

Insurance Coverage for Mold-Related Claims: A Critical Analysis of Potential Insurer Defenses Under Third-Party and First-Party Policies

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In recent years, firms in the construction industry have faced an increasing number of claims related to the presence of mold, fungi, or similar substances in buildings that they own or that they constructed or designed. Developers, design firms, contractors, architects, engineers, manufacturers and suppliers of building materials, building owners, property managers, realtors, and others have become targets in lawsuits. In many cases, depending on the precise language of their policies and controlling state law, companies may be entitled to insurance coverage under commercial general liability (“CGL”) policies for the costs and liabilities associated with mold-related lawsuits. Even if they have not yet been sued, many property owners have discovered that their property has been impacted by the accumulation of mold. In many cases, property owners may be entitled to insurance coverage under their first-party property policies for the cost of removing mold from buildings that they own.

This article examines several defenses that insurers are likely to assert in response to mold-related claims under CGL policies and first-party policies. Based on analogous cases, policyholders may make persuasive arguments to overcome all of these

defenses and obtain coverage. Further, policyholders may seek additional damages against carriers that deny mold claims in bad faith.

I. CGL POLICIES POTENTIALLY AFFORD COVERAGE FOR MOLD-RELATED CLAIMS

CGL policies generally afford coverage for “all sums” that the policyholder becomes liable to pay for claims alleging “property damage,” “bodily injury,” or “personal injury.” Many CGL policies also afford coverage for claims for property damage or bodily injury arising from the “completed operations” of the policyholder. This coverage often protects design and construction firms from claims related to their “work.”

Plaintiffs in tort cases involving mold often allege that the presence of mold resulted in property damage or diminution in property value or that their exposure to micotoxins resulted in bodily injury. If lawsuits clearly allege property damage or bodily injury, policyholders persuasively may argue that mold-related claims trigger coverage under CGL policies. Some courts, moreover, have held that CGL policies afford coverage for claims alleging diminution in property value.¹ In addition, because

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¹ See *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 481 (Ill. 2001); *Wisconsin Label Corp. v. Northbrook Property & Casualty Ins. Co.*, 221 Wis. 2d 800, 586 N.W.2d 29 (1998) (“tangible property may be damaged if ‘diminished in value or made useless,’ even if the tangible property suffers no actual physical injury.”).

many plaintiffs allege that the presence of mold forced them to evacuate their property, policyholders persuasively may argue that mold-related claims trigger coverage under the personal injury coverage part commonly found in CGL policies, which covers claims alleging “wrongful eviction” or “interference with the private right of occupancy.”

Insurers have and likely will continue to assert numerous defenses to mold-related claims. The following chart briefly summarizes several of those

defenses and indicates how policyholders and/or courts have responded to the defenses. This article then focuses on the following two defenses in more detail: (1) the pollution exclusion defense, and (2) the “expected or intended” defense. Finally, this article examines additional damages that may be available to policyholders if insurers deny mold claims in bad faith.

POTENTIAL INSURER DEFENSES	RESPONSE OF POLICYHOLDERS AND/OR COURTS
<p>The “Business Risk” Exclusion Defense</p> <p>Insurers may deny coverage on the basis of certain “business risk” exclusions, one form of which generally bars coverage for a policyholder’s own work or own product.</p>	<p>Courts generally hold that many forms of business risk exclusions bar coverage only for the replacement cost of a defective product itself, at most, but do not bar coverage for the cost of labor, repair, or other associated costs. In addition, the exclusions typically do not bar coverage for, among other things, claims alleging that the policyholder’s defective product or defective work caused additional property damage or bodily injury.²</p> <p>Thus, even assuming <i>arguendo</i> that a business risk exclusion prevented a contractor from recovering for the cost of repairing a roof that it installed improperly, the exclusion arguably would not bar coverage for mold-related damage that resulted from the leaking roof.³</p>

² See Peter Kalis, *Policyholder’s Guide to Insurance Coverage*, §10.02[B].

³ *Radenbaugh v. Farm Bureau General Ins. Co.*, 610 N.W.2d 272 (Mich. Ct. App. 2000).

POTENTIAL INSURER DEFENSES	RESPONSE OF POLICYHOLDERS AND/OR COURTS
<p>Trigger-Related Defenses</p> <p>When a loss occurs continuously over several policy periods, a court must decide which of the policies are potentially “triggered.” In cases arising in the context of environmental and asbestos claims, courts have adopted a variety of “trigger” theories (see adjacent column). Based on the facts of a specific claim, and applicable trigger law, an insurer may deny a claim on the grounds that its policy is not “triggered” because the injury at issue purportedly did not take place during the policy period.</p> <p>Mold Exclusions</p> <p>Insurers sporadically are attempting to add mold-related exclusions to CGL policies, although it does not appear that the insurance industry has developed a standard form.⁹</p>	<p>Depending on the facts of a particular claim, a variety of trigger positions may apply in the context of mold claims:</p> <ul style="list-style-type: none"> ■ Exposure Trigger (if a claimant was exposed to mold during multiple policy periods, then all policies in effect during the entire period of “exposure” would be triggered).⁴ ■ Initial Exposure Trigger (only the policy in effect when the plaintiff was first “exposed” to the mold would be triggered).⁵ ■ Installation Trigger (policy in effect on date of installation of defective product is triggered).⁶ ■ Manifestation Trigger (only the policy in effect when the plaintiff’s injuries first became known or “manifest” would be triggered).⁷ ■ Continuous Trigger (all policies in effect from the date of the initial exposure to the mold through the manifestation of the alleged injuries would be triggered).⁸ <p>Coverage will vary depending on the precise terms of any valid and applicable exclusion. Courts have not yet had a chance to interpret mold exclusions in CGL policies.</p> <p>Insurers generally are not entitled to modify existing policies without sufficient consideration and generally may not add exclusions retroactively.</p>

⁴ *Cole v. Celotex Corp.*, 599 So. 2d 1058 (La. 1992). See generally John M. Sylvester and John T. Waldron, III, *Insurance Coverage for Damage Caused by Mold and Fungus Infestation*, Construction Law and Business, at 47, 49 (Summer 2000)(discussing trigger issues).

⁵ *Eljer Mfg., Inc. v. Liberty Mutual Ins. Co.*, 972 F.2d 805 (7th Cir. 1992)(holding that coverage is triggered as of the date of installation of defective product into a building).

⁶ *Eljer*, 972 F.2d 805.

⁷ *Eagle-Picher Indus., Inc. v. Liberty Mutual Ins. Co.*, 682 F.2d 12 (1st Cir. 1982), cert. denied, 460 U.S. 1028 (1983).

⁸ *J.H. France Refractories Co. v. Allstate Ins. Co.*, 626 A.2d 502 (Pa. 1993).

⁹ Patrick J. Wielinski, *Third Party Insurance for Mold Claims*, 11 Coverage 21 (Nov./Dec. 2001), at 21.

The Pollution Exclusion Defense

Insurers may argue that mold is a type of pollutant and, therefore, falls within the scope of an exclusion barring coverage for certain pollution-related claims. Over the years, CGL insurers have used various forms of the pollution exclusion. For purposes of illustration, one version of the pollution exclusion bars coverage for bodily injury and property damage claims:

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).

Several courts have rejected the application of the pollution exclusion to mold-related claims. For example, in *Stillman v. Charter Oak Fire Ins. Co.*,¹⁰ a federal district court in Florida held that the pollution exclusion was ambiguous and, thus, did not apply to a claim filed by office workers allegedly exposed to mold emitted by a defective HVAC system.

In addition, policyholders may contest the applicability of the pollution exclusion to mold-related claims for other reasons. First, certain pollution exclusions do not apply to claims arising from “completed operations.”¹¹ Thus, to the extent that a complaint seeks damages from a contractor or design firm related to buildings that have been completed, the pollution exclusion may not apply at all.

Second, the pollution exclusion arguably applies only to claims involving industrial environmental pollution, rather than claims involving damage to buildings and homes, such as mold-related claims. For example, in holding that the pollution exclusion did not apply to a claim arising from the release of carbon monoxide fumes in a building, one court reasoned that the “history of the pollution exclusion indicates” that it should be applied only to traditional environmental litigation claims.¹²

Third, mold and fungi arguably are not “irritants, contaminants, or pollutants,” as those terms are used in the pollution exclusion. In analogous cases, courts have held that the exclusion did not apply to substances that naturally occur in the environment, such as bacteria¹³ or carbon monoxide.¹⁴

Fourth, mold-related claims arguably do not involve a “discharge, dispersal, release, or escape” of pollutants into the environment. Courts have reasoned that the terms “discharge,” “dispersal,” “release,” and “escape” are “terms of art in environmental law which generally are used with reference to damage or injury caused by improper disposal or containment of hazardous waste.”¹⁵ Based on this reasoning, one court held that the pollution exclusion did not apply to a mold-related claim because “no contaminants were released, but rather formed over time” inside the walls of a building.¹⁶ For similar reasons, certain courts have held that the pollution exclusion does not apply to claims involving indoor emissions.¹⁷

The “Expected or Intended” Defense

CGL policies generally bar coverage for claims for property damage or bodily injury that is “expected or intended from the standpoint of the insured.”

¹⁰ No. 1949-CV-Highsmith (S.D. Fla. June 18, 1993), *rev'd on procedural grounds*, 88 F.3d 911 (11th Cir. 1996).

¹¹ *See West American Ins. Co. v. Tufco Flooring East, Inc.*, 104 N.C. App. 312, 409 S.E.2d 692 (1991).

¹² *Western Alliance Ins. Co. v. Gill*, 686 N.E.2d 997, 999 (Mass. 1997).

¹³ *Keggi v. Northbrook Prop. & Cas. Ins. Co.*, 13 P.3d 785 (Ariz. 2000).

¹⁴ *Donaldson v. Urban Land Interests, Inc.*, 564 N.W.2d 728 (Wis. 1997).

¹⁵ *Essex Ins. Co., Inc. v. Berkshire Envtl. Consultants, Inc.*, No. 99-30280-FHF, slip op. at 7 (D. Mass. 2002), *reprinted in* Mealey's Litigation Reports: Insurance (Feb. 12, 2002).

¹⁶ *Leverence v. United States Fid. & Guar.*, 158 Wis. 2d 64, 97, 462 N.W.2d 218, 232 (1990)(emphasis added).

¹⁷ *See Stoney Run Co. v. Prudential-LMI Commercial Ins. Co.*, 47 F.3d 34 (2d Cir. 1995); *American States Ins. Co. v. Koloms*, 177 Ill. 2d 473, 687 N.E.2d 72 (1997).

Insurers may attempt to deny coverage on the ground that companies knew or should have known about the presence of mold in their buildings. Courts, however, have placed several restrictions on the “expected or intended” defense. To prevail, an insurer may need to prove that the policyholder actually knew about the mold at issue; proof that the policyholder should have known or that a reasonable policyholder would have discovered the mold may not defeat coverage.¹⁸ In addition, an insurer may need to prove that the policyholder subjectively expected or intended the specific property damage or bodily injury at issue in the claim.¹⁹ Proof that the policyholder was aware of mold in one area of a building may not defeat coverage arising from the existence of mold in another area of the building. Similarly, proof that the policyholder was aware of mold produced by a HVAC system may not defeat coverage for mold produced by a leaking foundation.

II. FIRST-PARTY PROPERTY POLICIES POTENTIALLY AFFORD COVERAGE FOR MOLD-RELATED LOSSES

Many property owners have discovered the presence of mold in their buildings or homes. If left unchecked, the presence of mold in the building may lead to a sharp decrease in the value of the property or may expose the occupants of the buildings to harmful micotoxins. Thus, property owners often must incur substantial costs to remove mold from their property. In many cases, property owners may recover this cost from their first-party insurers. Many first-party property policies contain the following insuring agreement:

Except as hereinafter excluded this policy insures against all risks of direct physical loss of or damage to the property insured.

Courts have held that “all risk” policies create a “special type of coverage extending to risks not usually covered under other insurance” and should, therefore, be interpreted broadly.²⁰

In the context of first-party policies, insurers may assert several defenses to coverage for mold-related claims. First, insurers may argue that mold-related claims are not covered because commercial property companies purportedly knew about specific water problems or generally have known about the issue of mold for years and, therefore, the losses are not “fortuitous.” Although first-party policies do not contain the word “fortuitous,” some courts have held that “all risk” policies cover only “fortuitous” losses—that is, losses that were “not certain to occur”²¹ or were “dependent on chance.”²² The majority of courts, however, have interpreted the “fortuity” defense narrowly, holding that “fortuity” must be measured from the subjective viewpoint of the policyholder at the time the policy was issued.²³ In other words, a court must ask whether the policyholder knew of the specific mold-related loss at issue on the inception date of the policy. The fact that the policyholder was aware that mold claims were becoming more common or that it faced some risk of mold-related damage in the future does not defeat coverage.²⁴ Similarly, the fact that in hindsight one might conclude that a reasonable policyholder should have known of the risks of mold does not defeat coverage.²⁵

In addition, insurers may deny coverage on the grounds of various exclusions in first-party policies, including exclusions that bar coverage for losses arising from “design defects” or “faulty workmanship.” Insurers may argue that because mold damage arises from flaws in the design or construction of a building, there is no coverage.

¹⁸ *Vermont Mut. Ins. Co. v. Singleton*, 446 S.E.2d 417 (S.C. 1994).

¹⁹ *United States Fid. & Guar. Co. v. Armstrong*, 479 So. 2d 1164, 1167 (Ala. 1985).

²⁰ *See Texas Eastern Transmission Corp. v. Marine Office-Appleton & Cox Corp.*, 579 F.2d 561, 564 (10th Cir. 1978).

²¹ *Avis v. Hartford Fire Ins. Co.*, 195 S.E.2d 545, 548 (N.C. 1973).

²² *Insurance Co. of N. Am. v. U.S. Gypsum Co.*, 870 F.2d 148, 151 (4th Cir. 1989).

²³ *See Compagnie des Bauxites v. Ins. Co. of N. Am.*, 724 F.2d 369, 372 (3d Cir. 1983).

²⁴ *U.S. Gypsum Co.*, 870 F.2d at 151.

²⁵ *See Compagnie des Bauxites*, 724 F.2d at 372.

In response, policyholders may argue that the exclusions do not apply because there is no “design defect” or “faulty workmanship.” The mere fact that a roof or wall leaks does not necessarily prove the existence of a “design defect.” To the contrary, numerous other factors may have contributed to the presence of mold in the building, such as rain, floods, or problems with the materials used to construct the building. In addition, design defect and faulty workmanship exclusions often contain “ensuing loss” provisions that restore coverage for losses that arise from the design defect or faulty workmanship. For example, many courts have held that when a defective piece of property threatens other insured property, the ensuing loss provision restores coverage.²⁶

In addition, certain first-party policies may contain an exclusion barring coverage for “mold or other fungi.” Depending on the precise language of the mold exclusion, however, policyholders may still obtain coverage for certain mold-related claims. For example, certain exclusions bar coverage for damage caused by “mold or other fungi,” but contain an exception restoring coverage for “ensuing loss caused by water damage ... if the loss would otherwise be covered under the policy.” Based on this “ensuing loss” provision, one court held that a policy afforded coverage for claims for mold-related damage that arose from water damage caused by a

leaking roof. The court reasoned that the “mold that followed the water damage was caused by water damage. Therefore, under the facts of the case, the exclusion for fungi and mold does not apply.”²⁷

III. POTENTIAL BAD-FAITH DAMAGES

As noted above, insurers may assert several types of defenses to mold-related claims under both third-party and first-party insurance policies. The willingness of insurers to assert questionable defenses may be tempered in light of several recent decisions involving multi-million dollar awards to policyholders due to the insurers’ bad-faith handling of mold claims. For example, in *Hatley v. Century-National Ins. Co.*,²⁸ a jury in Arizona recently awarded \$4 million in punitive damages based on allegations that the insurer delayed handling the claim.²⁹

IV. CONCLUSION

Depending on the precise terms of their policies, policyholders often have strong arguments to obtain insurance coverage for mold-related lawsuits and/or to pay to remove mold from their own property. For business planning purposes, companies involved in the construction and design industries should carefully review their insurance policies for potential coverage for mold-related claims.

²⁶ See *Schloss v. Cincinnati Ins. Co.*, 54 F. Supp.2d 1090, 1096 (M.D. Ala. 1999); *National Fire Ins. Co. of Pittsburgh, Pennsylvania v. Valero Energy Corp.*, 777 S.W.2d 501, 506 (Tex. App. 1989).

²⁷ *Home Ins. Co. v. McClain*, No. 05-97-01479-CV, slip op. at 2 (Tex. Ct. App. Feb. 10, 2000), reprinted in Mealey’s Emerging Insurance Disputes (Feb. 25, 2000).

²⁸ No. CV 2000-006713 (Ariz. Super. Ct., Maricopa County)(Nov. 24, 2001).

²⁹ See also *Ballard v. Farmers Ins. Exchange*, No. 99-05252 (Tex. Dist. Ct., Travis County, 345th Judicial District) (June 1, 2001)(jury awarded a married couple a judgment of \$32 million against its homeowners insurer); *Anderson v. Allstate Ins. Co.*, No. CIV-00-907 (E.D. Cal. 2000)(\$18 million awarded to homeowner in mold coverage action), reprinted in Mealey’s Emerging Insurance Disputes, Nov. 22, 2000.

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