

MOLD CLAIMS: A BASIC FRAMEWORK FOR FINDING COVERAGE UNDER COMMERCIAL PROPERTY AND GENERAL LIABILITY POLICIES,
by Whitney E. Stein, Copyright 2001 Insurance Law Group, Inc.

The presence of mold at toxic levels in buildings – just one iteration of “sick building” syndrome and a condition that is being hailed as the next great bastion for toxic tort litigation – is becoming an increasing concern among policyholders. The losses from mold damage (for remediation costs, as well as business interruption and extra expense losses) can easily reach into the hundreds of thousands of dollars, and even millions of dollars. And that does not even include a policyholder’s potential liability to employees and third parties for bodily injury claims arising out of exposure to mold at toxic levels. As a result, policyholders increasingly are turning to their insurers for coverage of all sorts of mold claims.

Pending Legislation Could Heighten Liability and Loss Associated With Mold

Based on our experience, we are here to say that the risk of mold losses and claims is real. In addition, the potential for future losses and claims involving property damage and bodily injury arising out of the presence of toxic mold in buildings is growing. As public attention focuses upon “sick building syndrome” and more worker complaints concerning the presence of potentially toxic levels of mold in buildings are heard, lawmakers across the country are focusing their attention on responding to their constituents.

As but one example of that, the California Senate recently proposed legislation that could heighten liability and loss associated with the presence of toxic levels of mold in buildings. Senate Bill 732, introduced on February 23, 2001, proposes enactment of the Toxic Mold Protection Act, which, among other things, would require the State Department of Health Services to adopt specific regulations to protect the public health from toxic mold.

If enacted as currently proposed, the Toxic Mold Protection Act would call for the establishment of permissible exposure limits to mold, similar to maximum contaminant levels set for air and water quality, and set standards for the identification and remediation of mold.

Moreover, the proposed bill will require property owners to conduct tests to determine the levels of mold present in both commercial and residential properties prior to leasing or transferring title of those properties. The property owners will be required to disclose the results of those tests to prospective tenants/title holders. Such testing and disclosure requirements are likely to uncover the presence of mold in many buildings and lead to a flurry of remediation efforts. Not only will those testing requirements have impact with regard to the future activities, but also the results likely will lead to claims for bodily injury and property damage (i.e., claims that personal property stored in the

buildings have been exposed to mold and now are damaged) by former tenants and other occupants (such as workers) of the buildings.

If this type of legislation is passed in several states throughout the country, we could experience another boon in toxic tort litigation – mold losses and claims. Thus, we believe that it is important for policyholders to know about the issues discussed in this article.

Coverage Issues are Prevalent

Mold claims can trigger any number of coverage issues under various policy forms. In this article, we will examine just a few of the coverage issues that property owners and contractors may face in their effort to find coverage for property damage and bodily injury claims associated with the presence of toxic mold in buildings under commercial property policies and commercial general liability (“CGL”) policies. This article is not exhaustive of all of the arguments that may be advanced either in favor of coverage or against it. But we believe that it is a good starting place in understanding the primary arguments often advanced by carriers in an effort to deny coverage for mold claims under commercial property and CGL policies and some of the responses that a policyholder can make to such arguments.

First-Party Mold Losses Under Commercial Property Policies

For property owners, the question of whether costly and time consuming mold remediation efforts (and related business interruption and extra expense losses) may be covered under commercial property policies is becoming more important, as public attention focuses on the presence of mold as creating a “sick building,” unfit for occupancy. As with any type of claim, first and foremost, a review of the express language in the property policy is key to determining the availability of coverage.

The Importance of “All Risk” Coverage

As an initial matter, it is important to understand whether the insurance policy at issue is a “specified perils” policy or “all risk” policy. It must be kept in mind that “all risk” commercial property policies are intended to provide coverage for any physical loss or damage to covered property from an external cause or peril, other than those that are expressly excluded. In other words, as long as the insured can show that it sustained some “physical loss or damage” to covered property, it has satisfied its burden of proof under an “all risk” policy to demonstrate a loss for which it is entitled to coverage. The burden then shifts to the insurer to demonstrate that an exclusion applies to bar coverage. While generally insurance policies of any kind must be interpreted broadly in favor of finding coverage, many commentators have observed that this rule applies with perhaps greater force in the context of “all risk” policies, where the intent and understanding of the parties is to provide broad coverage.

With that maxim in mind, we turn to the question of coverage for mold damage. Faced with a property damage claim for the presence of toxic mold, a commercial property insurer may respond by asserting that the presence of mold in a building does not constitute a direct physical loss to the property. Such an argument fundamentally misconstrues the meaning of “direct physical loss” and of “indirect loss,” as those terms are commonly used in commercial property policies. Direct physical loss means physical damage to the property, as opposed to indirect or intangible loss, such as diminution in value, or other purely economic impact, unaccompanied by a distinct, demonstrable, physical alteration of the property. The presence of mold in a structure at a concentration requiring remediation and/or creating a “sick building” reflects a physical alteration of the property and constitutes physical damage.

Exclusions for Faulty Workmanship, Latent Defect and the Like

Mold problems often arise out of some sort of faulty construction, design or equipment or some form of deterioration that permits the intrusion of water, such as rainwater, or the development of excess moisture in a building. As an example, mold may develop because windows are installed improperly and permit rainwater to enter a building, or because a vapor barrier is inadequate. Commercial property policies, however, typically exclude coverage for loss caused by “faulty workmanship, material, construction or design” or “deterioration, . . . wear and tear, inherent vice or latent defect.” Pointing to such exclusions, a commercial property insurer may argue that the mold damage faced by an insured is not covered because it resulted from an excluded cause, i.e., faulty workmanship, faulty design, deterioration, etc.

The key to confronting such exclusions is to explore the exceptions to the exclusions, which confirm what coverage is available in such circumstances. Exclusions for damage caused by faulty workmanship, faulty design, deterioration and so forth often contain “resulting damage” and/or “ensuing loss” exceptions that confirm coverage for mold damage in such circumstances. Courts have interpreted an ensuing loss as that loss which follows as a chance, likely or necessary consequence. Accordingly, a policyholder can argue that the mold damage is a resulting or ensuing loss that fits within the parameters of such exceptions. Looking at the example of the improperly installed windows, a policyholder can argue that the improperly installed windows permitted water to leak into the building, and then, as a result of the water intrusion, mold developed. The mold damage, therefore, is a resulting or ensuing loss. In this example, the cost of replacing or repairing the improperly installed windows might be excluded under the faulty construction or workmanship or latent defect exclusions, but the costs of repairing the resulting mold damage should be covered under the resulting damage or ensuing loss exception. Thus, while a policyholder may not find coverage for all of the “damage” to its building, it should be able to find coverage for a substantial part of the repair and remediation costs, and business interruption and extra expense losses flowing from such covered damage.

The “Contamination” Exclusion

Another argument that a carrier might advance to avoid a coverage obligation in the circumstances of a toxic mold claim is that mold damage constitutes “contamination.” Commercial property policies typically exclude damage due to contamination. A contamination exclusion may have wording similar to the following:

This policy excludes the following unless directly resulting from other physical damage not excluded by this Policy:

- 1) contamination, including but not limited to the presence of pollution or hazardous material; . . .

Following the rules of policy interpretation that exclusions to coverage must be drawn narrowly, a policyholder should always look to the precise terms of any “contamination” exclusion before acceding to a carrier’s attempt to apply it to a mold claim. Because most property policies do not define the terms “contamination,” “pollution” and “hazardous material,” the policyholder can argue that mold does not fall within the parameters of an exclusion employing those undefined terms. A narrow construction of the terms contamination, pollution and hazardous material may be limited to include only conditions relating to industrial pollutants. Such terms do not necessarily evoke images of naturally occurring and ever-present multi-cellular organisms, such as mold. On that basis alone, it can be argued that mold does not constitute “contamination” for purposes of the “contamination” exclusion.

Another argument a policyholder can make is based on the fact that some commercial property policies contain an express “mold” exclusion. By way of example, one standard form of commercial property policy contains the following exclusions:

“We DO NOT INSURE against loss caused by

1. Wear and tear, marring or scratching, deterioration, inherent vice, latent defect or mechanical breakdown.
2. Rust, mold, or wet or dry rot.
3. Contamination, smog or smoke from agricultural smudging or industrial operations . . .”

While the express exclusion of damage caused by mold may be bad news for one policyholder, the fact that such policy language exists may benefit other policyholders whose policies do not expressly exclude mold damage. The existence of the more particularized exclusion in other policy forms supports the argument that mold simply does not fall within the parameters of the undefined terms “contamination,” “pollution” or “hazardous material” as used in “contamination” exclusions found in commercial property policies. In fact, the very format of the exclusion quoted above, which separates

“mold” and “contamination”, demonstrates that at least one carrier considers mold and contamination as two separate and distinct perils. Other carriers similarly separate out mold and contamination into different exclusions, further supporting this argument.

In sum, when faced with a toxic mold property damage, business interruption and extra expense loss, a policyholder should carefully review its commercial property policy to determine whether the policy provides coverage for some or all of the losses. If the policy arguably provides coverage, the policyholder should pursue coverage for its losses, and should not take “not covered” as an acceptable response from its insurer(s) without thoroughly examining the coverage issues involved.

Third-Party Mold-Related Liability Claims Under CGL Policies

While a property owner may look first to a commercial property policy for coverage of remediation costs, the property owner may also look to the contractor that was responsible for design or construction of the building or HVAC system to pay for mold damage. And the property owner may be faced with a third-party claim for bodily injury associated with exposure to toxic mold. In either event, the focus will turn to commercial general liability (“CGL”) insurance, that carried by the property owner and that carried by the contractors who worked on the property. How might CGL insurers respond to such third-party claims for property damage and bodily injury?

Is There “Property Damage”?

With respect to property damage claims, a CGL insurer might first deny coverage by asserting that the presence of toxic mold in a building does not constitute “property damage” as that term is defined in a standard CGL policy. Insureds must remember that such a definition can be satisfied by either showing “physical injury” to “tangible property” or “loss of use of tangible property” that has not been “physically injured.” It would seem that one of these definitions is triggered. As noted above, the presence of mold should be construed as direct physical loss or damage, for purposes of coverage under a commercial property policy, so it would seem that mold constitutes “physical injury” to “tangible property” for the purposes of a CGL policy. Even assuming for the sake of discussion that a court would not make such a finding, that should mean that the second definition is satisfied, because mold causes loss of use of “tangible property” (i.e., the building or structure in which the mold is present).

Does the Pollution Exclusion Apply?

With respect to both property damage and bodily injury claims, CGL insurers most likely will rely on one or more forms of a pollution exclusion to deny coverage. CGL policies typically contain exclusions for bodily injury and property damage “arising out of the actual, alleged or threatened discharge, dispersal, release or escape of pollutants.” “Pollutants” is a term often defined as “any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and

waste.” “Pollutants” is not typically defined expressly as including mold or fungus. The terms “irritant” and “contaminant” typically are not defined.

Some insurers have argued that mold is an “irritant” or “contaminant” and that, therefore, the pollution exclusion bars coverage for mold claims. In response, policyholders can argue that the undefined terms “irritant” and “contaminant” do not clearly include mold and that the policy is ambiguous in that respect. Insureds can then argue that such an ambiguity, especially when it deals with exclusions, should be construed in favor of coverage.

In addition, policyholders also might be able to point to the drafting history of pollution exclusions in CGL policies. The drafting history of the “sudden and accidental” and so-called “absolute” pollution exclusions used in CGL policies has been the subject of much litigation. The attention given to that drafting history has resulted in the publication of testimony, documentary evidence, and court decisions demonstrating that the pollution exclusion was intended to be limited to excluding from coverage only environmental pollution resulting from industrial activities. The drafting history does not support the concept that insurers, in drafting the pollution exclusion, intended to exclude from coverage claims associated with toxic substances in an enclosed building or work space.

There is an additional argument that can be made for “property damage” claims. Even if mold were held by a court to be included within the undefined term “contaminant” or “irritant,” at least one court has held that mold damage to property does not fall within the scope of the so-called “absolute” pollution exclusion. That court reasoned that mold grows. It is not discharged, dispersed, or released, and it does not escape. Based on that characterization, the court concluded that the pollution exclusion does not bar coverage for mold damage. As noted above, by the exclusion’s own terms, it bars coverage only if the damage arises out of the “discharge, dispersal, release or escape” of pollutants.

In sum, the availability of coverage for mold-related third-party property damage and bodily injury claims under any particular CGL policy most likely will focus upon the scope of any pollution exclusion in the policy. To date, the few courts across the country that have examined that issue have decided it in inconsistent ways. It is vital, therefore, for policyholders (property owners and contractors alike) to understand what law might apply to the CGL policy(ies) at issue when determining whether mold claims can be covered.

Concluding Thoughts

The risk of a first-party mold loss or third-party mold claim is real for all types of policyholders, large and small. And if pending legislation is passed, this risk will just increase. Accordingly, it is important for policyholders to know now how their programs will respond to mold losses and claims. Such an understanding will allow policyholders to know what to do if a loss occurs or claim arises. It will also help policyholders

identify whether their insurance programs need to be amended to better respond to mold losses and claims in the future. And if a policyholder is faced with a mold loss or claim, as with any other kind of coverage matter, a policyholder should never accept an insurer's denial of coverage without thoroughly examining the issues. If there are arguments for coverage for the particular loss or claim at issue, then coverage should be pursued.

Insurance Law Group, Inc. is a law firm that is dedicated to servicing the legal needs of policyholders in insurance coverage matters. Whitney E. Stein is Senior Coverage Counsel at the firm. She has spent more than a decade representing policyholders in various aspects of giving coverage advice and pursuing claims against insurance companies. Copies of this and other articles written by the members of Insurance Law Group, Inc. can be found at the firm's website, www.inslawgroup.com. Ms. Stein can be contacted on phone 1-818-649-7635, or at wstein@inslawgroup.com.