

## INSURANCE COVERAGE FOR MOLD AND FUNGI CLAIMS: THE NEXT BATTLEGROUND?

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### I. INTRODUCTION

Over the next few years, the insurance industry will continue to contend with a burgeoning number of claims seeking coverage for mold-related damages under both property and liability insurance policies. The basis of the underlying lawsuits is not unlike traditional toxic torts: the plaintiffs claim that they, and their personal property, have been continuously exposed to molds, fungi, and other substances in their homes or workplaces. As a result of this alleged continuous exposure, the plaintiffs claim that they have incurred personal injury, such as respiratory problems and cognitive defects, and damage to their property, such as water damage to their personal property and to the interior of their homes or apartments.

In response to such claims, insureds have begun to seek coverage from their primary and excess insurance carriers. Examining these claims under traditional insurance coverage principles, the courts have begun to address certain issues under liability and property policies. To date, the bulk of mold-related coverage litigation has focused on the alleged applicability of various policy exclusions, including, but not limited to, the pollution exclusion and the so-called mold exclusion. Insurers continue to deny defense and/or indemnity claims under these exclusions. However, courts and juries appear reticent to accept the insurance industry's broad and expansive interpretation of these exclusions.

In addition to juries awarding compensatory damages in such coverage cases, large jury verdicts have been awarded against the insurance industry for bad faith denials of coverage. In one instance, a jury recently awarded

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a Texas homeowner \$32 million in compensatory and punitive damages.<sup>1</sup> Similarly, in November 2001, an Arizona jury returned a \$4.25 million verdict in a homeowner's claim against the insurer for its bad faith refusal to cover mold remediation.<sup>2</sup> One insurance industry spokesperson estimated that mold claims in 2001 would total \$85 million.<sup>3</sup>

The massive influx of mold-related claims has left the insurance industry, courts, and insureds with little guidance, standards, or expectations as to the appropriate extent of coverage. In response, state governments and the insurance industry are beginning to explore the possibility of defining mold standards and coverage at both the legislative and regulatory levels.

In sum, the explosion of mold-related claims has raised a number of significant insurance questions, with recent developments shedding some light on the answers to those questions. These recent developments are discussed below.

## II. LIABILITY INSURANCE IN RESPONSE TO CLAIMS OF MOLD AND FUNGI EXPOSURE

Depending on the facts and specific policy language at issue, policyholders faced with liability from mold and fungi exposure claims may be able to protect themselves by accessing their insurance coverage under both (1) bodily injury and property damage liability coverage and (2) personal injury liability coverage.

### A. *Bodily Injury and Property Damage Liability Coverage*

To determine whether insurance is available under bodily injury and property damage liability coverage, there are several key questions that must be addressed, including the following: (1) what is the appropriate trigger of coverage, (2) were the damages at issue expected or intended, and (3) does the pollution exclusion apply?

#### 1. Trigger of Coverage

The trigger-of-coverage issue involves the question of which policy periods' insurance policies are responsible for covering a particular claim. Depending on the facts involved, there are several different theories of the trigger of coverage that potentially may be applicable to mold-related claims. For instance, if the mold, fungi, or other substance at issue was introduced into the property at a specifically identifiable point in time, a

1. *Ballard v. Fire Ins. Exch.*, Index No. 99-05252 (Tex. Dist. Ct., Travis Cty. June 1, 2001), reported in 1 MEALEY'S LITIG. REP.: MOLD 6 (June 2001).

2. *Hatley v. Century Nat'l Co.*, Index No. CV 2000-006713 (Ariz. Super. Maricopa Cty. Nov. 2001), reprinted in 1 MEALEY'S LITIG. REP.: MOLD 12 (Dec. 2001).

3. Robert W. Mitchell, *Insurer Says Mold Claims Surge This Year*, NAT'L UNDERWRITER, June 11, 2001.

party could contend that the policies on the risk at that point of the claimants' "initial exposure" should be triggered.<sup>4</sup> If the claimants were exposed to mold or fungi over multiple policy periods, all of the policies on the risk during those periods would be triggered under an exposure theory.<sup>5</sup> If the alleged personal injuries of the claimants were diagnosed or became reasonably capable of medical diagnosis at a specific point in time, the policies on the risk at that time would be triggered under a "manifestation" trigger of coverage.<sup>6</sup> Finally, if the claimants were continuously exposed to mold or fungi and, during and after that period of exposure, developed progressively worsening injuries as a result of that continuous exposure, then all of the policies on the risk from the time of the initial exposure through the manifestation of the alleged personal injuries could be triggered under a "continuous injury trigger" theory.<sup>7</sup> Determining which trigger-of-coverage theory applies depends on the specific policy language at issue, the intent of the insurers in drafting that language, the individual facts of the case, and applicable state insurance law. To date, no reported decision has discussed "trigger of coverage" with respect to mold-related claims. Nevertheless, when determining which particular liability insurers are potentially responsible for covering these types of claims and, thus, which insurers should be placed on notice of the claims, consideration should be given to each of the foregoing trigger theories.

## 2. The Expected or Intended Exclusion

In an effort to avoid their coverage obligations, insurers may contend that the injuries allegedly suffered by the claimants are excluded because the policyholders allegedly knew or should have known about the presence of the substances in their buildings. In response, policyholders have two primary arguments that they should assert in rebuttal. First, policyholders may assert that the question is not whether they knew about the alleged presence of mold and fungi, but whether they knew that that condition

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4. See generally *Eljer Mfg., Inc. v. Liberty Mut. Ins. Co.*, 972 F.2d 805 (7th Cir. 1992) (holding that a building incurred property damage at the time of the installation of the defective product at issue).

5. See generally *Porter v. Am. Optical Corp.*, 641 F.2d 1128, 1145 (5th Cir.) (adopting exposure trigger theory in the context of asbestos bodily injury claims), *cert. denied*, 454 U.S. 1109 (1981); *Ins. Co. of N. Am. v. Forty-Eight Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980) (same), *reb'g granted, in part, clarified*, 657 F.2d 814 (6th Cir.), *cert. denied*, 454 U.S. 1109 (1981); *Cole v. Celotex Corp.*, 599 So. 2d 1058 (La. 1992) (same).

6. See generally *Eagle-Picher Indus., Inc. v. Liberty Mut. Ins. Co.*, 682 F.2d 12 (1st Cir. 1982) (holding that coverage of an asbestos bodily injury claim was triggered when the disease manifested or "became reasonably capable of medical diagnosis"), *cert. denied*, 460 U.S. 1028 (1983).

7. See generally *Keene Corp. v. Ins. Co. of N. Am.*, 667 F.2d 1034 (D.C. Cir. 1981) (adopting continuous trigger in asbestos bodily injury context), *cert. denied*, 455 U.S. 1007 (1982); *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502 (Pa. 1993) (same).

would cause the specific bodily injury and property damage allegedly suffered by the claimants.<sup>8</sup> Second, policyholders may argue that a loss is covered even if a court were to find that they reasonably should have known that the mold or fungi would cause damage, so long as they did not actually know that damage would ensue.<sup>9</sup>

Obviously, whether a particular policyholder actually knew that the alleged mold or fungi would cause bodily injury or property damage in a given instance is a fact-specific inquiry that will vary from case to case. Policyholders should be sensitive to the above arguments as the facts are developed in their defense of specific cases so that they may maximize their ability to withstand an insurer's contention that the injuries suffered by the claimants were expected or intended.

### 3. The Pollution Exclusion: Mold as Analogous to Indoor Air Quality Cases

In addition to their assertion that the injuries at issue were expected or intended, insurers may raise the so-called pollution exclusion as a defense to mold claims. Several recent decisions involving indoor air quality, including cases involving exposure to carbon monoxide, carbon dioxide, lead paint, and other contaminants, may provide insight into how courts will handle denials by insurers of mold-related claims based on the pollution exclusion.

A typical pollution exclusion commonly provides that coverage is excluded for bodily injury and property damage

arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalis, toxic chemicals, oil, or other petroleum substances or derivatives (including any oil refuse or oil mixed with waste), liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or any water course or body of water.<sup>10</sup>

Policyholders can attack the application of this and similar exclusions on three principal grounds. First, an insured may assert that, as a threshold matter, the mold or fungi at issue does not fall within the meaning of the phrase "irritants, contaminants or pollutants," as used in the exclusion. Second, an insured may assert that such pollution exclusions apply only, if ever, to cases of industrial environmental pollution and are clearly inap-

8. *See, e.g.*, *Vermont Mut. Ins. Co. v. Singleton*, 446 S.E.2d 417 (S.C. 1994) (intentional injury exclusion did not bar coverage where insured had not intended the injury resulting from his voluntary act).

9. *See, e.g.*, *U.S. Fid. & Guar. Co. v. Armstrong*, 479 So. 2d 1164, 1167 (Ala. 1985) ("[T]he legal standard to determine whether the injury was either expected or intended . . . is a purely subjective standard.")

10. *See, e.g.*, *Park-Ohio Indus., Inc. v. Home Indem. Co.*, 785 F. Supp. 670, 674 (N.D. Ohio 1991), *aff'd*, 975 F.2d 1215 (6th Cir. 1992).

plicable to cases involving indoor air quality.<sup>11</sup> Finally, an insured may contend that exposure to the mold, fungi, or other substances does not constitute “discharge, dispersal, release or escape” within the meaning of the pollution exclusion.

*a. Insureds’ Reasonable Expectations of Coverage for Claims Based on Indoor Air Quality* In determining the applicability of the pollution exclusion, many courts refer to the “common sense” approach, which focuses on the reasonable expectations of the insured. For instance, in a frequently cited case, *Pipefitters Welfare Educational Fund v. Westchester Fire Insurance Co.*,<sup>12</sup> the Seventh Circuit examined the limits of the terms “irritant” and “contaminant” in the pollution exclusion.<sup>13</sup> The court explained as follows:

The terms “irritant” and “contaminant,” when viewed in isolation, are virtually boundless, for “there is virtually no substance or chemical in existence that would not irritate or damage some person or property.” . . . Without some limiting principle, the pollution exclusion clause would extend far beyond its intended scope, and lead to some absurd results. To take but two simple examples, reading the clause broadly would bar coverage for bodily injuries suffered by one who slips and falls on the spilled contents of a bottle of Drano, and for bodily injuries caused by an allergic reaction to chlorine in a public pool. Although Drano and chlorine are both irritants or contaminants that cause, under certain conditions, bodily injury or property damage, one would not ordinarily characterize these events as pollution.<sup>14</sup>

Under *Pipefitters*, the determinative factor, the court explained, is whether a reasonable policyholder would characterize the hazard as “pollution.”<sup>15</sup> If the answer is “no,” then the court should find the policy ambiguous and construe its language in favor of coverage.<sup>16</sup>

The reasoning of the court in *Pipefitters* is frequently cited in decisions that attempt to put reasonable limits on the broad interpretation of pollution exclusions proffered by insurers. Under *Pipefitters*, courts shift their focus to the reasonable expectations of the insured. If a court concludes that a reasonable insured would expect coverage, then it should find the policy language ambiguous and construe it reasonably in favor of coverage.

*b. The Pollution Exclusion as Limited to Instances of Industrial Environmental Pollution* Courts frequently hold that the pollution exclusion is intended

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11. See, e.g., *Stoney Run Co. v. Prudential-LMI Commercial Ins. Co.*, 47 F.3d 34, 37 (10th Cir. 1995) (“[A] reasonable interpretation of the pollution exclusion clause is that it applies only to environmental pollution, and not to all contact with substances that can be classified as pollutants. We hold that the release of carbon monoxide into an apartment is not the type of environmental pollution contemplated by the pollution exclusion clause.”).

12. 976 F.2d 1037 (7th Cir. 1992).

13. *Id.* at 1043.

14. *Id.*

15. *Id.*

16. *Id.* at 1043–44.

to apply only, at most, to instances of industrial environmental pollution. For instance, relying in part on *Pipefitters*, the Maryland Court of Appeals, in *Sullins v. Allstate Insurance Co.*,<sup>17</sup> held that the pollution exclusion did not apply to injuries resulting from exposure to lead paint.<sup>18</sup> Examining the historical development of the pollution exclusion, the court concluded that the insurance industry's intention "was to exclude only environmental pollution damage from coverage."<sup>19</sup> This result was further evidenced by the use of the words "discharge," "dispersal," "release," "escape," "contaminant," and "pollutant." These terms are, according to the court, "terms of art in environmental law," further supporting its conclusion that the pollution exclusion is limited to instances of environmental pollution.<sup>20</sup> Hence, the exclusion was found inapplicable to injuries arising from indoor lead paint exposure.<sup>21</sup>

Another series of decisions, discussing the applicability of the pollution exclusion to releases of carbon monoxide and carbon dioxide, have similarly limited the scope of the exclusion. For example, in *Donaldson v. Urban Land Interests, Inc.*,<sup>22</sup> the Wisconsin Supreme Court held that the pollution exclusion was ambiguous when applied to the buildup of carbon dioxide in a sick-building case and, consequently, did not bar coverage.<sup>23</sup> In reversing the lower court's unanimous ruling that carbon dioxide is a "pollutant," the court relied on *Pipefitters*' "reasonableness limitation" on the pollution exclusion.<sup>24</sup> As *Pipefitters* explained, injuries resulting from everyday activities "gone slightly, but not surprisingly awry" necessitate a finding that the pollution exclusion clause is ambiguous "because [the insured] could reasonably expect coverage" for injuries from carbon dioxide buildup.<sup>25</sup> The court focused on the fact that "unlike the nonexhaustive list of pollutants contained in the pollution exclusion clause, exhaled carbon dioxide is universally present and generally harmless in all but the most unusual circumstances."<sup>26</sup>

Similarly, the Tenth Circuit, in *Stoney Run Co. v. Prudential-LMI Commercial Insurance Co.*,<sup>27</sup> held that the release of carbon monoxide into an apartment was not the type of environmental pollution contemplated by

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17. 667 A.2d 617 (Md. Ct. App. 1995).

18. *Id.* at 624.

19. *Id.* at 622.

20. *Id.* at 622-23.

21. *Id.* at 624.

22. 564 N.W.2d 728 (Wis. 1997).

23. *Id.* at 732.

24. *Id.*

25. *Id.*

26. *Id.*

27. 47 F.3d 34 (10th Cir. 1995).

the pollution exclusion clause.<sup>28</sup> This finding was based on the court's review of New York law, which interprets the pollution exclusion to apply "only to environmental pollution, and not to all contact with substances that can be classified as pollutants."<sup>29</sup> This determination supported a finding of ambiguity resulting in coverage for the insured.<sup>30</sup>

In another case involving carbon monoxide, the Illinois Supreme Court refused to apply the pollution exclusion to injuries stemming from the accidental release of carbon monoxide fumes emitted from a faulty furnace.<sup>31</sup> In that case, the insurer argued that carbon monoxide is defined as "a colorless odorless very toxic gas" and regulated by the federal government as a "pollutant" under the Clean Air Act and that, accordingly, the pollution exclusion should bar coverage.<sup>32</sup> The court was chiefly concerned, however, with what it "perceive[d] to be an overbreadth in the language of the exclusion, as well as the manifestation of an ambiguity which results when the exclusion is applied to cases which have nothing to do with 'pollution' in the conventional, or ordinary, sense of the word."<sup>33</sup> The court agreed with the insured's argument that, in the absence of a *Pipefitters*-type limitation, the exclusion is so expansive that "the terms 'irritants' and 'contaminants' could even be applied to such everyday elements as water and air."<sup>34</sup> In finding coverage, the court agreed with those cases restricting the exclusion's "otherwise limitless application" to only those "hazards traditionally associated with environmental problems."<sup>35</sup> This result was premised on the court's "review of the history of the pollution exclusion" which demonstrated that "the predominate [sic] motivation in drafting . . . [the exclusion] was the avoidance of the 'enormous expense and exposure resulting from the explosion of *environmental* litigation.'"<sup>36</sup>

The common thread in each of these cases is the courts' unwillingness to extend the pollution exclusion beyond its intended meaning, despite the broad interpretation of the exclusion advanced by the insurers.<sup>37</sup>

The applicability of indoor air quality cases to mold and fungi exposure is unclear. Some of these decisions, however, may be instructive. For instance, mold and fungi infestations are likely to be analyzed under the

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28. *Id.*

29. *Id.* at 37.

30. *Id.* at 39.

31. *American States Ins. Co. v. Koloms*, 687 N.E.2d 72, 73 (Ill. 1997).

32. *Id.* at 76.

33. *Id.* at 79 (citations omitted).

34. *Id.* at 77-78.

35. *Id.* at 79.

36. *Id.* at 81.

37. *But see* *Assicurazioni Generali, S.p.A. v. Neil*, 160 F.3d 997, 1006 (4th Cir. 1998) (denying coverage for injuries from carbon monoxide based on pollution exclusion); *Peace v. N.W. Nat'l Ins. Co.*, 596 N.W.2d 429, 438-39 (Wis. 1999) (applying the pollution exclusion to the release of lead paint).

*Pipefitters* and *Donaldson* approaches. Under *Pipefitters*, a court must determine whether a reasonable insured would consider a mold or fungi infestation to fall within the meaning of the exclusion. Under *Donaldson*, a court would focus on the fact that mold and fungi occur naturally and are not typically considered to be “pollutants” by reasonable insureds. Under either analysis, a court should find that the pollution exclusion does not apply to bodily injury or property damage arising out of exposure to mold or fungus.

*c. What Constitutes “Discharge,” “Dispersal,” or “Release” Under the Pollution Exclusion?* The question of whether mold exposure involves a “discharge,” “dispersal,” or “release,” as those terms are used in the pollution exclusion, represents another challenge facing the courts. Although research has not revealed any direct authority on this issue in the context of mold-related claims, several courts have narrowly construed these terms and held that the pollution exclusion was never intended to apply to claims based on indoor air quality. These decisions illustrate the courts’ focus on the history of the pollution exclusion in determining the intent of the terms “discharge,” “dispersal,” and “release.”

For example, in *Island Associates v. Eric Group, Inc.*,<sup>38</sup> the court explained that the pollution exclusion does not bar coverage for fumes confined to a small area within a worksite because such fumes had not been “discharged, dispersed, [or] released.”<sup>39</sup> In doing so, the court stated as follows:

Without belaboring the obvious, we hold that this exclusion is intended to shield the insurer from the liabilities of the insured to outsiders, either neighboring landowners or governmental entities enforcing environmental laws, rather than injuries caused by toxic substances that are still confined within the area of their intended use.<sup>40</sup>

Lending further support to the court’s holding was the fact that the operative terms “discharge,” “dispersal,” “release,” and “escape” constitute “environmental terms of art.” Hence, the pollution exclusion is limited, at most, to certain discharges of pollutants in the industrial environmental context.<sup>41</sup>

Similarly, the Sixth Circuit has also refused to classify the presence of fumes in a manufacturing plant as a “discharge,” “dispersal,” or “release.”<sup>42</sup> In that case, the policy terms at issue excluded coverage for damages arising

38. 894 F. Supp. 200 (W.D. Pa. 1995).

39. *Id.* at 203; *but see Peace*, 596 N.W.2d at 440 (the pollution exclusion applies to the release of paint in an insured’s apartment).

40. *Island Assoc.*, 894 F. Supp. at 203.

41. *Id.* at 204; *see also* *Nautilus Ins. Co. v. Jabar*, 188 F.3d 27, 30 (1st Cir. 1999) (terms “discharge,” “dispersal,” “release,” and “escape” are terms of art in environmental law and are generally used to refer to damage or injury resulting from environmental pollution).

42. *Lumbermens Mut. Cas. Co. v. S.W. Indus., Inc.*, 39 F.3d 1324, 1336 (6th Cir. 1994).

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out of “the discharge, dispersal, release or escape” of pollutants “into or upon land, the atmosphere, or any watercourse or body of water.”<sup>43</sup> In construing the meaning of these terms, the court noted as follows:

A “discharge” is defined as “a flowing or issuing out.” To “disperse” is defined as “to cause to breakup and go in different ways”; “to cause to become spread widely.” A “release” is defined as “the act of liberating or freeing discharge from restraint.” An “escape” is defined as an “evasion of or deliverance from what confines, limits, or holds.”<sup>44</sup>

The fumes and dust leading to the injuries at issue were confined to the inside of the plant, to the area where the injuries occurred.<sup>45</sup> Thus, based on the intent of these terms, the court found that the presence of the fumes and dust in the air inside the plant did not fall within the scope of the pollution exclusion:

It strains the plain meaning, and obvious intent of the language to suggest that these fumes, as they went from the container to [the injured’s] lungs, had somehow been “discharged, dispersed, released or escaped.” Or considering that the fumes were confined to [the injured’s] work area, that they had been discharged into the “atmosphere,” as that word is ordinarily understood.<sup>46</sup>

Given the absence of case law applying the pollution exclusion to mold-related claims, it is difficult to predict with certainty how a court would respond to an insurer’s reliance on that exclusion. Nevertheless, based on the favorable case law rejecting the insurers’ assertion of the pollution exclusion in the indoor air quality cases, policyholders may succeed in defeating the insurers’ anticipated attempt to evade coverage for mold-related claims based on this exclusion.

### B. *Personal Injury Liability Coverage*

In addition to coverage for bodily injury and property damage liability, building owners, operators, and contractors should look to their coverage, if any, for personal injury liability to respond to mold, fungi, and other related claims. For example, personal injury coverage often insures injury arising out of “wrongful entry or eviction or other invasion of the right of

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43. *Id.*

44. *Id.* (quoting Webster’s THIRD NEW INTERNATIONAL DICTIONARY (1986)).

45. *Id.*

46. *Id.*; *see also* Lititz Mut. Ins. Co. v. Steely, 785 A.2d 975 (Pa. 2001) (underlying lead paint bodily injury tort claims were not barred by the absolute pollution exclusion because the process by which lead paint degraded and became available for ingestion/inhalation did not unambiguously involve a “discharge, dispersal, release or escape” as required by the exclusion); *but see* Madison Constr. Co. v. Harleysville Mut. Ins. Co., 735 A.2d 100, 108 (Pa. 1999) (discussing the pollution exclusion in the context of a case involving concrete sealant).

private occupancy.”<sup>47</sup> In sick-building cases, the claimants’ allegations may often be interpreted to fall within this covered offense. For instance, claimants may allege that the presence of mold or fungi has interfered with their use of the building or otherwise impaired their ability to occupy the building. In such cases, policyholders should analyze their personal injury coverage to ensure that insurance assets are being maximized.<sup>48</sup>

As an example, one of the most highly publicized sick-building cases involved construction defects caused in part by mold in a Florida courthouse.<sup>49</sup> Within a few years after the courthouse was completed, employees, occupants, and visitors were evacuated from the building based on complaints of health problems.<sup>50</sup> Subsequent air tests indicated the presence of two highly unusual toxic molds.<sup>51</sup> After incurring millions of dollars in remediation costs, the county in which the courthouse was located sued the construction manager and sureties for breach of contract.<sup>52</sup> At the conclusion of the trial, the jury awarded over \$11.5 million to the county, and this award was affirmed by the appellate court.<sup>53</sup>

### III. PROPERTY INSURANCE TO COVER THE COST OF REPAIRING DAMAGE CAUSED BY MOLD AND FUNGUS INFESTATION

Many policyholders have discovered that their property has been damaged as a result of a buildup of mold and fungus infestation, often because of water accumulation behind interior walls. These policyholders may be required to expend substantial amounts of money repairing this damage. Property insurance policies may provide insurance protection for losses to insured property as a result of mold and fungus infestation. For instance, homeowner policies potentially provide coverage for damage caused in residential contexts. Similarly, owners and operators of commercial buildings or multiunit residential complexes may possess all-risk property insurance that provides coverage for the cost of repairing physical loss or damage caused by any risk not specifically excluded.<sup>54</sup>

47. See 1 COMMERCIAL LIABILITY INSURANCE IV.T.23 to IV.T.28 (International Risk Management Institute 1996) (reprinting Broad Form Comprehensive General Liability Endorsement GL 0404).

48. Depending on the type of property damage alleged by a claimant, building owners and operators will also want to examine their first-party property insurance policies to determine whether the remediation of such damage would be covered by those policies. See section III *infra*.

49. *Centex-Rooney Constr. Co. v. Martin County*, 706 So. 2d 20 (Fla. Dist. Ct. App. 1997).

50. *Id.* at 26.

51. *Id.* at 24.

52. *Id.*

53. *Id.* at 26. *Centex-Rooney* is one of the few reported decisions where the court allowed expert testimony relating to the alleged health hazards stemming from toxic molds.

54. All-risk policies are typically given a broad and comprehensive interpretation. See *Ins.*

Insurers of these first-party property policies will likely raise numerous defenses to claims for coverage for damage caused by mold and fungus infestation. As with claims for coverage under liability policies, claims for coverage under property policies will raise several questions, including: (a) what is the appropriate trigger of coverage, (b) were the damages at issue fortuitous, and (c) does an exclusion apply?

#### A. *Trigger of Coverage*

Compared to cases involving liability insurance, courts have issued relatively few decisions in the context of property insurance policies that address the issue of the appropriate trigger of coverage for property damage claims involving a damage process that takes place over multiple policy periods before it is discovered.

In *Aluminum Co. of America v. Accident & Casualty Insurance Co.*,<sup>55</sup> the court adopted a version of the continuous-injury trigger in a case involving environmental property damage claims.<sup>56</sup> Under this approach, the policies on the risk from the beginning of the damage process through the discovery of the damage would be triggered.

Courts in other contexts have adopted a “manifestation” trigger in which the only policies that would be triggered would be those in effect at the time that the damage was discovered. For example, in *Prudential-LMI Commercial Insurance Co. v. Superior Court*,<sup>57</sup> building owners sought to recover under property policies for damage to their building caused by cracking to the foundation and floor slab. Addressing the trigger of coverage, the California Supreme Court held that a “manifestation” trigger applied and hence that only the policy in effect at the time that the damage was discovered was triggered.

#### B. *Fortuity*

Property insurers may also contend that loss or damage caused by mold and fungus infestation was not fortuitous. For instance, if a building owner knew at the time it purchased the insurance that its roof had leaked and allowed water to accumulate, the property insurer may attempt to use this knowledge to allege that the building owner should have known that mold and fungus infestation would develop therefrom.

Policyholders can attack these fortuity-related arguments on several

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Co. of N. Am. v. U.S. Gypsum Co., 870 F.2d 148 (4th Cir. 1989). In contrast to named peril policies, which generally require that a loss event be covered by a specifically identified peril, such as fire, windstorm, or lightning, all-risk insurance policies broadly cover physical loss or damage to insured property arising out of any peril, unless specifically excluded.

55. No. 92-2-28065-5 (Wash. Super. Mar. 8, 1996).

56. *Id.*

57. 798 P.2d 1230 (Cal. 1990).

grounds. First, it is well settled that all-risk policies are to be construed broadly in favor of coverage.<sup>58</sup> Second, the fortuity analysis turns on the policyholder's actual and subjective state of mind at the inception of the policy period, not on what the insurer contends the policyholder objectively "should have known."<sup>59</sup> In this regard, practitioners should remember that losses that may seem, in hindsight, to have been inevitable or certain may not have been understood as such by the policyholder prior to the loss.

### C. Exclusions

Property insurers may allege that coverage is precluded because of various policy exclusions contained in their policies, including so-called mold exclusions.

#### 1. The So-Called Mold Exclusion: Excluded Peril or an Ensuing Loss?

A typical mold exclusion precludes losses caused by "wear and tear, deterioration or any quality in property that causes it to damage or destroy itself" and "rust, rot, mold or other fungi." However, this exclusion further states that "we do cover ensuing loss caused by . . . water damage . . . if the loss would otherwise be covered under this policy." Thus far, most of the litigation in this area involves the interplay between these two provisions.

For example, in *Home Insurance Co. v. McClain*,<sup>60</sup> the homeowner's policy at issue excluded damage caused by, among other things, "mold or other fungi," but contained an exception that stated that "we do cover ensuing loss caused by . . . water damage . . . if the loss would otherwise be covered under the policy."<sup>61</sup> After a leaking roof led to water accumulation and resulting mold and fungi infestation, the insured made a claim under its homeowner's policy. To qualify as an ensuing loss caused by water damage, "the mold and fungi would necessarily have to follow or come afterward as a consequence of the water damage."<sup>62</sup> The court found that the mold and fungi damage followed as a consequence of water damage and, therefore, that coverage existed under the ensuing loss exception to the "mold or other fungi" exclusion.<sup>63</sup>

Other courts adopt a slightly different formulation for dealing with mold damage caused by other factors. For instance, in *Sunbreaker Condominium*

58. See, e.g., *Compagnie des Bauxites v. Ins. Co. of N. Am.*, 724 F.2d 369, 373 (3d Cir. 1983).

59. *Id.* at 372; *Peters Township Sch. Dist. v. Hartford Accident & Indem. Co.*, 833 F.2d 32, 37 (3d Cir. 1987); *Klockner Stadler v. Ins. Co. of the State of Pa.*, 780 F. Supp. 148, 157 (S.D.N.Y. 1991).

60. No. 05-97-01479-CV, 2000 WL 144115 (Tex. Ct. App. Feb. 10, 2000).

61. *Id.* at \*3.

62. *Id.*

63. *Id.*

*Association v. Travelers Insurance Co.*,<sup>64</sup> the Washington Court of Appeals held that fungus damage would be covered if the efficient proximate cause of the loss were wind-driven rain, which was a covered peril under the policy.<sup>65</sup> If, however, the cause of the loss were *nonwind*-driven rain, which was an excluded peril, the fungus damage would not be covered.<sup>66</sup> Under the efficient proximate cause test, insurers remain liable for losses efficiently caused by a covered peril even though other, excluded perils contributed to the loss.<sup>67</sup>

Similarly, in *Bowers v. Farmers Insurance Exchange*,<sup>68</sup> a Washington appellate court held that a landlord was entitled to coverage for mold damage resulting from a tenant's marijuana-growing operation.<sup>69</sup> In *Bowers*, the insured acknowledged that the mold was the immediate cause of the damage but argued that the vandalism was the efficient proximate cause and hence that the claim did not fall within the mold exclusion.<sup>70</sup> The appellate court agreed, citing factors such as the tenant's diversion of heat to create a grow room, irrigation of the plants, creation of a sauna-like environment as proof of vandalism, and the tenant's malicious and conscious disregard of the landlord's rights.<sup>71</sup>

However, the ensuing loss exception may not apply to all mold damage. In *Merrimack Mutual Fire Insurance Co. v. McCaffree*,<sup>72</sup> the Texas Court of Civil Appeals refused to find coverage under the ensuing loss exception.<sup>73</sup> In that case, the insured had incurred damage to a shower stall, which led to leaking water, the growth of mold and fungi, and then the rotting and deterioration of wood in the insured's house.<sup>74</sup> The court explained that the policy excluded damage caused by "rust, rot, mould [sic] or other fungi." Further, according to the court, since the fungi *directly* caused the damage or deterioration to the property, the exclusion seemed to apply.<sup>75</sup> The only problem, the court acknowledged, was whether to give effect to the ensuing loss clause.<sup>76</sup> Finding that the ensuing loss clause did not apply, the court explained that the mere growth of fungi in a favorable atmosphere cannot be said to be "water damage," as that phrase is used in the clause: "The water which ran from the shower could very well have created an atmosphere or

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64. 901 P.2d 1079 (Wash. Ct. App. 1995).

65. *Id.* at 1084.

66. *Id.*

67. *Id.* at 1083.

68. 991 P.2d 734 (Wash. Ct. App. 2000).

69. *Id.* at 738.

70. *Id.* at 737.

71. *Id.*

72. 486 S.W.2d 616 (Tex. Civ. App. 1972).

73. *Id.* at 619.

74. *Id.* at 618.

75. *Id.*

76. *Id.*

environment which could have, and possibly did, contribute to the growth of fungi, which, in turn, caused the rot and deterioration of the structure.”<sup>77</sup> Under these circumstances, however, the court concluded that the ensuing damage was not caused by water damage.<sup>78</sup>

In sum, as these cases illustrate, notwithstanding the so-called mold exclusion, the ensuing loss exception and the efficient proximate cause rule afford insureds coverage for property damage that is causally connected to mold or fungus infestation.

## 2. Other Exclusions

Insurers may also rely on other exclusions commonly found in property insurance policies, such as the faulty workmanship, inherent vice, wear and tear, corrosion, or contamination exclusions. For example, in cases in which wear and tear causes a roof leak and that leaking leads to mold and fungus infestation, an insurer may contend that the damage caused by the mold and fungus is excluded under the wear and tear exclusion. Like the ensuing loss exception at issue in *McClain*, however, the wear and tear exclusion often does not apply to property damage that ensues as a result of defective construction or other covered cause.<sup>79</sup>

Similarly, in cases in which a construction defect permits rainwater to enter a building, resulting in the development of mold and fungus, an insurer may argue that the damage caused by the mold and fungus is excluded under an exclusion for faulty workmanship. Depending on the circumstances, an insured may contend that this exclusion does not apply for at least two reasons. First, the insured may assert that the construction defect does not constitute faulty workmanship as those terms are used in the exclusion.<sup>80</sup> Second, the insured may argue that the rainwater, assuming that it is a covered peril, rather than any alleged faulty workmanship, was the efficient proximate cause of the mold and fungus infestation and resulting damage and hence that coverage exists.

#### IV. BAD FAITH JUDGMENTS AND THE RESPONSE OF STATE LEGISLATURES AND COMMERCIAL LIABILITY INSURERS

Although the future of mold coverage litigation is still unsettled, it is clear that insurers and legislators have taken notice. Recent jury verdicts in the

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<sup>77</sup> *Id.*

<sup>78</sup> *Id.* at 619.

<sup>79</sup> *See, e.g.,* Sentinel Mgmt. Co. v. New Hampshire Ins. Co., 563 N.W.2d 296, 301–02 (Minn. Ct. App. 1997) (loss caused by release of asbestos fibers in buildings fell within ensuing loss exception to wear and tear exclusion in all-risk property policy).

<sup>80</sup> *See, e.g.,* M.A. Mortenson Co. v. Indem. Ins. Co. of N. Am., No. 98–2319, slip op. (D. Minn. Dec. 23, 1999) (rejecting insurer’s reliance on, among other things, faulty workmanship and inherent vice exclusions and finding coverage under builder’s risk policy for rain damage to construction subgrade).

millions of dollars have alerted insurers to the potential for substantial liability for improperly denying coverage in mold-related cases. While the costs relating to property damage and bodily injury are great, it is the potential for punitive damage awards that most frightens the insurance industry. In response to the burgeoning litigation and awards, at least two state governing bodies have attempted to set clearer standards for mold coverage. The insurance industry, on the other hand, may be on its way to revising its policy language in an effort to minimize exposure to mold liabilities.

#### A. *Bad Faith Judgments*

When an insured files a claim with its insurer, the insurer must examine the claim to see if it falls within the coverage of the policy. If the insurer, without a reasonable basis, denies coverage for a claim that may fall within the policy's provisions, then its denial constitutes bad faith.<sup>81</sup> Along with damages for loss, bad faith damages can, of course, include awards for punitive damages.<sup>82</sup>

In the context of mold-related claims, insurers often try to deny claims on the basis of mold exclusions. As previously discussed, this denial often fails because the mold is usually a result of a covered event, such as water damage or a plumbing discharge.<sup>83</sup> If the insurer ignores the effect of, for instance, an ensuing loss provision and denies coverage based on a mold exclusion, it runs the risk of large bad faith punitive damage awards.<sup>84</sup>

Three recent multimillion-dollar bad faith awards to homeowners in mold cases have undoubtedly caught the attention of insurance companies. Insurance companies must now be especially cautious when denying mold-related claims not only because of these decisions, but also because of both a new public awareness of mold-related illnesses and legislative measures designed to ensure mold coverage and testing.<sup>85</sup>

##### 1. *Ballard v. Fire Insurance Exchange*

In *Ballard v. Fire Insurance Exchange*,<sup>86</sup> a Texas jury awarded the plaintiff \$32 million after finding that her insurance carrier, Fire Insurance Ex-

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81. 6 CALIFORNIA TORTS § 82.50 (Neil M. Levey et al. eds. 2001). Note that certain jurisdictions substitute the "reasonable" standard for denying coverage with a "fairly debatable" standard. *Rossmannith v. Union Ins. Co.*, No. 1-280/00-1138 (Iowa Ct. App. Nov. 16, 2001), reprinted in 1 MEALEY'S LITIG. REP.: MOLD 12 (Dec. 2001).

82. 3 BUSINESS TORTS § 23.04 (Joseph D. Zamore ed. 2001).

83. See section III.C.1 *supra*.

84. *But see Rossmannith*, No. 1-280/00-1138 (upholding insurer's denial of coverage for additional water damage caused by insured's failure to prevent further damage).

85. Mark C. Raskoff, *Mold Contamination Liability and Coverage Issues*, 1 MEALEY'S LITIG. REP.: MOLD 4 (Apr. 2001).

86. Index No. 99-05252 (Tex. Dist. Ct., Travis Cty. June 1, 2001), reported in 1 MEALEY'S LITIG. REP.: MOLD 6 (June 2001).

change, a subsidiary of Farmers Insurance, acted unfairly, deceptively, and fraudulently when evaluating and denying a mold-related property damage claim. The claim occurred after a bathroom plumbing leak caused the hardwood floor in the plaintiff's home to buckle. The insurance adjuster attributed the buckled floor to slab settling, which was not covered under the policy. Subsequently, the insurer's engineer determined that the plaintiff had both a kitchen and a bathroom leak. A contractor advised the plaintiff to remove the damaged floor to avoid the growth of mold.<sup>87</sup>

The plaintiff alleged that, despite her repeated warnings about the growth of mold, the insurer refused to pay for the removal of the floor, consenting only to the removal of the most damaged floorboards. The next month, the insurer offered to settle the claim for \$108,316, but the plaintiff refused because of new mold growth on the windows, door frames, stairs, and walls. The insurer's engineers also discovered a dangerous black mold growing behind the plaintiff's refrigerator. The plaintiff, her husband, and her son all became ill.<sup>88</sup>

At trial, the plaintiff alleged that the insurer acted in bad faith by denying her claim and failing to offer a fair settlement. After a four-week trial, the jury found as follows: (1) the insurer engaged in an unfair or deceptive act or practice that caused damages; (2) the insurer engaged in a false, misleading, or deceptive act that the plaintiff relied upon to her detriment; (3) the insurer engaged in an unconscionable action that caused damages to the plaintiff; (4) the insurer committed fraud against the plaintiff; and (5) the insurer failed to appoint a competent, independent appraiser. The jury awarded \$2,547,350 to replace the home; \$1,154,175 to remediate the home; \$2,000,000 to replace the contents of the home; \$350,000 for past and future living expenses; \$176,000 for the appraisal process; \$12,000,000 in actual damages; \$5,000,000 for mental anguish; and \$8,891,000 in attorneys' fees.<sup>89</sup>

## 2. *Anderson v. Allstate Insurance Co.*

In *Anderson v. Allstate Insurance Co.*,<sup>90</sup> the plaintiff claimed that Allstate Insurance Company breached its covenant of good faith and fair dealing after failing to adequately respond to a plumbing leak and resulting mold growth. Responding to a claim by the plaintiff for damage caused by a burst of pipes in the plaintiff's home, the insurance adjuster noticed the growth of mold and mildew in all of the home's rooms. Because of re-

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87. *Id.*

88. *Id.*

89. *Id.*

90. No. CIV-00-97 (E.D. Cal. 2001), reprinted in 15 MEALEY'S LITIG. REP.: INS. 9 (Jan. 9, 2001).

modeling, the plaintiff was not living in the house at the time of the plumbing leaks or the mold growth.

The plaintiff sued the insurer in the U.S. District Court for the Eastern District of California, contending that the insurer failed to sufficiently remove and repair the mold damage, to appoint competent adjusters, and to make a fair settlement offer. At trial, the insurer contended that legitimate coverage issues existed because the plaintiff's homeowner's policy excluded losses for discharges from frozen pipes when a house is vacant, unoccupied, or under construction. According to the insurer, under these circumstances, it is the duty of a homeowner to maintain heat in the dwelling or shut off and drain the plumbing system.<sup>91</sup>

Finding that the insurer had breached both its insurance policy and its duty of good faith, the jury awarded the plaintiff nearly \$500,000 in compensatory damages and \$18 million in punitive damages. Although the insurer's subsequent motion for a new trial was denied, the judge in December 2001 did reduce the jury's punitive damage award from \$18 million to \$2.5 million, five times the amount of the plaintiff's actual damages.<sup>92</sup>

### 3. *Hatley v. Century National Insurance Co.*

In *Hatley v. Century National Insurance Co.*,<sup>93</sup> an Arizona jury awarded \$4 million to the plaintiffs-homeowners after Century National Insurance Company delayed remediating mold contamination. The mold in the plaintiffs' home was discovered after a physician discovered *Aspergillus* mold spores in the lungs of the plaintiffs' son. The son's doctor advised the plaintiffs to search their home for mold. After discovering mold in the kitchen and bathroom, the plaintiffs filed a claim with their homeowner's insurer, requesting that the mold be removed. The plaintiffs argued that the mold was caused by water damage, which was a covered loss under the policy.<sup>94</sup>

The insurer denied coverage for the mold-related damage, contending that the mold was caused by a preexisting condition and further that the policy included a mold exclusion. The insurer also denied the plaintiffs' request for alternate living expenses so that the family could move out of the home until the mold was removed. Only after the plaintiffs hired a private adjuster, complained to the Department of Insurance, and sought media attention did the insurer agree to pay for alternate living expenses and some remediation.<sup>95</sup> After the insurer's motion for summary judgment

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91. *Id.*

92. *Id.*

93. Index No. CV 2000-006713 (Ariz. Super. Maricopa Cty. Nov. 2001), reprinted in 1 MEALEY'S LITIG. REP.: MOLD 12 (Dec. 2001).

94. *Id.*

95. *Id.*

on the bad faith claim failed, a jury found for the plaintiffs, awarding \$244,000 in compensatory damages and \$4 million in punitive damages.<sup>96</sup>

### B. State Response

Verdicts like these and the multitude of pending mold cases in general have prompted responses from a number of state regulatory and legislative bodies, including the Texas Insurance Board and the California legislature.<sup>97</sup>

#### 1. Texas Department of Insurance Retains Basic Mold Coverage

In November 2001, the Texas insurance commissioner adopted a restructured homeowner's policy that requires basic mold coverage.<sup>98</sup> A press release described the new regulations as follows:

The order provides coverage in the basic policy for removal of mold that results from water discharge, leak or overflow that is sudden and accidental, including those that are hidden or concealed. If a policyholder continuously ignores indications of an obvious water problem, such as wet carpeting, the claim for mold removal could be denied.<sup>99</sup>

The insurance commissioner's order makes clear that there is coverage for mold resulting from hidden or concealed water leakage or seepage, whether that leakage took place gradually over a period of time or not. For instance, the order states that the term "sudden" as used in the order is "intended to exclude loss caused by mold resulting from leakage or seepage of water over a period of time *that is not hidden or concealed*."<sup>100</sup>

#### 2. California Is the First State to Enact a Law Addressing Standards for Mold Exposure

In October 2001, California Governor Gray Davis signed two bills into law addressing toxic mold.<sup>101</sup> The first, the Toxic Mold Protection Act of 2001 (the Act), requires the California Department of Health Services to develop standards for (1) permissible levels of mold exposure in indoor environments, if feasible; (2) the identification of mold; and (3) the

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96. *Id.*

97. The Florida Department of Insurance has also been asked to address the situation. A department official reported to *Mealey's* that nearly fifty insurers have filed exclusions for approval with the department. See 1 MEALEY'S LITIG. REP.: MOLD 12 (Dec. 2001). The department, in conjunction with the Insurance Services Office, Inc., and the National Association of Insurance Commissioners, is attempting to develop a nationwide uniform response to mold-related claims.

98. *Id.*

99. *Id.*

100. *Id.* (emphasis added).

101. Linda Bondi Morrison, *The "Molden" State: Evaluating Third-Party Mold Claims Under California Law*, 1 MEALEY'S LITIG. REP.: MOLD 12 (Dec. 2001).

remediation of mold-related damage.<sup>102</sup> The Act further requires that owners of commercial and residential property disclose, in writing, the presence of mold that exceeds permissible levels. A violation of this provision will result in penalties to be established by the Department of Health Services.<sup>103</sup> The mold standards will be established by a task force formed by the Department of Health Services.<sup>104</sup> This task force will be comprised of health officers, medical experts, mold abatement officers, and affected consumers and industries, including residential, commercial, and industrial tenants, homeowners, landlords, insurers, and builders.<sup>105</sup> Although members of the mold task force must bear all costs of their participation, the lawmakers state that they believe that the businesses affected by the Act will benefit through participation and the establishment of new standards.<sup>106</sup>

The second piece of legislation, Assembly Bill 284, effective on January 1, 2002, establishes a California Department of Health Services “mold program.”<sup>107</sup> The new law requires the California Research Bureau to study and publish findings on fungal contamination in indoor environments.<sup>108</sup> Ultimately, this research may help the State of California provide guidance to the public on the prevention and remediation of mold-related damage.<sup>109</sup>

### C. Insurance Industry Response

As was the case several years ago with respect to asbestos, insurers may modify the standard form language that they use in their policies in an attempt to limit their exposure to mold liabilities. Although the standard forms have yet to be changed, certain carriers have suggested the following endorsement:

#### Fungus, Mildew and Mold Exclusion

This insurance does not apply to:

1. “Bodily injury,” “property damage,” “personal or advertising injury” or “medical payments” arising out of, resulting from, caused by, contributed to, attributed to, or in any way related to any fungus, mildew, mold or resulting allergens;
2. Any costs or expenses associated, in any way, with the abatement, mitigation, remediation, containment, detoxification, neutralization, monitoring,

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102. *Id.*

103. *See* Toxic Mold Protection Act of 2001, art. 5, § 26154.

104. *See id.* § 26101.7.

105. *Id.*

106. *Id.*

107. Chapter 550, Laws of 2001. *See also* Morrison, *supra* note 101.

108. *Id.*

109. *Id.*

removal, disposal or any obligation to investigate or assess the presence or effects of any fungus, mildew, mold or resulting allergens; or

3. Any obligation to share with or repay any person, organization or entity, related in any way to items 1 and 2.<sup>110</sup>

The use of such an endorsement presumably would lead to new litigation regarding, for instance, whether this exclusion can be given any effect in the face of ensuing loss provisions or the efficient proximate cause test.

#### V. CONCLUSION

Insureds facing claims for damage allegedly caused by mold or fungi exposure or infestation may have significant opportunities for insurance coverage under their liability and/or property insurance policies. Once a coverage claim is made by an insured, insurers will undoubtedly attempt to impose numerous roadblocks to coverage, including the so-called expected or intended, pollution, and mold exclusions. Nonetheless, as illustrated above, these defenses may be more limited than they may first appear. For instance, courts frequently construe pollution exclusions as ambiguous, especially outside the context of traditional environmental pollution claims. Similarly, courts have often found coverage despite the existence of a mold exclusion because the damage at issue has constituted an ensuing loss. Furthermore, as the verdicts in *Ballard*, *Hatley*, and *Centex-Rooney* illustrate, insurers that improperly deny coverage may subject themselves to awards for punitive damages, attorneys' fees, and other tort damages. In sum, policyholders facing mold-related damages or liability should use their full arsenal of affirmative weapons, including, where appropriate, a claim of bad faith to compel insurers to meet their coverage obligations.

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110. Patrick J. Wielinski, *Third Party Insurance Coverage for Mold Claims*, 11 COMMITTEE ON INSURANCE COVERAGE LITIGATION 6 (2001).