Insurance Coverage for Mold Related Cases

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I. MOLD CLAIMS ARE BECOMING MORE SIGNIFICANT.

A. Insurers Paid Out $157.3 Million In Mold-Related Claims In The First Half Of 2001. Kelly Johnson, "Lawsuits Fuel Homeowners Insurance Crunch," Sacramento Business Journal, July 5, 2002. That is a result of both an increase in claims and an increase in payments per claim.

1. The Insurance Information Institute reports the average cost of a mold-related claim more than doubled between 2000 and 2001. See, www.iii.org/media/hottopics/hot/house.

2. Property casualty insurers paid $52 billion more in claims and expenses than they collected in 2001, with underwriting losses in homeowner's insurance from 2000-2002 estimated at $19 billion. Id.

3. In 2001, $843 million worth of mold claims were filed in Texas alone. Id. Allstate's monthly tally of mold claims in Texas went from 40 in the first three months of 2001 to 1,000 in the first three months of 2002. Wall Street Journal, May 14, 2002, at A-1, D-1.

II. FIRST-PARTY COVERAGE.

A. All-Risk Versus Named Peril Coverage.

1. Named peril coverage covers only those risks specifically identified in the policy as being covered. All-risk coverage, on the other hand, covers all risks of loss that are not specifically excluded from coverage under the policy. In application, the difference between all-risk and named peril coverage is all about presumptions and burdens of proof.

B. Triggering the Coverage Grant.

1. Most property and other first-party policies require a "risk of direct physical loss" to trigger coverage, whether the coverage provided is all-risk or named peril. In connection with mold coverage, insurers raise two main arguments.

a. Insurers may argue that mold loss is not "physical" loss

(1) Some insurers have attempted to argue that mold damage does not constitute "physical" loss. Those insurers reasoned that if mold simply causes a diminution in the value of a contaminated building, for example, that loss is not "physical" loss. They further argue that even if the presence of mold creates a health hazard, that is still not a "physical" loss.

(a) This argument should not present significant problem in Minnesota. In Sentinel Management, the Minnesota Court of Appeals ruled that the presence of asbestos in a building constituted direct physical loss. See, e.g., Sentinel Management Co. v. New Hampshire Ins. Co., 563 N.W.2d 296, 300 (Minn. Ct. App. 1997), aff'd in relevant part, reversed in part, 615 N.W.2d 819 (Minn. 2000) ("Although asbestos contamination does not result in tangible injury to physical property to the physical structure of the building, a building's function may be seriously impaired or destroyed and the property rendered useless by the presence of contaminants. . . . Under these circumstances, we must conclude that contamination by asbestos may constitute a direct, physical loss to property under an all-risk insurance policy. . . . 'Direct physical loss' provisions require only that a covered property be injured, not destroyed. . . . Direct physical loss also may exist without structural damage to the insured property.")

(b) Insurers sometimes skip over the fact that the typical coverage grant covers not "direct physical loss," but "risks of direct physical loss." This distinction is especially relevant given Minnesota's past treatment of imminent covered loss. See, e.g., Witcher Const. Co. v. St. Paul Fire & Marine Ins. Co., 550 N.W.2d 1 (Minn. Ct. App. 1996) (lack of a covered loss "does not alter Witcher's common law duty to prevent harm to the insured property or the insurer's corresponding obligation to reimburse Witcher for those efforts." The insurer is therefore accountable "for its share of any reasonable and necessary costs of preventing an imminent covered loss to the insured policy.")

(c) There also may be coverage for loss of use. Mold constitutes a health hazard which may require occupants to vacate premises, or otherwise render physical space unusable. That, too, should be sufficient to trigger coverage. Some first-party policies will directly cover loss of use of property not physically damaged. Even when the policy language does not expressly cover loss of use, some courts will infer such coverage. Under Minnesota law, such loss of use is deemed physical loss. See,

e.g., General Mills, Inc. v. Gold Medal Ins. Co., 622 N.W.2d 147, 152 (Minn. Ct. App. 2001) ("Whether or not the oats could safely be consumed, they legally could not be used in General Mills' business. . . . [Therefore] the district court did not err in finding this to be an impairment of function and value sufficient to support a finding of physical damage.")

b. Insurers may argue that mold loss is not "direct" physical loss.

(1) Insurers sometimes argue that physical loss is not direct if it is temporally removed from the triggering event. See, e.g., Louisville & Jefferson City Metropolitan Sewer District v. Travelers Ins. Co., 753 F.2d 533 (6th Cir. 1985). However, such arguments are properly rejected, if only because there is no evidence to support the notion that "direct" was meant to be used in a temporal sense, as opposed to a causal sense. Id.

C. Potential Exclusions From First-Party Coverage.

1. The presence of a specific mold exclusion (now quite common) may well preclude coverage under those policies to which it is attached. But check to ensure that the exclusion was not added mid-year without consent.

2. If a policy has no mold exclusion, or contains a mold exclusion which is unenforceable as a result of some procedural defect, other potentially applicable exclusions still must be addressed. Most prevalent are various versions of the wear and tear/latent defect exclusion (some versions of which also contain express reference to mold), various water damage exclusions (to the extent that water infiltration was the original loss which then gave rise to the mold), and the "faulty workmanship, construction or design" exclusions, given that some in the construction field argue that it is defects in newer home construction and design which has given rise to increasing numbers of mold claims on a residential level. Mold problems experienced in office towers, schools, airports and other more extensive construction projects will also almost always give rise to construction defect claims. (In addition, of course, there is also always an issue with respect to the ubiquitous pollution exclusion, which is addressed separately infra.)

D. Coverage for Ensuing Loss.

1. To avoid the effect of some of these exclusions, policyholders should look to argue that the exclusion in question does not apply to "ensuing loss." For example, there should still be coverage when mold is an ensuing loss arising from an otherwise covered event, such as a burst water pipe frozen in the winter, roof damage from a storm, and the like. Coverage for ensuing loss may be available even in the presence of a mold exclusion, although some courts disagree. See, e.g., Fiess v. State Farm Lloyd, No. lt-02-1912, S.D. Tex., 2003 U.S. Dist. LEXIS 10962.

E. Procedural Defenses.

1. Insurers may seek to raise notice or other timeliness-related procedural defenses in response to a mold claim. Usually the basis is that the mold is the consequence of some other event, which itself should have been disclosed and made the subject of a claim. Thus far, such arguments have not been warmly received. See, e.g., Flores v. Allstate Texas Lloyds Co., No. M-02-410, S.D. Texas (July 16, 2003).

III. THIRD-PARTY LIABILITY COVERAGE.

A. Occurrence-Based Versus Claims-Made Policies.

1. General liability policies are usually occurrence-based, while professional liability policies are typically claims-made policies.

2. Claims-made policies cover claims first made during the policy period, regardless of when the event(s) giving rise to the claim took place. However, claims-made policies cover only those claims brought during the time period referenced in the policy; if claims arise afterwards, then coverage will not be available (although hopefully it will be a validation under a new, superseding policy, assuming one is purchased). Occurrence-based policies, on the other hand, stay in effect forever, to cover claims made against the policyholder at any point in time, as long as they arise out of covered events occurring during the term of the policy.

3. The difference is significant for unforeseen risks, in that claims-made insurers can add exclusions, such as mold exclusions, to new policies, and they will take virtually immediate effect. However, general liability insurers cannot retroactively add new exclusions to old occurrence-based policies. Thus, asbestos, environmental and other "long-term exposure" claims frequently trigger coverages going back decades. While mold claims are unlikely to go back quite that far, they may well trigger coverage purchased prior to the addition of the new mold exclusions.

B. Triggering the Coverage Grant .

1. Bodily injury.

a. A claim of bodily injury (including, in most jurisdictions, emotional distress) arising out of an occurrence during the policy period will trigger bodily injury coverage.

2. Property damage.

a. A claim of damage to property of another (usually expressly including loss of use of property that has not been physically damaged) arising out of an occurrence during the policy period will trigger property damage coverage.

3. Personal advertising injury.

a. A claim of any of certain enumerated non-bodily tort injuries arising from an "offense" rather than an "occurrence" during the policy period will trigger personal injury coverage. Among the torts most likely to trigger coverage for mold-related losses is invasion of a private right of occupancy, although advertising injury coverage should also be examined.

C. Potential Exclusions From Third-Party Coverage.

1. The "business risk" exclusions.

a. Chief among the exclusions potentially applicable to CGL coverage are a series of exclusions referred to collectively as the "business risk" exclusions. They include the "your product" and "your work" exclusions, as well as portions of the "latent defect" and related exclusions. In Minnesota, the "business risk" rule bars coverage where "the insured-contractor can take pains to control the quality of the goods and services supplied. At the same time, he undertakes the risk that he may fail in this endeavor and thereby incur contractual liability whether express or implied. The consequence of not performing well is part of every business venture; the replacement or repair of faulty goods and works is a business expense, to be borne by the insured-contractor in order to satisfy customers." See Bor-Son Bldg. Corp. v. Employers Commercial Union Ins. Co., 323 N.W.2d 58, 64 (Minn. 1982).

2. Limitations to the "business risk" rule

a. By the terms of most policies, the "business risk" exclusions do not apply to damage to **other** property. If your defective work/product causes damage to other property, that loss remains covered. It may therefore be important to argue that mold constitutes damage to (other) property, as with first-party policies.

b. Work performed by a subcontractor.

(1) The Minnesota Court of Appeals has held that, under the new CGL policy language, the "business risk doctrine" would not preclude the payment of insurance for faulty workmanship or materials provided by a subcontractor. This "new" broad form language provides that the "your work" exclusion "does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor." O'Shaughnessy v. Smuckler Corp., 543 N.W.2d 99, 103-05 (Minn. Ct. App. 1996).

IV. THE IMPACT OF THE POLLUTION EXCLUSION ON COVERAGE FOR MOLD LOSSES.

A. Regardless of the Policy, Insurers Continue to Argue That the Pollution Exclusion Should Preclude Coverage For Loss Arising From Mold.

1. Although the post-1986 pollution exclusion (which insurers like to refer to as the "absolute" pollution exclusion) is broad, properly construed it should not apply to mold.

a. "Pollution" is commonly defined as "any actual, alleged or threatened discharge, dispersal, escape, migration, release or seepage of any pollutant."

(1) Some courts have held that the "discharge, dispersal, escape, migration, release or seepage" language is a term of art with historical underpinnings. At minimum, a reasonable layman's reading of that language suggests something more dramatic than the growth of a mold or fungus.

b. "Pollutant" is separately defined in the pollution exclusion, typically as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste."

(1) Conspicuously absent from the definition of "pollutant" is anything living, including molds, bacteria and the like.

c. Some insurers argue that it is only the spores from the mold, and not the mold itself, which causes damage or loss, or poses a risk to human health. These insurers then argue that the spores are in fact "released" or "dispersed" by the mold.

(1) Mold releases spores like trees shed leaves in the Fall; they are an essential ingredient of the mold, and their "release" is inevitable. Moreover, it is not just the spores, but the mold, which is the unwanted visitor. Perhaps the easiest response, however, is to note that no matter how clever the insurer's argument, it could hardly do more than create an ambiguity, which must be construed in favor of coverage.