tangible property ..." *Wyoming Sawmills,* 282 Or. at 404, 578 P.2d 1253. In holding that the installation of warped studs in a building did not constitute "physical injury to or destruction of tangible property," the Oregon Supreme Court declared that use of the word "physical" within a comprehensive liability policy indicated that the policy was not intended to afford coverage for consequential or intangible damage. *Id.* at 406, 578 P.2d 1253. The insurer's liability was limited to the portion "of the labor expense ... attributable to tearing out and putting back other

parts of the building ... in order to replace the studs ..." *Id.* at 408, 578 P.2d 1253. To the extent the insured tried to recover for labor costs attributable to the removal and replacement of the studs, such recovery was denied. *Id.*

***5** This court has extended *Wyoming Sawmills* ' interpretation of the word "physical" in a liability policy to a property insurance contract with language almost identical to the one at issue in the present dispute. In *Great Northern Ins. Co. v. Benjamin Franklin Fed. Sav. and Loan Ass'n.,* 793 F.Supp. 259, (D.Or.1990), the court held that the removal of non-friable asbestos at a building owner's discretion was not a loss resulting from "a direct physical loss or damage by a Covered Cause of Loss[ ]", defined as "direct physical loss or damage ..." *Id.* at 261. The issue in *Great Northern* and *Wyoming Sawmills* is the same as the issue here: Whether the policy language was intended to include consequential or intangible damages such as depreciation in value. Both courts answered the question in the negative, as this court shall as well. "The inclusion of the terms 'direct' and 'physical' could only have been intended to exclude indirect, nonphysical losses." *Great Northern,* 793 F.Supp. At 263.

The policy language in this case is not ambiguous. Therefore, only direct, physical loss of or damage to covered property is covered by the policy. This conclusion is consistent with plaintiff's assertion that all of the property has suffered direct, physical loss. Moreover, it is consistent with the weight of authority holding that loss in value is not covered by standard form "all-risks" property insurance. *See e.g. Glenns Falls Ins. Co. v. Covert,* 526 S.W.2d 222 (Tex.Civ.App.1975); *Blaine Richards & Co., Inc. v. Marine Indem. Ins. Co of America,* 635 F.2d 1051 (2nd Cir.1980); *Wichter Constr. Co. v. Saint Paul Fire and Marine Ins. Co.,* 550 N.W.2d 1 (Minn.App.1996). Couch, § 148:46 *supra.* The policy issued to plaintiff by defendant does not cover consequential or intangible damage. To the extent that plaintiff seeks to recover for losses other than direct physical loss or damage (e.g. loss in value solely from a decision not to sell as first quality goods), plaintiffs may not recover. The next issue is to determine what constitutes physical loss or damage.

III. What is "Direct, Physical Loss?"

In its motion for partial summary judgment, defendant asks the court to rule that, as a matter of law, plaintiff's claims for damages to property stored in the White Stag Building and not subjected to direct water intrusion are not covered under the policy issued by defendant to plaintiff. Def.'s motion for partial sum. jdgt. at 1. Defendant contends that while all of the property in the White Stag Building is insured by the policy, only a small portion of the property (that which has sustained damage by water intrusion) has sustained a direct physical loss. Def.'s sum. jdgt. memo. at 4.

***6** On the other hand, plaintiff maintains that apart from the issue of whether economic damages are covered under the policy, all of the property stored in the warehouse has suffered direct physical loss or damage due to direct contact with water or prolonged exposure to high humidity and mold and mildew from the air and wet garments. Pl.'s resp. to def.'s motion for sum. jdgt. at 6. In so far as all the property in the building has suffered direct, physical loss or damage, plaintiff contends that the issue in this case is not coverage of property, but the extent of damages to the property covered. That question, according to plaintiff, is one of fact for resolution at trial and not on summary judgment. *Id.* at 8. Plaintiff argues that because defendant has paid plaintiff for damage to the building and for certain water-saturated garments, defendant has essentially admitted coverage for some categories of damage and can no longer assert that the amount of coverage is a matter of law. Pl.'s resp. to def.'s motion for sum. jdgt. at 8, n. 1.

Plaintiff cites *Farmers Ins. Co. of Oregon v. Truitanich,* 123 Or.App. 6, 858 P.2d 1332 (1993) and *Largent v. State Farm Fire & Cas. Co.,* 116 Or.App. 595, 842 P.2d 445(992), (two cases in which odor from methamphetamine "cooking" was held to constitute "direct physical loss" to houses) in urging the court to adopt a liberal interpretation of the phrase "direct physical loss." In *Largent,* the Court of Appeals of Oregon found that the sudden discharge of chemicals from the production of methamphetamine permeated porous materials such as drapes, carpets, walls and woodwork. The suddenness of the permeation of the chemicals distinguished the loss from those resulting from contamination, which would have been excluded from the policy. 116 Or.App. At 598. In *Trutanich,* the same court concluded again that odor can constitute physical damage to the house. Therefore, under a policy insuring against "accidental physical loss," the cost of removing the odor from the house was covered. *Trutanich,* 123 Or.App. at 1335. These cases suggest that physical damage can occur at the molecular level and can be undetectable in a cursory inspection.

In making damage determinations, courts consider the nature and intended use of the property itself and the

purpose of the insurance contract. *Western Fire Ins. Co. v. First Presbyterian Church,* 165 Colo. 34, 437 P.2d 52 (1968) (where gasoline vapors penetrated foundation of insured church and accumulated, rendering building uninhabitable, property held to have suffered a "direct, physical loss"); *Matzner v. Seaco Ins. Co.,* 1998 WL 566658 (Mass.Super.1998) (relying on *First Presbyterian* and holding that carbon monoxide levels in apartment building sufficient to render building uninhabitable were a "direct, physical loss"). Although damage determinations are not subject to an objective standard of review, the court notes that what may constitute damage in the retail clothing industry might not constitute damage to the personal property of a homeowner. For example, if an article of retail clothing has an odor strong enough that it must be washed to remove it, (and the garment therefore cannot be sold as new) it has sustained physical damage and would be covered under an "all-risk" property insurance policy. The same piece of clothing in an individual's wardrobe, for example a shirt worn around a smokey campfire, would not be said to be physically damaged if a mere washing would remove the odor.

***7** However, it is important to distinguish between the necessity of washing the garment because of its strong odor, and the decision by the retailer not to sell the garment as new, merely because it has been exposed to elevated levels of spore counts, for example, and may or may not develop mold or mildew in the future. The decision not to sell the garment as new, in the absence of distinct and demonstrable physical change to the garment necessitating some remedial action that would preclude honestly marketing as first quality goods, is not a covered loss. Furthermore, such damage that requires remedial action to some items is not sufficient to prove such damage to all items.

The recognition that physical damage or alteration of property may occur at the microscopic level does not obviate the requirement that physical damage need be distinct and demonstrable. In the methamphetamine odor damage cases, the physical damage is demonstrated by the persistent, pervasive odor. In the absence of such odor, no physical damage could be found. The mere adherence of molecules to porous surfaces, without more, does not equate physical loss or damage.

The distinct and demonstrable requirement necessarily implicates the insured's burden of showing that a covered loss has occurred. In this case, some of the goods suffered direct physical loss or damage from water. Plaintiff presented them and defendant paid for them. Other goods have suffered direct physical loss or damage from mold and defendant's counsel indicated at oral argument that they will be covered. *Trutanich* instructs that goods with heightened spore counts may be damaged if they will later develop odor or other effects so as to now require washing or such treatment that they may not be sold as first-quality goods. Plaintiff, however, is not relieved of its burden to prove damage to its property before it may recover. [2]

CONCLUSION

Under an "all-risks" property insurance policy, coverage is predicated on physical loss of or damage to insured property. Defendants are correct that this case is about what goods have sustained such damage. Goods need not have been water-soaked from the water intrusion to be covered. Fabric and garments in the White Stag Building that are moldy as a result of the September 14, 1996 water leak are covered property under the plaintiff's policy. Furthermore, fabrics and garments with a pervasive, persistent or noxious odor may also be physically damaged property pursuant to plaintiff's policy. Likewise, if plaintiff establishes at trial a class of garments which has increased microbial counts and that will, as a result, develop either an odor or mold or mildew, these items may be covered as well. Therefore, defendant's motion for partial summary judgment is denied to the extent that it seeks an order that plaintiff has failed to raise a material issue of fact regarding direct physical loss of or damage to any category of plaintiff's property. The record does not support summary judgment for defendant on this issue.

***8** While proving physical loss of or damage to covered property will be difficult, and the burden remains with the plaintiff, I cannot say at this stage that plaintiff can not prevail. For fabric and garments that plaintiff establishes the presence of a pervasive, persistent or noxious odor, or mold or mildew, or are physically changed in some manner that will lead to such damage, the policy does provide coverage. IT IS ORDERED, Defendant's motion for partial summary judgment is GRANTED in part, and DENIED in part.

IT IS SO ORDERED.

All Citations

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Footnotes

1 After *Linnton Plywood,* the Oregon Supreme Court spoke on the issue of interpretation of ambiguous insurance contracts in *Hoffman Constr. Co. v. Fred S. James & Co.,* 313 Or. 464, 836 P.2d 703 (1992). If the court is unable to ascertain the intent of the parties from the plain meaning of the policy language, ambiguous language should be considered in its immediate context. *Hoffman,* 313 Or. at 469, 836 P.2d 703. If more than one plausible interpretation still exists, ambiguous language is to be considered in the context of the policy as a whole. If one interpretation is in accord with all the provisions of the policy and one interpretation is not, the offending interpretation must be rejected. If consideration of the language at issue in light of the entire policy does not resolve the ambiguity, only then is it necessary to resolve the ambiguity against the insurer.

2 Plaintiff has alleged that because defendant's agent MF Bank mixed some wet goods with dry goods, it is now impossible to tell which ones are damaged. Therefore, according to plaintiffs, all the property in the White Stag Building is a total loss. The extent of such mixing is unclear from affidavit testimony, but resolution of the issue has no bearing on the outcome of the case. Plaintiff has pointed to no policy language or other authority in support of its position that the good-faith actions of defendant's salvage company somehow relieves plaintiff of its burden of showing physical damage to the particular items it claims are covered.