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Sickly Abodes: As Mold Continues to Spread, Homeowners Should Know Fungus is not Always Covered.

It is a situation that has become all too common in recent years. A homeowner experiences water damage to his or her home. Fortunately, the homeowner has insurance, so the problem will be quickly resolved.

Right?

Wrong!

All too often, the insurance company does not respond in a timely manner, or worse yet, tries to deny coverage altogether. As a result, mold begins to grow near the water-damaged areas, and then continues to spread throughout the home. In time, only substantial remediation will return the home to its former condition. Meanwhile, the homeowner's family begins to experience significant adverse health consequences from the spreading mold.

The potential hazards caused by mold have become all too clear in recent years. The media sensationalizes the subject with headlines that advertise the dangers of exposure to toxic mold. See, e.g., The New York Times Magazine, Aug. 12, 2001. Mycologists and other experts have confirmed that exposure to toxic mold does indeed cause certain medical symptoms. See Eckardt Johanning, M.D., M.Sc., Clinical Findings Related to Indoor Fungal Exposure - Review of Clinic Data of a Specialty Clinic, in BIOAEROSOLS, FUNGI AND MYCOTOXINS: HEALTH EFFECTS, ASSESSMENT, PREVENTION AND CONTROL (Eckardt Johanning ed. 1999). Because of the health risks, only substantial remediation will make mold-contaminated homes habitable once again.

The title of this article is more than just a clever play on words. It poses a question with serious repercussions for both homeowners and the insurance industry. The largest verdicts in mold litigation cases have resulted from first-party bad-faith claims against insurance companies. In *Ballard v. Fire Insurance Exchange*, No. 99-05252 (Texas, Travis County Dist. Ct. June 1, 2001), for example, the jury awarded \$32 million to a Texas couple after Fire Insurance Exchange (a member of the Farmers Insurance Group) improperly handled a mold claim.

These large verdicts result when insurance companies unfairly, fraudulently and deceptively handle water-damage claims. In *Anderson v. Allstate Insurance Company*, No. CIV-00-907 (E.D. Cal. Oct. 4, 2000), for example, Tom Anderson made a claim on his Allstate homeowner's policy when a pipe burst in his house. Rather than tendering a sum of money sufficient to repair the damage, Allstate tried to lowball Mr. Anderson by offering an amount far below his policy limits. Mr. Anderson refused the offer, and Allstate took no action for over a year. Meanwhile, toxic mold began to grow and spread throughout the house, making it uninhabitable. Mr. Anderson sued for breach of contract and breach of the duty of good faith and fair dealing. The jury awarded Mr. Anderson \$18 million in punitive damages, although the judge later reduced the award.

The relevant question for both homeowners and insurance companies has become: When is mold covered under a homeowner's policy? There has been a lot of confusion over the answer to this question. The main source of the confusion is the "mold exclusion" in homeowner's policies. However, the presence of this

exclusion does not necessarily prevent coverage for mold contamination.

The Mold Exclusion and the Ensuing Loss Exception

Homeowner's policies are usually "all risk" policies. That is, any loss that is not specifically excluded in the policy is covered.

Homeowner's policies generally exclude coverage for mold contamination. For example, the Insurance Services Office's standard HO-3 policy provides: "We do not insure, however, for loss . . . Caused by . . . smog, rust or other corrosion, mold, wet or dry rot" (emphasis added).

However, these mold exclusions often contain an "ensuing loss" exception that reinstates coverage for an "ensuing loss caused by . . . water damage . . . if the loss would otherwise be covered under this policy" (emphasis added).

Thus, the mold exclusion only applies to mold that occurs naturally over time and is not the result of a covered event. It is an entirely different story when considering mold that results from water damage. When mold develops as the result of a covered water loss, there is the likelihood that the mold damage will also be covered.

Coverage in such circumstances depends on how courts interpret the homeowner's policy. At the present time, there are no determinative decisions from California's appellate courts that indicate whether mold resulting from a water loss is covered. But case law from other jurisdictions provides some indication of how the ensuing loss exception has been interpreted. Most of these cases come from Texas.

The majority rule appears to be that the ensuing loss provision does cover mold damage. Several courts have held that the ensuing loss exception does provide coverage for mold that results from a covered water loss. According to these courts, if a house experiences water damage, and mold develops as a result of the water damage, then the mold would be covered as an ensuing loss regardless of the mold exclusion if the water damage is a covered loss under the policy.

For example, in *Home Insurance Company v. Dennis D.*, No. 05-97-01479-CV, 2000 WL 14415 (Tex. Ct. App. - Dallas, Feb. 10, 2000), the Texas Court of Appeals in Dallas held that "[the insurance company] ignores that the ensuing loss provision is not limited by the mold and fungi exclusion . . . "Ensuing losses" mean losses which follow or come afterward as a consequence. To be 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."

The July 2001 Fire, Casualty & Surety Bulletin agreed with these courts. According to the FC&S Bulletin, which is the industry standard for interpreting insurance policies, mold originating from covered water damage should be covered under the ensuing loss exception.

Alternatively, a few courts have interpreted the ensuing loss exception to disallow coverage if the water loss is the cause of the mold damage, but to provide coverage if the water loss ensues from the mold damage. In other words, any mold, including mold damage that results from a covered water loss, would still be excluded by the mold exclusion. However, if new water damage occurs as a result of the mold damage (which itself resulted from the original water damage), this new water damage would be covered.

For example, in *Harrison v. USAA Insurance Company*, No. 03-00-00362-CV, 2001 WL 391539 (Tex. Ct. App. - Austin, April 19, 2001), the Texas Court of Appeals in Austin held that "[t]o qualify for the [ensuing loss] exception, ensuing water damage must follow from one of the types of damage enumerated in [the exclusion]

. . . In other words, the ensuing loss provision covers water damage that results from rather than causes rotting" (citations omitted, emphasis added).

It is therefore possible to have a situation where water damage occurs to a house, mold develops as a result of the water damage, and then additional water damage results from the mold growth. According to these courts, only the initial and the resulting water damage would be covered by the policy, but the mold would be excluded.

The Insurance Industry Responds

Insurance companies have responded to the rising number of first-party bad-faith mold cases by explicitly eliminating coverage for water and/or mold damage. These reductions are a response to the homeowners who have successfully argued that mold should be covered as an ensuing loss from water damage.

Farmers Insurance Group has eliminated coverage for mold damage in 30 of the 41 states it serves, including California. See Jennifer L. Reichert, Homeowners, Insurers Spar Over Spores in Toxic-Mold Cases, TRIAL, Sept. 2001, available at <http://www.atlanet.org/homepage>. In Texas, the "big three" homeowner's insurance companies - Allstate, Farmers and State Farm - are refusing to sell policies that include water and mold damage to new customers. See Terrence Stutz, Mold Battle Hits Home Buyers, THE DALLAS MORNING NEWS, Oct. 19, 2001, available at http://www.dallasnew.com/texas_southwest.

On September 18, 2001, the Texas Department of Insurance introduced a proposal to cap coverage for mold resulting from water damage in homeowner's policies to \$5,000. See <http://www.state.tx.us>. Policyholders would be able to buy additional mold coverage in amounts equal to 25%, 50% or 100% of their current policy limits. The proposal seeks to curtail large rate increases and the rising number of homeowner's policies that do not cover water damage. According to Texas Insurance Commissioner Jose Montemayor, "The staff proposal would let individual homeowners consider their own needs and pay for the amount of mold cleanup coverage they desire."

Advice to Policyholders

What can policyholders do to decrease the risk that coverage for mold contamination resulting from water damage will be denied? For starters, policyholders should contact their homeowner's insurer immediately after discovering water damage. Studies have shown that mold may begin developing as quickly as 24 to 72 hours after water damage occurs. See, e.g., Everette L. Herndon & Chin S. Yang, Mold & Mildew: A Creeping Catastrophe, Claims, Aug. 2000, available at <http://www.claimsmag.com/Issues/Aug00/mold.asp>. By giving the insurance company immediate notice of the water damage, the homeowner can easily argue that any mold growth resulted from the insurance company's bad faith delay tactics.

In addition, immediately making a claim for water damage prevents the insurance company from later arguing that the presence of mold is not a result of the water damage, but rather is mold that has naturally developed in the house over time. As mentioned above, standard mold exclusions typically exclude "naturally-growing" mold, whereas mold that results from water damage may be covered, depending on the particular court's interpretation of the homeowner's policy. When a claim is made within 24 to 72 hours, the claims adjuster will see that no "naturally-growing" mold is already in the residence. Thus, any mold that later develops as a result of the insurance company's bad faith denial tactics will necessarily be from the water damage.

Conclusion

A particular court's interpretation of the mold exclusion and the ensuing loss exception determines whether mold resulting from water damage is covered under a homeowner's policy. The general rule appears to be

that the ensuing loss exception does cover mold resulting from covered water damage. At the present time, there is no relevant appellate court case law on the subject in California. It is expected that California courts will follow the trend set by the courts in other states that allow mold coverage under the ensuing loss exception.

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