

Epidemic of Mold Litigation Plagues Insurance Industry

By

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One of the oldest life forms on Earth is spawning a new species of toxic tort claims across the nation. The recent proliferation of mold litigation has left legal and medical experts debating the complex health implications of this pervasive menace. Of course, the perennial question for the insurance industry is much more direct ... who is ultimately going to have to bear the financial burden of these thriving mold claims? This article will discuss some of the more significant insurance coverage issues that must be addressed in an effort to answer that crucial question.

First, we will review some of the latest legal developments which have precipitated the recent rise in attention to this ancient problem. For example, on June 4, 2001, the progressive San Francisco County Board of Supervisors passed an ordinance amending the County Health Code so as to include mold and mildew as public nuisances that need to be abated. Although this has occurred very recently, the potential health risks of mold were apparently recognized over two thousand years ago, as reflected in the hygiene directives contained in the Old Testament of the Bible. Leviticus 14:33-53 makes reference to the "greenish or reddish depressions which seem to go deeper than the surface of the wall" of a house and sets forth an elaborate scheme for removing such an unhealthy condition.

The City of New York presently has the most comprehensive guidelines for assessing and remediating mold problems. There are also several proposed statutes on the issue pending in the California State Legislature. Unfortunately, specific California regulatory standards on mold are not expected any time soon. While workable political solutions still remain elusive, claimants flock to the courts for relief.

On May 10, 2001, California Lawyer magazine reported: "An estimated 2,000 plaintiffs are currently involved in pending toxic mold cases throughout California — a phenomena that is attributable to scientific advances that have linked mold growths indoors to a variety of health problems".¹ On June 11, 2001, the National Underwriter, "Hot News", quoted a spokesman for Farmers Insurance in reporting "the insurer expects mold claims to reach \$85 million by the end of 2001, a five-fold increase compared to the previous year."²

Although California and Texas appear to have most of the mold claims, the phenomena is spreading from coast to coast. Indeed, in New York City, over 300 tenants in an apartment complex have claimed mold problems and filed a class action lawsuit seeking in excess of \$10 billion.³ Whereas back in California, a Superior Court Judge and court employees are suing the County for failing to repair a leaky air conditioner

1. Deborah Rosenthal, "Think Mold: It's the Next New Thing in Toxic Tort Litigation", *California Lawyer*, May 10, 2001.

2. Robert W Mitchell, "Insurer Says Mold Claims Surge This Year", *National Underwriter*, "Hot News", June 11, 2001.

3. Everett L. Herndon, Jr., and Chins S. Yang, "Mold and Mildew: A Creeping Catastrophe", *Mealey's Mold Litigation Conference Materials*, June 2001, page 333.

unit that caused a "black, slimy mold" to invade her courtroom. The plaintiffs claim severe rashes, respiratory problems, dizziness and abdominal pains. See, *Krant v. County of Tulare*, No. 00-0190367 (Superior Court, Tulare County, March 27, 2000).⁴

Similar claims involving contaminated courthouses have already been resolved in Florida. In that state, in recent years, two courthouses contaminated by toxic mold, one in Polk County, the other in Marin County, generated two lawsuits. The Polk County suit resulted in a settlement of \$48.5 million, and the Marin County case concluded with a settlement of \$8 million and a jury verdict of \$14 million. The jury verdict was later affirmed by the Florida District Court of Appeal.⁵

The latest and biggest concern for insurers, however, is the very real specter of bad faith punitive damage verdicts in mold cases. In *Anderson v. Allstate Insurance Co.*, Nos. 01-15145, 01-15246, 01-15307 & 01-15330 (9th Cir.), Allstate is appealing a \$2.5 million punitive damage award. In *Anderson*, a Federal jury awarded plaintiff nearly \$500,000.00 in compensatory damages and \$18 million in punitive damages; however, the trial court reduced the punitive damage award to \$2.5 million. In that case, which was tried in the U.S. District Court for the Eastern District of California, the plaintiff successfully alleged that Allstate maliciously handled water and mold damage claims under her homeowner's policy.⁶

In *Ballard, et al., v. Fire Insurance Exchange, et al.*, No. 99-05252, Texas Dist., Travis Co., a Texas jury awarded a homeowner \$32 million after finding that their carrier acted in bad faith in evaluating their mold property damage claim. That verdict, which came down on June 1, 2001, involved the refusal of the homeowner's insurer to fix a plumbing leak which resulted in the contamination of the insured's home with "toxic mold".⁷ In an interesting adjunct to the

Ballard case, the "Texas Grand Jury found reason to continue a criminal investigation of the child endangerment charges involving Farmers Insurance Company of Los Angeles, California. A four-month investigation was prompted by a criminal complaint filed by a wife and her husband alleging that Farmers' microbiologist found the family to be living in a space containing *Stachybotrys chartarum*, but neither Farmers nor the microbiologist informed the family of their discovery until the mold had caused irreversible health effects. The Grand Jury stated that the case merited possible further action and requested that the investigation remain open pending additional information into Farmer's conduct."⁸

Obviously, given the potential severe consequences, an insurance company confronted with a garden variety mold claim should take all reasonable measures to prevent it from transmutating into a monstrous bad faith claim, or even a criminal prosecution. As usual, sound claims handling practices begin with a solid understanding of the pertinent facts, the applicable policy provisions, and the controlling law. Although the facts of each mold claim will differ, almost all of them can be expected to involve a water intrusion issue, since mold and mildew need moisture to thrive.

Moreover, even though the pertinent provisions are similar in many policies on the market today, there are significant distinctions that must be closely scrutinized in every case. Furthermore, although the law in this newly developing area is far from established, and the published legal authority is somewhat scant, trends seem to be developing. The balance of this article will be devoted to an analysis of key cases concerning insurance coverage for mold damage in the context of both first and third party claims.

4. Sylvia Sieh, "Will 'Toxic Mold' Be the Next Asbestos?" *Lawyers Weekly USA*, October 2, 2000, (2000 IWUSA 853).

5. *Rosenthal*, supra.

6. "Allstate Urges 9th Circuit To Reverse Punitive Damage Award In Mold Damage Case", *Mealey's Litigation Report: Mold*, June 2001, page 8.

7. "Jury Awards \$32 million In 'Toxic Mold' Case", *Lawyer's Weekly USA*, June 11, 2001 (2001 IWUSA 458); See also, *Mealey's Litigation Report: Mold*, June 2001, page 6.

8. John G. Delany, III, et al., "Insurance Coverage; Claims Handling Strategies; Overview of Mold Litigation; and Mold Internet Directory", *Litigation Forum, Inc.*, Mealey's Publications, June 2001, page 39.

A. Coverage for First Party Property Damage Claims under Standard Homeowners' Policies

Insurance policies tend to vary depending on the company and the State of issuance. There are, however, "standard" or "model" policies that are published by the Insurance Services Office, Inc. ("ISO"). These standard policy provisions often form the basis for many of the policies issued by various insurance companies.⁹ The most commonly used ISO homeowners' policy is generally referred to as the "HO-3" and was issued by the ISO in 1991.¹⁰ The HO-3 provides coverage for certain Structures, such as Dwellings, but only if there is a "direct physical loss" to covered property. Water and mold can normally be expected to cause sufficient damage so as to constitute the "direct physical loss" required by the policy.¹¹

Assuming that mold has resulted in the requisite direct physical loss to the covered property, the insured must still overcome the "mold exclusion" contained in the standard HO-3 policy. That exclusion provides as follows: "We do not insure, however, for loss: ... 2. Caused by: ... e.(1)Wear and tear, marring, deterioration ... (3) Smog, rust or other corrosion, mold, wet or dry rot: ... (5) Discharge, dispersal, seepage, migration, release or escape of pollutants..."¹² [Emphasis added].

"For mold to be excluded, it must fit into the category of the exclusions typically referred to as the 'wear and tear' type exclusions."¹³ This means that if the mold or any damage has occurred naturally over time as a result of climatic conditions, such as high humidity, rather than a covered event such as a pipe burst, the exclusion applies so as to bar coverage.¹⁴ This will of course turn on the facts of each particular case. The cases discussed below, however, are illustrative of the way in which various courts have dealt with the issue.

In *Bowers v. Farmers Insurance Exchange* 99

Wash.App. 41,991 P2d 734 (2000), a homeowner brought a claim for mold damage to a rental house when the homeowner's tenants converted the premises into a marijuana growing operation. The insurer denied the claim based on the mold exclusion. The insured contended that the damage was covered under the coverage for vandalism or malicious mischief, which was provided by the policy. The court agreed with the insured and held that the tenant's vandalism was the efficient proximate cause of the loss and, therefore, the mold damage was covered.

Likewise, in *Sunbreaker Condominium Assoc. v. Travelers*, 79 Wash.App 368,901 P2d 1079 (1995), the court held that fungus damage would be covered if the efficient proximate cause of the loss was wind driven rain which was a covered peril under the policy. The fungus damage would not be covered, however, if the cause of the loss was non-wind driven rain, since that was an excluded peril under the policy.

In *Home Insurance Company v. McClain*, 2000 WL 144115 (Tex.App.-Dallas, Feb. 10, 2000), a Texas appellate court found that the damage caused by mold and fungi was an "ensuing loss" of covered water damage.¹⁵ This was because the water entered the house from a leaking roof which pooled in crawl spaces and caused the mold and fungi to grow. Since the mold and fungi was caused by covered water damage, the court concluded that the exclusion for mold and fungi did not apply.

The *McClain* court distinguished its decision from an earlier decision that it issued. In that earlier case, *Merrimack Mutual Fire Insurance Co. v. McCaffree*, 486 S.W.2d 616 (1972), the Texas Court of Appeals for Dallas held that the mold damage was not covered, pursuant to the exclusion for deterioration, rot, mold or other fungi. In the *McCaffree* case, a shower stall had been constructed without a shower pan. The evidence showed that water had been leaking over a period of many years, which caused fungi to develop and rot the wood. Therefore, the

9. Everett L. Herndon, Jr., "Are Mold Claims Covered Under a Homeowner's Policy?", *Mealey's Mold Litigation Conference Materials*, June 2001, page 327.

10. Id.

11. Id.

12. The subject of the applicability of pollution exclusions to mold claims will be discussed in the next section.

13. Herndon, supra.

14. Id.

15. Caution: This case is not officially published and may not be cited as authority.

damage was found to fall within an express exclusion under the policy.

A similar decision was reached in *Aetna Casualty & Surety Company v. Yates*, 344 F.2d 939 (5th Cir. 1965). In that case, the insured claimed a loss resulting from the rotting away of joists, sills and subflooring of a home because the crawl space under the house was inadequately supplied with vents. The air trapped in the crawl space and subfloors and sills, which had been chilled by air conditioning, produced condensation of moisture which resulted in rotting. The policy excluded loss caused by inherent vice, deterioration, rot, mold or other fungi or dampness of atmosphere, but contained an exception for an ensuing loss caused by water damage. The appellate court held that the rotting caused by the condensation of moisture was not caused by "water damage" within the meaning of the policy and the claim was properly denied.

At this time, there are very few published cases nationwide that specifically address the enforceability of a mold exclusion. As can be seen from the cases discussed above, however, they tend to focus on an efficient proximate cause type analysis to determine whether the predominant cause of the loss was a covered, rather than an excluded, peril under the policy. In California, the leading case on the application of the efficient proximate cause doctrine is *Garvey v. State Farm & Casualty Company*, 48 Cal.3d 395, 257 Cal.Rptr. 292 (1989). In response to *Garvey*, some insurance carriers have inserted language in their policies seeking to enforce exclusions, regardless of whether the excluded cause of a loss acted alone or in conjunction with a covered cause of a loss.

At least two Federal cases since *Garvey* have upheld an insurer's right to so limit the coverage in a policy, stating that the plain language of the policy limitations must be respected. See, *State Farm Fire & Casualty Company v. Martin*, 872 F.2d 319, 321 (9th Cir. 1989) (applying California law); and *Cuevas v. Allstate Insurance Company*, 872 F.Supp. 737, 740 (S.D. Cal. 1994) (applying California law). On the other hand, one California Court of Appeal case has sought to extend the *Garvey* doctrine by holding that an insurer may not limit its liability, despite contrary policy language, when a covered peril is the efficient proximate cause of a loss. See, *Howell v. State Farm & Casualty Company*, 218 Cal.App.3d 1446, 1452, 267

Cal.Rptr. 708 (1990). The California Supreme Court will undoubtedly need to rule on the validity of "anti-*Garvey*" provisions seeking to limit the application of the efficient proximate cause doctrine. Until it does, the issue will remain somewhat unsettled in California, at least depending upon whether one finds oneself in State or Federal Court.

A related issue concerns whether insurance carriers will be permitted to impose policy sublimits for mold related damage. The author currently has a case pending before a California Court of Appeal concerning whether a sublimit for "pollution cleanup" would apply to the asbestos abatement of a building. In that case, asbestos damage was expressly excluded from coverage under the policy, but the earthquake which allegedly caused that damage was a covered cause of loss. A decision in that case is expected within the next year. It may shed further light on how California appellate courts are likely to view similar coverage limitations that carriers may seek to enforce with respect to mold damage.

Until further guidance is provided by the courts, insurance carriers would be wise to assume that a standard mold exclusion, standing alone, will not be sufficient to protect them from bad faith claims. Insurance carriers should not deny claims, based solely on the mold exclusion, without any investigation as to the cause of the mold related damage. Given the current state of the law, if the efficient proximate cause of the loss was a covered peril, such as damage from wind driven rain, or a broken pipe, the subsequent damage should also be considered covered. This would include any such resulting damage relating to mold.

B. Coverage for a Third Party Liability Claim under Standard CGL Policies

Most commercial entities that have liability insurance coverage have been issued a standard Commercial General Liability ("CGL") policy. These policies typically provide coverage for "all sums which the insured shall become legally obligated to pay as damages because of bodily injury or property damage".¹⁶ Of course, that coverage is subject to a number of exclusions. The applicability of what has become known as the "absolute pollution exclusion", which made its appearance in 1986, generally depends upon the resolution of two issues. Those

that the pollution exclusion did not bar coverage. In *American States Ins. Co. v. Kolonis*, 687 N.E.2d 72 (1997), the Supreme Court of Illinois held that the accidental release of carbon monoxide into a building, due to a broken furnace, did not constitute the type of environmental pollution contemplated by the pollution exclusion. In *Stoney Run Company v. Prudential-LMI Commercial Ins. Co.*, 47 F.3d 34 (2nd Cir. 1995), the court also held that the release of carbon monoxide into an apartment was not the type of environmental pollution contemplated by the pollution exclusion. The court found that the provision was at least ambiguous when applied to the facts of the case, and thus coverage existed.

In *Donaldson v. Urban Land Interests*, 564 N.W.2d 728 (1997), the Supreme Court of Wisconsin held that the absolute pollution exclusion did not apply so as to bar coverage for the release of carbon dioxide into a building. In that "sick building" case, the plaintiffs alleged that an inadequate air exchange ventilation system in an office building caused an excess of accumulation of carbon dioxide in their work area. The court stated: "We are therefore hesitant to conclude that a reasonable insured would necessarily view exhaled carbon dioxide as in the same class as 'smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste.'" ²²

In *Sullins v. Allstate Insurance Co.*, 667 A.2d 617 (1995), the Court of Appeals of Maryland held that the pollution exclusion did not permit an insurance carrier to bar coverage in a case involving exposure to lead paint. Rather, the court concluded "that the insurance industry intended the pollution exclusion to apply only to environmental pollution."²³

The author has located no published decisions nationwide specifically discussing the application of the absolute pollution exclusion to a third party claim of injury or damage caused by mold. That mold case is undoubtedly currently incubating in the appellate courts and will probably emerge in the near future. The appellate courts have been inconsistent in their application of the pollution exclusion to other claims involving indoor contamination and "sick building" claims. Therefore, it is difficult to predict how they will rule on the mold coverage issue in any particular

jurisdiction, or whether a consensus will eventually develop.

At present, both insurance companies and insureds apparently have ample legal authority available to argue whether the pollution exclusion should or should not be applied to claims of indoor contamination, such as those involving injury or damage resulting from mold. If the court focuses on the strict wording of the pollution exclusion, it could very well find that mold would qualify as a "contaminant". On the other hand, the various terms within the pollution exclusion tend to address inorganic substances; rather than organic (albeit primitive) life forms like mold.

The author believes that this should probably be sufficient so as to create an ambiguity and focus the inquiry on the objectively reasonable expectations of the insured. If the analysis gets to that stage, coverage will undoubtedly be afforded to these claims. This is because mold would not ordinarily be considered a "pollutant"; at least not in the same sense as one would view an industrial discharge of toxic waste into the environment.

The issue regarding whether mold constitutes a "pollutant" and/or "discharge of a pollutant" may soon become academic, at least with respect to the interpretation of new CGL policies. This is because the author understands that numerous insurance companies are endeavoring to revise their CGL policies so as to specifically exclude claims for injury or damage caused by mold. The efficient proximate cause analysis, discussed in the preceding section, only applies to first party claims. Therefore, a clear and conspicuous exclusion relating to mold damage in a CGL policy may very well dispose of the issue in the third party context.

Commercial insureds at risk of third party mold claims would be well advised to carefully scrutinize any proposed new policy to determine if it will provide coverage for potential claims in this developing area of toxic tort law. In the meantime, it is significant that the 1986 absolute pollution exclusion does not specifically reference mold, and that the duty to defend is broader than the duty to indemnify. Therefore, under many existing CGL

22. *Donaldson* at 732-733.

23. *Sullins* at 623.

policies, insureds should at least be able to expect a defense, pursuant to a reservation of rights, for most third party claims alleging injury or damage caused by mold.

C. Other Key Coverage Issues Relating to Mold Claims

There is a myriad of potential coverage issues involved in the handling of mold claims, as there is in most insurance claims. A detailed discussion of those issues would be beyond the scope of this article. Nonetheless, a listing of the major insurance coverage issues that may arise should be helpful. These potential coverage issues include the following: Late notice; owned property exclusion; applicability of personal injury coverage; presence of covered property damage; trigger of coverage; occurrence; known loss/loss in progress; mitigation; own work exclusion; faulty workmanship; duty to defend; extracontractual exclusions; allocation; and excess coverage.²⁴

The practitioner will undoubtedly wish to consult a current insurance law treatise which discusses the law in his or her jurisdiction.²⁵ One issue that certainly deserves further discussion here, however, is the one concerning notice.²⁶ The notice issue is particularly important in mold cases because the nature of the claim is such that one can expect the problem to get worse if the cause of the water intrusion is not promptly addressed.

"While all claims should be responded to and handled promptly, timeliness on covered water claims is especially critical. A prompt response and immediate commencement of cleanup and drying is essential in reducing or eliminating further damage, particularly by mold. The sooner the water is removed and the property dried out, the less property damage there will be and any related claim will also be correspondingly minimized. Water damage that is not addressed within 24 to 72 hours may result in the

growth and spreading of mold which could be toxic."²⁷

If the insured does not give proper notice to the insurance carrier, it may be difficult, if not impossible, for the carrier to determine if the mold damage was the result of long term deterioration, which would place it within an exclusion. The prejudice to the carrier that might result from such late notice could justify a proper denial of the claim. If a first party insured gives timely notice to the carrier, and the adjuster fails to retain qualified experts to promptly investigate the damage, the carrier may very well place itself in the position of not being able to assert the mold exclusion in the homeowner's policy. This is because any delay by the carrier could make it impossible for the experts to differentiate between any mold damage resulting from an excluded cause of loss such as deterioration, as opposed to a covered cause of loss such as a broken pipe.

In the third party context, it is also important to ascertain when the development of the mold occurred. This is necessary to determine whether a duty to defend or indemnify has been triggered by a policy issued by a particular insurance carrier for a particular period. In California, the Supreme Court ruled in *Montrose Chemical Corp. v. Admiral Insurance Co.*, 10 Cal.4th 645, 42 Cal.Rptr.2d 324 (1995), that a continuous trigger of coverage should be applied in environmental claims.

In *Montrose*, "[t]he court held that liability insurance coverage is triggered under all policies in effect while continuous and progressive bodily injury or property damage develops and such coverage remains in effect until the imposition of liability on the insured for such bodily injury or property damage is a certainty. Thus, an insurer has a duty to defend as long as injury or damage potentially could have occurred during its policy period."²⁸

The author understands that various insurance carriers are presently drafting "anti-*Montrose*" policy provisions in an attempt to nullify the application of

24. See, *Delany*, supra, pages 11-12.

25. For California practitioners, the author highly recommends John K. DiMugno's and Paul E. B. Glad's *California Insurance Law Handbook: A Reference and Guide*, 2001.

26. See, DiMugno, supra, Section 59.

27. Everett L. Herndon, Jr. and Chin S. Yang, "Mold & Mildew: A Creeping Catastrophe", *Mealey's Mold Litigation Conference Materials*, June 2001, page 335.

28. DiMugno, Section 44.18(1), pages 852-853.

a continuous trigger of coverage. It remains to be seen whether such provisions, seeking to limit the application of a continuous coverage trigger, will be enforced by the California courts. In the meantime, insureds and insurers alike would be well advised to promptly seek to investigate mold claims. In the event a claim is covered, they should try to work together to eliminate any water damage that could give rise to a more serious toxic tort claim. This is not only the best practice legally, but also morally, especially when continuing, and potentially worsening, health risks are concerned.²⁹

"The Center for Disease Control in Atlanta has identified more than 3,000 molds, of which approximately 25 have been found to be toxic, causing many respiratory problems."³⁰ The latest pro-insured bad faith verdicts would certainly seem to indicate that juries are inclined to identify and side with a homeowner prosecuting such a claim. This is the case even though there is a scarcity of epidemiological

evidence concerning the causal link between exposure to mold and many of the adverse health consequences that are being claimed.³¹

Whether the potential adverse health consequences of mold are serious and permanent is likely to be debated for some time to come. While advances in assessing and remediating mold problems are likely, an early end to the epidemic of mold litigation currently plaguing the insurance industry is not.

Until a "cure" for this litigation is found, the best medicine will be a prompt and conscientious evaluation of each mold claim. This must include an informed application of the pertinent policy provisions to the facts, in light of the applicable law. In this way, the insured should receive the protection to which they are entitled under the policy. Also in this way, insurance companies should avoid the substantial costs associated with having manageable mold claims mutate into virulent bad faith claims.

29. See, e.g., the *Ballard* case discussed above.

30. Thor Kamban Biberman, "Dormitory At San Diego State Closed Over Toxic Mold", *San Diego Daily Transcript*, July 2, 2001, page 1B.

31. See, Patrick J. Perrone, et al., "Excluding Expert Witness Testimony In Mold Litigation", *Mealey's Litigation Report: Mold*, June 2001, page 22.