The Mold Exclusion

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In the late 1990s and early 2000s, 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 provided all-risk or open-perils coverage for direct physical loss to the dwelling, but contained a standard mold exclusion that was generally interpreted as excluding only damage that was caused by the peril of naturally occurring mold. It did not exclude the mold growth and damage that occurred as a result of a covered water damage claim.

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 faced tens of thousands of claims nationwide for mold damage associated with covered water damage claims, with hundreds of millions of dollars in claims on the line along with a lengthy and expensive litigation process.

By no later than 2001, the insurance industry was acutely aware of the potential cost of covering mold damages resulting from a covered cause 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.

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. This usage is ambiguous and misleading when placed in an exclusion that typically deals only with perils.

Eradicating the Problem

Some companies took the approach of trying to eliminate any and all mold exposure from their policies, shifting the loss and financial burden instead 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 it was caused.

However, an endorsement that excludes mold as a peril and tries to eliminate damages caused by another covered peril (such as a water loss) may run counter to state law and may be against public policy. A blatant attempt by an insurance company to deny coverage for damages resulting from a covered cause of loss may not stand legal scrutiny.

Other companies took a different approach, opting to first exclude mold both as a peril and a damage, and then providing limited coverage for mold, mold damages, and mold-related claims if the mold resulted from another covered cause of loss. These endorsements generally agreed to add back coverage for mold claims but also put forth a separate policy sub-limit (such as $5,000)

to cover claims related to mold, such as physical damage to dwelling and contents, remediation, testing, and additional living expense.

Depending on the specific wording of the endorsement, these revisions may have some problems. Some endorsements provide mold limits for Coverages A, B, or C. The key word in these endorsements, of course, is "or." When written this way, 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.

Since the basic homeowner's 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 the insurer 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 a total of at least $15,000 (and possibly another $5,000 or 12 months for ALE.). If the form is viewed as ambiguous, it likely will be interpreted in favor of the insured.

When some mold endorsements talk about the $5,000 sub-limit for mold, they do so in terms of remediation, which the endorsement defines as covering repairs, investigation, and ALE. The insurance industry standard 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. When the insurer agrees to provide $5,000 coverage for mold and then charges investigation costs against that limit, the insurer 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 their physical loss.

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 fail to warn the insured properly of the limitation on mold damage.

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.

Water damage claims are among the most common property-damage claims made, both in terms of number of claims made and dollars paid. Adjusters should be very aware of the need to immediately remove water and start dry down of the property to mitigate damage.

In the case of water damage claims, the industry standard is to make contact in 24 hours and inspection in 48 hours. It is imperative in a significant water damage claim that inspection is made in 48 hours and that the insured be urged to obtain immediate emergency water removal

services to mitigate the damages. The insured also should 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.

The duty may be statutory, judicial, or simply an insurance industry standard, but the general rule is that an insurance company has a duty to offer, provide, and assist the insured in collecting the available policy benefits.

Most insureds are not aware of the areas where water may remain hidden and cause further damage, but adjusters are. Most insureds are not aware of the dangers of the continuing presence of water in these hidden areas. Again, 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 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 insurance company can commit bad faith 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.

A Duty to Perform

When the insurance industry knowingly instituted measures to eliminate coverage for mold damage or to cap mold damages, 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 claim payments that the insurance companies would be required to make in mold-related claims. 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, the financial burden would fall on the insured.

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

An adjuster 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 or failure of the

adjuster to immediately advise, offer, and assist the insured with emergency water removal and dry down of the covered property loss, the adjuster may be in bad faith under an insurance contract or liable in tort outside of the contract for causing a damage that may not be covered. In such cases, there may be a claim directly against the adjuster or insurance company, or under the errors and omissions policy carried by the adjuster or insurance company.

If there is both water damage and mold damage, at the very least the insurer 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. 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 10 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 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 mishandled, 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 may not be allowed to mishandle a covered water damage claim that allows 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. 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 emergency services will go a long way towards assisting the insured in mitigating the water damage preventing the mold growth that companies have worked so hard to avoid paying.

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