After The Mold Exclusion
Water Damage - Covered Mold Damage??

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This article deals only with first party property coverages, and does not deal with liability policies.

A BRIEF HISTORY

In the late 1990's and early 2000's, the insurance industry saw a very sharp increase in the number of claims being submitted for mold damage associated with covered water damage claims. At that time most property policies had a standard mold exclusion that had been present for many years. The standard Homeowners 3 form from the Insurance Services Office, Inc. provided all risk or open perils type coverage for direct physical loss to the dwelling, but had the following exclusion:

> *We do not insure, however, for loss:*
> *2. Caused by:*
> *e. Any of the following:*
> *(3) Smog, rust or other corrosion, mold, wet or dry rot;*
> *3. Excluded under Section I - Exclusions.*
> *Under Items 1. And 2., any ensuing loss to property described in Coverages A and B not excluded or excepted in this policy is covered.*

This standard mold exclusion is generally interpreted as excluding only damage that was caused by the peril of naturally occurring mold and does not exclude the mold growth and damage that occurred as a result of a covered water damage claim. In California, the exclusion is consistent with California Insurance Code section 530:

> *530. An insurer is liable for a loss of which a peril insured against was the proximate cause, although a peril not contemplated by the contract may have been a remote cause of the loss; but he is not liable for a loss of which the peril insured against was only a remote cause.*

In the early 2000s the public became more aware of a potential health hazard resulting from prolonged exposure to mold. As a result, the insurance industry was faced nationwide with tens of thousands of claims for mold damage associated with covered water damage claims with the result being potential payment of hundreds of millions of dollars in claims, often after fighting and losing a lengthy and expensive litigation process.

Three examples of water damage claims that resulted in mold contamination, followed by lawsuits:

In Fall 2000, a Federal Court jury in Sacramento, CA awarded $500,000 general and special

damages plus $18,000,000 punitive damages in the case of Anderson v Allstate. The trial judge reduced the punitive damages to $2,500,000 and both sides appealed. The U.S. Court of Appeals, 9th Circuit, agreed with a finding of bad faith but eliminated the punitive damages. The Court allowed the general and special damages of $500,000 to stand.

An article in July 2001 by the Independent Insurance Agents of America, Inc. (IIAA) reported that in Spring 2001 a Texas state court jury had awarded a verdict of $32.1 million in the case of Ballard v Farmers. The IIAA article went on to report that, according to the carrier, similar claims could easily approach $130 million in Texas alone.[1]

A Superior Court jury in the case of Rogers v USAA, in San Diego, CA, in January 2004, awarded general and special damages of $437,500 and punitive damages of $1,750,000. The trial judge eliminated the punitive damages. A California Court of Appeals ruling reinstated the punitive damages of $1,750,000.

CHANGES

By no later than 2000 and 2001 the insurance industry was acutely aware of the potential cost of covering mold damages resulting from covered causes of loss. The industry prepared and then enacted a number of changes and endorsements to existing property policies. These changes and endorsements were aimed at eliminating or limiting coverage for any mold damages.

A common feature of both types of changes or endorsements is to eliminate both a peril and a damage, with interchangeable, ambiguous and undefined terminology. Often the word Amold@ is used both as a peril and a damage with little if any differentiation.

Property insurance policies provide coverage or indemnity for damages caused by perils or risks. Exclusions in these policies eliminate certain named perils or risks from coverage. The mold exclusions added by the insurance industry since 2000 are worded to exclude both peril (mold) and damage (mold), often without distinction. As such, the exclusions utilize the same word, Amold,@ but without distinction. This usage is ambiguous and misleading when placed in an exclusion which typically deals only with perils.

ELIMINATING MOLD FROM THE POLICY

Some companies took the approach of trying to eliminate any and all mold exposure from their policy with the result being to shift the loss and financial burden back to the policyholder. These endorsements or changes were worded with the aim of totally eliminating any coverage for mold, mold damage or mold related damage or expense regardless of how caused.

These type endorsements, which attempt to eliminate any payments for mold altogether, may face an obstacle in statutes like California's Insurance Code section 530 (see above.)

An endorsement that excludes mold as a peril and tries to eliminate damages caused by another peril that is covered may run counter to state law and may be against public policy. Mold

resulting from a covered cause of loss (e.g. a covered water damage claim) would appear to be the type of situation contemplated by the California legislature when it enacted Insurance Code section 530. A blatant attempt by an insurance company to deny coverage for damages resulting from a covered cause of loss may not stand legal scrutiny.

LIMITING COVERAGE FOR MOLD

Other companies took the approach of having the endorsements or changes first exclude mold, both as a peril and a damage, and then add back or provide a limited coverage for mold, mold damages and mold related claims if the mold resulted from a cause of loss that is covered. These endorsements or changes generally agreed to add back coverage for mold claims but also put forth a separate policy sub-limit (e.g. $5,000) to cover claims relating to mold, such as physical damage to dwelling and contents, remediation, testing and additional living expense.

Depending on the specific wording of the change or the endorsement, these revisions may have some problems

For example, the Allstate Homeowners Deluxe Plus policy, as is standard with Homeowner policies and other property policies, has separate policy limits for covered property such as: A-Dwelling, B-Other Structures, C-Contents and D-Additional Living Expense (ALE).

Allstate mold endorsement, Form AP1290, page 3, Section VI, talks about Coverages A, B or C. The key word in this endorsement is "or." The endorsement does not clearly state that there is one single cumulative policy sub-limit of $5,000 applicable to mold for all of the insured property combined.

Instead, the endorsement states:

> *In the event of a covered water loss under Coverage A B Dwelling Protection, Coverage B B Other Structures Protection or Coverage C B Personal Property Protection, we will pay up to $5,000 for mold, fungus, wet or dry rot protection.*

Since the basic Allstate policy has separate limits of liability for each coverage (A, B, C and D) it is logical and reasonable for an insured to understand that Allstate intended to provide a separate $5,000 sub-limit for each of the Coverages, A, B and C (and possibly D.) This would be $5,000 for the Dwelling, $5,000 for Other Structures and $5,000 for Contents - for at least $15,000 total (and possibly another $5,000 or 12 months for ALE.).

At the very least, the form is ambiguous and may be interpreted in favor of the insured.

The Allstate policy, like some other policies, has a separate Limit of Liability for ALE and expresses the limit in terms of a time limit (12 months) rather than dollars. In those cases, the insured might reasonably expect the time limit to apply rather than the $5,000 sub-limit mentioned in the mold endorsement.

When the Allstate mold endorsement talks about the $5,000 sub-limit for mold, it does so in terms of "remediation" which the endorsement defines as covering repairs, investigation and ALE. The insurance industry standard, as well as Allstate's past practice, has been that the cost of investigating the claim has not been part of the policy limit available to the insured for A, B, C or D, but has been part of the routine adjustment expense. Past practice has been that the investigation cost was not charged against the benefits (limits of liability) available to the insured and did not reduce the limits available to the insured, for which the insured had paid a premium. When Allstate agrees to provide $5,000 coverage for mold and then charges investigation costs against that limit, Allstate is intentionally transferring part of its normal adjustment expense to the policyholder and depriving the policyholder of the full limit or sub-limit of coverage normally available to indemnify the insured for the physical loss suffered.

Additionally, most property policies, when they place dollar limits on certain categories of items or loss (such as jewelry, cash, etc), place the Limitations together in one place where the sub-limits can be easily discerned by the policyholder. Placement of a sub-limit on mold damages in a section where one normally encounters only exclusions of perils may serve to unduly confuse an insured and/or fail to warn the insured in plain English of the Limitation on mold damage.

HANDLING WATER DAMAGE CLAIMS

If the mold exclusions withstand legal scrutiny, the insurance industry is still left with the problem of dealing with sudden water damage claims that are promptly reported. Procedures must be implemented to deal with these claims in order meet industry standards, minimize water damage and prevent the growth of mold that might follow.

Insurance industry standards call for the insurance company to promptly and fully investigate a claim made by an insured, determine coverage, determine the full extent of damage, prepare a complete scope of loss or damage, try to get an agreed on scope of loss with the insured and extend to the insured any benefits available under the policy.

Water damage claims are among the most common property damage claims made, both in terms of number of claims made and dollars paid on claims. Adjusters should be very much aware of the need to remove water and start immediate dry down of the property to mitigate damage. Insurance industry standards require that an adjuster should be able to handle claims assigned to him, such as water damage claims.

The insurance industry standard is to seek out coverage under a property policy and to advise and make available to the insured all benefits available to the insured under that policy, whether the insured is aware of the benefits or not or asks for the benefits or not. Such coverage, in a Homeowners policy for example, often includes Additional Protection or Other Coverages which provide for protection of property from further damage. These policy benefits would include the emergency removal of water and drying of the property to stop or mitigate additional water damage, with a side effect of preventing or stopping mold growth.

In the case of water damage claims the insurance industry standard is to make contact in 24 hours and inspection in 48 hours, as needed. It is imperative in a significant water damage claim that inspection be made in 48 hours and/or that the insured be advised and urged to obtain immediate emergency water removal services to mitigate the damages. The insured must also be advised as to whether or not such emergency services are covered under the policy and whether the insurance company will be paying for such services or not.

In many states the duty may be statutory, judicial or simply insurance industry standard. In California, for example, an insurance company has a statutory duty to offer, provide, and assist the insured in collecting the available policy benefits.

California Code of Regulations, Title 10, Chapter 5, Subchapter 7.5, Section 2695.4, Representation of Policy Provisions and Benefits, provides:

> *(a) Every insurer shall disclose to a first party claimant or beneficiary, all benefits, coverage, time limits or other provisions of any insurance policy issued by that insurer that may apply to the claim presented by the claimant. When additional benefits might reasonably be payable under an insured's policy upon receipt of additional proofs of claim, the insurer shall immediately communicate this fact to the insured and cooperate with and assist the insured in determining the extent of the insurer's additional liability.*

When an insurance company is investigating a water damage claim, it should immediately advise and make available to the insured any policy benefit available for emergency water removal and drying.

Sometimes adjusters make hurried inspections, or none at all, and then attempt to settle the water damage claim for only what is immediately and quickly visible during a rapid walk-thru of the property. Such a cosmetic repair in light of a significant water damage claim, with the potential for mold growth, is indicative of both unacceptable claims handling practices and an attempt to underpay a claim and withhold benefits from an insured. Such actions are in bad faith.

The potential presence of water in hidden or inaccessible areas is one of the major reasons to immediately call in an expert in water extraction and drying in order to locate the water, remove it and properly dry the property to prevent further damage.

Most insureds are not aware of the areas where water may remain hidden and cause further damage. Adjusters are. Most insureds are not aware of the dangers of the continuing presence of water in these hidden areas. Adjusters are.

Adjusters are, or should be, aware of the potential for further problems since they will often handle water damage claims on a frequent and routine basis. Adjusters are aware that the presence of water in a particular location is an indicator of possible or even probable hidden water in other locations. An adjuster that shows no awareness of this responsibility and takes no meaningful steps to do any of the necessary investigation is derelict in his responsibility. An

insurance company that allows an adjuster to be so derelict is sanctioning a serious breach of the duty of good faith and fair dealing and is failing to live up to the implied promise to the insured to provide capable and trained adjusters to deal with the claims reported.

Adjusters, much more than insureds, are aware of policy provisions providing coverage for emergency repairs and of the necessity and means to mitigate damage. It is the duty of the adjuster to advise the insured and offer the policy benefits available for such emergency services.

An insurance company can commit bad faith and/or be negligent to the extent of malpractice in their handling of routine water damage claims when their action or inaction results in new or additional damages and injuries.

WATER + MOLD = ???

When the insurance industry knowingly instituted measures to eliminate coverage for mold damage or to cap mold damages (e.g. $5,000 sub-limit), it was in response to an industry wide history and awareness of the expense of handling and paying mold claims.

These changes in coverage provided by the property policies are specifically designed to eliminate or limit claims payments that the insurance companies would be required to make in mold related claims. The changes were made with full knowledge by the insurance industry that mold related claims can be and were very expensive to settle. The industry also had full knowledge of the allegations that mold was a health hazard and that many people and doctors were claiming that exposure to mold growth and contamination resulting from covered causes of loss was causing significant health effects.

An insurance company, in limiting or capping mold claims, does so with the knowledge that what used to be covered mold claims often arose from covered water damage claims.

When the insurance industry re-wrote the policy provisions to exclude such an expensive set of damages, they did so with full knowledge that when they did not indemnify the insured for what used to be a covered damage, that the financial burden would fall on the insured.

Given that the insurance industry was in a superior position relative to experience with and knowledge of the possible adverse problems associated with delays and mishandling of water damage claims, it became incumbent on the industry to make sure that proper procedures were developed and implemented to handle these claims.

Starting by no later than 1999, many insurance companies did develop manuals and written procedures for handling mold claims, in addition to already existing manuals and procedures for handling water damage claims.

However, the number of claims and lawsuits since 1999 involving mold contamination resulting from covered water damage claims indicates that special handling of mold issues was often only lip service and not actual good faith claims handling.

An insurance company's knowing or willful or even negligent failure to properly handle a water damage claim is a severe breach of their duty to their policyholder.

The insurance industry, operating from a position of superior knowledge and under the duty of good faith and fair dealing, has a duty to warn the insured and building occupants of the potential of mold contamination and to advise, offer or assist the insured in mitigating the water damage in order to prevent a condition that the insurance industry is well aware of as a potential health hazard when property is not immediately dried down.

An adjuster, or any individual, may be held responsible for their conduct if their negligence causes damage or injury. In the same manner, if the growth of mold is caused by the negligence and/or failure of the adjuster to immediately advise, offer, and/or assist the insured with emergency water removal and dry down of the covered property loss, the adjuster may be held to be in bad faith under an insurance contract. Or he may be liable in tort outside of the contract for causing a damage (mold growth and/or contamination) that may not be covered under the policy of the insured. In such cases, there may be a claim directly against the adjuster and/or insurance company or under the errors and omissions policy carried by the adjuster and/or insurance company.

Dealing with a covered water damage claim, with potential mold growth, as merely a a cosmetic issue and/or the withholding of policy benefits and underpayment of a claim are consistent with attempting to reduce claims payments in order to increase insurance company profitability. Such actions are in bad faith.

If there is both water damage and mold damage, at the very least the insurance should determine the full scope of the covered water damage claim and extend coverage for the water damage, excluding only that which is necessitated due solely to mold and mold alone. Some companies have gone so far as to deny the water damage if there is mold associated with it. If the insurance company is going to deny the mold damage, there must be a segregation of damages. The duty to segregate damages may vary from state to state but the general industry standard is to pay for the covered water damage, regardless of the presence of mold. If cleaning up the covered water damage means coincidentally removing the mold, then so be it. A covered claim should be honored even if it also takes care of a non-covered loss.

It has been estimated that a mold claim may cost up to five or ten times what an ordinary water damage claim costs. Insurance companies know from expensive experience that the failure to properly and promptly handle a water damage claim could result in a mold claim. Such an awareness brings with it an obligation to the policyholder to promptly and properly handle a covered water damage claim. If the covered water damage is mis-handled by the adjuster the insured will be burdened with a mold claim of the very sort that the insurance company has gone to great lengths to avoid covering.

The insurance company is relying on the mold exclusion or limitation to preclude or limit

payment of mold claims. The insurance company might not be allowed to mis-handle a covered water damage claim, negligently allow mold to develop and then cite the mold exclusion and walk away from the problem.

It is imperative that insurance companies implement procedures and train adjusters to immediately respond to water damage claims and provide any emergency benefits available in the policy for removal of the water and drying down the property. The standard policy requires the insured to undertake reasonable mitigation efforts. Many insureds may be unaware of hidden damage or dangers and may not have the financial means to undertake extensive water removal and drying down. Offering immediate advice and providing any available policy benefits for emergence services will go a long way toward assisting the insured in mitigating the water damage and may prevent the mold growth that companies have worked so hard to avoid paying.

Mishandling of a water damage claim and/or withholding policy benefits may leave the insurance company with a bad faith exposure or a tort exposure if the mishandling and/or withholding results in mold growth that could and should have otherwise been avoided.

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[1] "*The Insurance Implications of Toxic Mold Claims*", July 2001, Independent Insurance Agents of America, Inc.