

# **Toxic Mold Losses; A Potential Billion Dollar Problem**

**By: Dennis W. Fredrickson & Timothy J. Grant**

## **Compliments of Fredrickson, Mazeika & Grant, LLP**

### **SAN DIEGO OFFICE**

550 West "C" Street, Suite 1410  
San Diego, California 92101  
619.234.1722/FAX: 619.234.1759

### **NEVADA OFFICE**

MAZEIKA & ASSOCIATES\*  
501 South Rancho Drive, Suite C-12  
Las Vegas, Nevada 89106  
702.384.4048/ FAX: 702.384.4484

\*Registered Name In Nevada

**website: [fmglegal.com](http://fmglegal.com)**

### **ORANGE COUNTY OFFICE**

18 Corporate Plaza Drive  
Newport Beach, California 92660-7901  
949.759.0102/ FAX: 949.759.0131

### **BAY AREA OFFICE**

100 The Embarcadero, 3<sup>rd</sup> Floor  
San Francisco, California 94105  
415.957.1900/FAX: 866.413.6263

### **ARIZONA OFFICE**

10645 North Tatum Boulevard, Suite 200-464  
Phoenix, Arizona 85028  
602.252.8830/ FAX 866.413.6263

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## **I. Proliferation of Claims Related to Mold Exposure**

In 1992, shortly after moving into a new facility, 80 percent of the employees at a Florida County courthouse complained of respiratory problems. Productivity fell, workers compensation claims rose, and eventually the new building was abandoned entirely. Litigation ensued and the total amount of all claims settled exceeded \$50 Million. According to the litigation, the cause of the loss was design and construction defects which facilitated the growth of toxic mold in the building. Unfortunately, the Florida courthouse loss is not an isolated event. Since 1990, the number of insurance claims for mold has skyrocketed. Every type of structure, from a bungalow in Southern California to a high rise in Las Vegas, falls prey to this type of claim. As a consequence of this proliferation of mold-related claims, an alert has been sounded in the construction industry, amongst owners of commercial and residential properties, and in the insurance industry which issues first party and third party liability policies affected by these burgeoning mold-related claims. Some even view this litigation area as the new asbestos litigation, and predict the same crippling repercussions will occur as have occurred to manufacturers, vendors, and installers of asbestos containing products, and to their liability carriers. To avoid this predicament, most insurance companies are now taking steps to exclude mold and water damage coverage from their policies. The specialty environmental insurance market is also limiting the scope of coverage for mold-related claims. However, these measures will not help those policies that potentially cover this type of claim which already have been issued.

## **II. What Is Mold?**

Molds are simple, microscopic fungi that grow on the surfaces and crevices of objects such as wood, carpeting, and cellulose-based objects including drop-down ceiling panels and drywall. More than 100,000 species of mold exist naturally in the environment, each at its own ambient level, depending on the locale. Mold and people have co-existed for thousands of years, and most individuals have developed a tolerance to mold exposure. The overwhelming majority of molds have little, if any, negative impact on human health. While it may not be possible to identify specific individuals who may be vulnerable to molds, health officials believe that older people, small children, infants, and those with compromised immune systems are most susceptible to mold-related illnesses.

Although the ease and speed with which mold grows and the extreme difficulty of removing it may seem to present insurmountable problems, it is important to remember that only some molds present problems. With so many people exposed around the world, and the spiraling trend of claim frequency and severity, mold exposure needs to be closely examined from a risk management perspective.

**1. Consequences of Mold Exposure.** In situations where there is a reaction, typical symptoms may include headaches, rashes, and respiratory tract and eye irritation. Some experts contend that more extreme symptoms exist, including complete immune system failure, loss of cognitive memory, brain damage, and even death. Because most symptoms are mild and common, the connection between mold and illness is difficult to prove. According to a recent

report on mold published in American Re (Toxic Mold, September 2001) the Centers for Disease Control states that while mold may cause health symptoms that are nonspecific, at present there is no test that proves an association between mold and particular health symptoms. A study by the Mayo Clinic, however, does suggest a link. Dr. David Sherris studied 210 patients with chronic sinusitis and found that most had allergic fungal sinusitis. When quoted in the 12/4/00 issue of Newsweek Magazine he stated the following:

*"The prevailing medical opinion has been that mold accounted for 6 to 7 percent of all chronic sinusitis. We found that it was 93 percent, the exact reverse."*

Despite the controversy, most experts agree the potential for problems exists and more research is needed. Over one hundred different species of mold are suspected of having the potential to negatively affect human health if touched, inhaled, or ingested. These molds include Arimonium, Aspergillus, Penicilium, Fusarium, Trichoderma, and Stachybotrys Chartarum. The ability of molds such as stachybotrys to release mycotoxins is the suspected reason for the most extreme symptoms of mold exposure. Mycotoxins, or toxins released by mold, include aflatoxins, trichothecenes, and volatile organic compounds. The conditions under which molds release toxins is relatively limited and not well understood.

This lack of understanding has caused many people to jump to the extreme belief that no molds are good for you. This reaction, however, discounts the pervasiveness of mold in the environment, and the benign or beneficial nature of many molds.

**2. Mechanisms of Mold Growth.** Mold can grow and exist where the following three criteria are satisfied:

- a.. Temperate climate (typically above 70 degrees Fahrenheit);
- b. Existence of nutrient source such as wood, paper, or other cellulose or carbon-based material; and
- c. Moisture is present (high humidity rather than pooled or running/dripping water is sufficient).

When these criteria are satisfied, mold growth can begin within 48 hours. Once mold growth begins, the problem becomes more complicated. Moisture is required for growth and, when removed, causes mold to stop growing and die.

**3. Mold Remediation.** Unfortunately, simply killing mold, either by removing the moisture or spraying with a substance such as bleach, does not eliminate the potential exposure. It is precisely when mold dries out that spore release becomes most vigorous, and it is often this airborne exposure, much like asbestos, that allegedly causes health problems. This quandary makes responding to a mold problem difficult. Killing the mold without proper controls allows spore dispersal resulting in both immediate and long-term problems. Thus, mold outbreaks

should be handled in a deliberate manner with extensive controls similar to those used in handling toxic waste or asbestos. Achieving complete removal of mold from drywall, ceiling panels and ventilation systems has proven difficult at best because spore-producing mold bodies remain in cracks, crevices and porous surfaces and cannot be removed by simple cleaning. Some experts increasingly contend that the only means of remediation is -complete removal and replacement of all contaminated material.

### **III. Mold Litigation**

Clearly, property owners, managers and tenants, lessors and lessees should be concerned about this increasingly problematic potential exposure. Architects, engineers, contractors and subcontractors have also been sued and have lost. Insurance companies have been sued based on two general principles: first, for bad faith when denying coverage for mold related claims; and second, for not alerting or protecting insureds from mold-related problems.

**1. Litigation Costs are on the Rise:** Mold litigation is likely to continue and escalate for sometime. Costs for litigation are also likely to rise. The increasing costs of mold-related litigation include the following:

**a. High Investigation Costs.** Building inspections to determine the cause, type, and extent of mold can cost upwards of \$1 million, which investigation costs are fully recoverable litigation expenses in a large number of states.

**b. Large Number of Claimants.** The sheer number of persons actually exposed and those claiming to be exposed results in a large number of plaintiffs, regardless of the actual physical manifestation of symptoms.

**c. Complex Subject Matter.** As is true of all complex subject matter, conveying a message to a jury is a slow, painstaking, and costly process that must be carefully managed to ensure jury members hear and understand each side's argument.

**d. Expert Witnesses.** Expensive witnesses, including industrial hygienists, engineers, epidemiologists, oncologists, and neurologists, may be required by both plaintiffs' and defendants' counsel to support litigation. Each side incurring in excess of \$250,000 for expert witnesses to support this type of litigation is fairly common.

**e. High Cost of Remediation.** The cost to remediate a mold problem can be substantial, up to \$150 per square foot, or more than 10 times the cost to simply remove and replace the construction materials. In certain cases, the most cost effective option, even with high costs of relocation and ALE, is to knock down the building and start over with a new structure.

**2. Recovery is Not Limited to Special Damages:** Recovery of damages in most construction related litigation is limited to those special damages relating to correcting defects in the building and the consequential or incidental damages flowing from the need to repair those defects. Only in unusual situations are other damages available to the injured party. That limitation is not always the case with mold-related claims.

**a. Potential Recovery of General Damages.** When a proven personal injury component is demonstrated to have been caused by mold exposure relating to a construction defect, recovery for general damages for pain & suffering is available. A recent jury award in Texas included a high six figure recovery for that component of damages alone.

**b. Potential Recovery of Punitive Damages.** In cases where fraudulent concealment or battery is alleged, the plaintiff will almost certainly bring a demand for punitive damages. Historically, plaintiffs have brought suit based on numerous theories including, but not limited to, negligence, strict liability, implied and express contracts, constructive eviction, breach of contract, and nuisance.

#### **IV. Available Insurance Coverage for Mold Claims**

There are various ways in which insurance policies cover and exclude mold claims. Mold claims have been made against a broad range of insurance policies including homeowners, commercial general liability and commercial property as outlined below.

**1. Homeowner's Policies.** Many of the mold stories reported in news arise in the context of a homeowner battling with its first party liability carrier over who will pay the bills for the alleged property damage and bodily injury arising from claims. Some of the personal lines policies used by insurance companies exclude coverage for loss caused by "*smog, rust or any other corrosion, mold, wet or dry rot.*" The operative issue surrounding this clause is whether the mold was the cause of loss or the result of another cause of loss that is not excluded.

At least one court has ruled on this exclusion issue and found that the mold exclusion did not apply if the "*efficient proximate cause*" of the damages was an otherwise covered peril, such as a leaking roof. Insurance industry experts agree that the intent of this exclusion is to preclude coverage for damages that are the result of mold that arises naturally as the result of humid conditions. Other exclusions exist in homeowner forms that may preclude coverage for mold-related losses. For example, a common argument is that mold growth results from poor maintenance of the insured property. Thus, insurers rely on the exclusion for loss arising from wear, tear and deterioration.

In addition, many policies contain exclusions for faulty design and construction defect losses. The standard policies also contain a pollution exclusion that precludes coverage for the "*discharge, dispersal, seepage, migration, release or escape*" of "*Pollutants*" unless the discharge is caused by a covered peril or other insured event. If the loss results from a covered peril, then the issue becomes whether mold is a Pollutant and whether the mold has been

*"discharged"* from the place in which it originated.

Even though Pollutant is defined as *"any solid, liquid, gaseous or thermal irritant or contaminant,"* some courts do not consider mold to be a Pollutant. The argument is as follows: Mold is an organic, naturally occurring substance, and the traditional meaning of a Pollutant is an industrial waste or other chemical. In addition, some insureds believe that if the carriers wanted to exclude mold as a pollutant they should have added the word *"mold"* within the definition of

Pollutant. Another argument is that no *"discharge"* has occurred. At least one court looking at this issue has ruled that mold trapped within the walls of a prefabricated home was not *"released"* into the environment and, therefore, the pollution exclusion did not apply. Some carriers are now including more *"absolute"* exclusions that preclude coverage for mold regardless of whether or not it is caused by a covered peril. This *"concurrent causation"* type language attempts to clarify that *"even if the mold is precipitated by an otherwise covered peril, the intent is to exclude the direct damage (if any) by the mold."*

**2. Commercial Property Policies.** The insuring agreement in most commercial property insurance forms state that the carrier will pay for direct physical loss of or damage to Covered Property caused by or resulting from any Covered Cause of Loss. A threshold issue presented is whether mold is simply a condition of the property, or whether it constitutes direct physical loss or damage. Since mold may be found everywhere, the mere presence of mold cannot be argued to fall within this definition.

Many property policy forms include exclusionary language which precludes coverage for *"loss or damage caused by or resulting from any rust, corrosion, fungus, decay, deterioration, hidden or latent defect or any property that causes it to damage or destroy itself and dampness or dryness of atmosphere."* Some forms add another exclusion that precludes coverage *"if damage .is the result of continuous or repeated seepage or leakage of water that occurs over a period of fourteen (14) days or more."* Thus, even if the efficient proximate cause was a covered peril such as a burst water pipe, and that condition occurred over a period of 14 days or more, no coverage would be afforded.

**3. Commercial General Liability Policies.** Builders, trades, design professionals, property managers, and others in the construction industry typically look to their Commercial General Liability (CGL) policy to provide coverage for third-party bodily injury and property damage claims arising from mold exposure. Most CGL policies will have some form of an *"absolute"* pollution exclusion. As with homeowner and property coverage, the exact wording of the exclusion, the specific circumstances of the loss, and applicable court decisions will determine how coverage might apply.

Another consideration is how CGL policies have responded to similar losses in the past. For example, on November 14, 2001 the Ohio Supreme Court ruled that carbon monoxide was not a *"pollutant"* in the context of a CGL absolute pollution exclusion. In that case, a woman died after inhaling carbon monoxide emitted from a faulty heating unit. The building owner and

manager filed a claim with its CGL carrier, and the carrier denied the claim based upon the absolute pollution exclusion. The court ruled that *"the policyholders reasonably believed that [the carrier] would insure them against premises hazards and did not anticipate coverage would be denied under the pollution exclusion."* This public policy argument is called the "reasonable expectation doctrine." That doctrine is based on the notion that in a situation in which the insured reasonably expects coverage, the policy should respond.

If a court finds that mold is a pollutant, the issue then becomes whether mold was "discharged" into the "environment." As indicated above, at least one court has said "no" in the context of that particular case, where mold was trapped inside walls of a prefabricated home. Some courts have made a distinction between indoor air and outdoor air for purposes of applying the pollution exclusion. For example, the Minnesota Supreme Court, in the context of an asbestos case, found that the pollution exclusion did not apply because the term "atmosphere" in the exclusionary language applied to claims relating to damage to the "natural environment" and not within a building.

In 1997, a New York trial court ruled that mold was indeed a "contaminant" that was "released" within the meaning of the pollution exclusion. The court's reading of the pollution exclusion *"looked more to the plain meaning of the words and less to traditional environmental concepts of pollution"* as other courts have done.

Depending upon the jurisdiction, it appears that courts will look at these issues differently. Cases could be decided based upon several factors ranging from public policy arguments to the plain meaning of the contracts. How it all plays out in the end is anyone's guess. However, one thing seems clear, the litigation over mold-related claims from both a liability and an insurance coverage standpoint is still in its infancy.

## **V. The Specialty Environmental Insurance Market**

Given the nature of potential losses due to mold, most organizations will look to specialty environmental insurers for coverage.

**1. The Trend Is to Exclude Coverage for Mold Claims:** Many pollution policies contain language that appears to go directly to the crux of the issue. For example, consider the following definition from a leading pollution underwriter:

*Pollution Condition means "the discharge, dispersal, release, seepage, migration, or escape of smoke, vapors, soot, fumes, ... or other irritants, contaminants or pollutants into or upon land, or structures thereupon, the atmosphere, or any watercourse or body of water including groundwater.*

As more is learned about this developing issue, even pollution underwriters have begun to express concerns and add mold exclusions to their policies. Fortunately for the insured, it does

not appear that mold exclusions are being added to all pollution policies in all situations. With aggressive marketing and satisfactory responses to underwriters' questions, pollution policies providing varying degrees of coverage have been obtained. Also, some jurisdictions, notably California, presently have legislation pending which would bar first party carriers from excluding mold coverage. The fate of those measures remain unknown, as presently no jurisdiction has yet to enact such legislation.

**2. Policy Interpretation Problems.** It is important to note that pollution policies which do not have a specific mold exclusion present special policy interpretation problems. Insureds opting to rely on a pollution policy to treat this exposure need to review and, if possible and deemed appropriate, seek to amend the policy language shortcomings discussed below. The better practice is to seek to obtain a pollution policy that more clearly affirms coverage, rather than relying on the policy's silence on the issue.

**a. Mold as a Pollution Condition.** The definition of "Pollution Condition" requires discharge, dispersal, release, seepage, migration, or escape. Although airborne spores fall within this definition, the mere existence of mold may not. The definitions do not clearly contemplate this biological formation or growth of a pollution condition. While the typical definition of a pollution condition or remediation expense does provide broad language, in no case does it make clear that mold is contemplated.

**b. Environmental Regulations.** At present, while many states and cities are considering codifying a standard, there are no legal or regulatory standards governing mold. California's SB 732 (2001) was codified in Civil Code Section 1102.6 (disclosures required in real estate transactions) and Health & Safety Code Sections 26100, *et seq.* The stated purpose of the legislation is to "*require the Department [of Health Services] to consider the feasibility of adopting permissible exposure limits to molds in indoor environments.*" This is a precursor to the possible adoption of a uniform standard for acceptable levels of given types of molds inside a living area, and acceptable forms of remediation. However, the Department does not have to report back its findings to the California Legislature until July 1, 2003. Also, these sort of studies are notoriously late due in large part to the political wrangling going on behind the scenes. In large part to the political difficulties surrounding the adoption and implementation of a uniform standard, at present (as of January 2002), the only currently operative, definitive statement regarding mold remediation is provided in New York City's Guidelines on Assessment and Remediation of Fungi in Indoor Environments. Even these standards lack the weight of a statute or regulation, and are only "guidelines" for the City to use. As such, it may prove difficult to trigger a pollution policy based on a "discovery" trigger, leaving insureds to rely solely on pollution policies' "claims" triggers.

**c. Extent of Clean-up.** Complicating matters, if the policy is triggered, to what extent does the problem get remediated and in accord with what technique? Currently, the generally accepted opinion is that all traces of mold should be removed, but will the insurer

agree? This approach is quite different from soil or groundwater remediation where it is common to leave residual contamination in place, often at high levels. Will insurers agree to cover the expense incurred to remediate in accord with asbestos like containment precautions, or will drywall, for example, simply be pulled out and disposed in the dumpster? Finally, will insurers agree to conduct air monitoring both during and following mold remediation to ensure the problem does not recur at some point in the future?

**d. Restoration Costs.** How do the costs to reconstruct walls, flooring, HVAC systems, ceilings, and other structures, as well as the costs to replace personal property and improvements, get covered? Arguably, the pertinent definitions that apply to clean-up costs and remediation expenses fall short of providing clear coverage for the inevitable expenses that occur as a result of having to remove an entire wall's drywall-eliminating the mold, but leaving no wall.

**e. Naturally Occurring.** Mold and fungus are naturally occurring and, in certain cases, might prompt a claim adjuster to preclude coverage based on language in many pollution policies stating that the coverage does not apply to "naturally occurring substances."

**f. Toxic Mold Only.** Certain underwriters have indicated that clarifying language will be added to affirm coverage for mold-related issues, but only if the mold is confirmed to be both toxic and airborne. It is not clear what constitutes a toxic mold and may not be for some time, which is exacerbated by the fact that the expense to confirm an airborne release is quite high.

## **VI. Conclusion.**

The debate over toxic mold claims and coverage-related issues is gathering momentum. Whether mold will indeed become the "next asbestos" remains to be seen. but early indications suggest some relevant similarities. An array of different businesses and their insurance programs will be affected by mold-related claims. Landlords, contractors, architects, building managers and most employers face liability arising from this issue. Mold is an issue that risk managers for all types of enterprises need to address. Until the adoption of a uniform standard governing what constitutes toxic mold levels and appropriate remediation, the expert toxicologists on the two sides on any given case can relatively freely opine about appropriate mold levels and methods of remediation. A uniform standard will put an end to much of that uncertainty. In the final analysis, the plaintiff's bar is placing great store in this type of a uniform standard because its adoption would make it much easier for the claimant to establish the basis for a mold claim. More and more legislatures and state insurance commissioners will inevitably enter the debate. As standard property and casualty insurance companies look to limit their exposure to claims arising from mold claims, specialty environmental insurance carriers may likely fill the coverage gap. At what cost, however, remains to be determined.