



A MILLIMAN GLOBAL FIRM

Milliman USA
Consultants and Actuaries

P&C

Perspectives
Current Issues in Property and Casualty

SPRING 2002

• 2001 – The Year in Review
page 4

An Overview of Mold-Related Litigation Against Insurers

Christine M. Fleming, Esq.

There has been a recent flurry of activity in the insurance industry surrounding the filing of mold-related claims and lawsuits. This article will provide an overview of the current status of mold-related litigation and suggest some possible responses by the insurance industry.

Two types of lawsuits have emerged from this body of claims. First, tenants and residents of homes and other buildings are suing their own insurers under first party property policies for failure to investigate and remediate mold damage resulting from covered property claims. In this article, these types of lawsuits will be referred to as “first party” cases. The second type of lawsuit is referred to as a “third party” case. In third party cases, a plaintiff files suit against a defendant, who then seeks insurance coverage under his liability policy. Several issues are common in both types of litigation.

The scientific evidence regarding the health effects of mold is not fully developed, but it suggests that only certain strains of mold are harmful to human health, and further that not everybody has an adverse reaction to these molds. These molds produce mycotoxins which can cause a toxic reaction in some humans. Mycotoxins in certain studies have been shown to have toxic effects on the liver, brain, kidneys, and heart. However, it has not been determined yet what amount and duration of exposure is needed to cause a serious health risk.

It is also not well established what kinds of illnesses may stem from exposure. Unlike asbestos, which has typical “signature” diseases uniquely connected to asbestos exposure, molds have not been shown to cause specific and identifiable illnesses. Rather, people have registered vague complaints ranging from headaches to asthma to canker sores.

Moreover, there are no biomarkers for mold. A biomarker is a chemical found in the body which can determine whether an individual has been exposed to a certain substance, such as mold.

Finally, there is little evidence that exposure to mold has long term effects. Studies have shown that when the exposed person is removed from the moldy environment, the ill effects of mold disappear. Again,

this is distinct from asbestos claims, in which exposure to asbestos has been associated with permanent injuries.

For many reasons, causation and damages are big issues in any type of mold litigation, both first party and third party, and in the investigation of mold claims by insurers. More research is needed, and more experts need to be identified and utilized to assist in sorting out these issues. Meanwhile, insurers need to develop procedures for handling these types of claims and resolving these issues in a way that protects the rights of the claimant, honors the terms of the insurance policy contract, and does not subject them to bad faith claims and punitive damage awards.

First Party Cases

In first party cases, plaintiffs typically notify their insurance company about a covered occurrence, such as water damage. The plaintiff later alleges that the insurer failed to respond in an appropriate or timely fashion to water damage, resulting in the contamination of the property by mold. The landmark case of the insurer’s first party duty is *Melinda Ballard v. Fire Insurance Exchange*. In that Texas case, plaintiff alleged that the insurance company knew about the presence of harmful mold in the affected residence but failed to warn the insured about the mold or to adequately remediate the mold. The jury returned a verdict for \$32.1 million. This award was for property damage alone, because the bodily injury evidence was excluded in that trial. Of the \$32.1 million, punitive damages and legal fees alone comprised \$20.9 million. In addition, criminal charges were brought against insurance personnel for violating child endangerment laws.

Just a half a year earlier, a California federal jury in *Anderson v. Allstate* returned a verdict of \$18.5 million to the plaintiffs. Eighteen million dollars of that award was for punitive damages. (*Anderson* has been appealed.) The plaintiffs alleged actions similar to those in the *Ballard* case (e.g., failure to warn and bad faith).

Cases such as *Ballard* and *Anderson* reinforce the well-established duty of the insurer to promptly and adequately investigate coverage and remediate first-party losses. In mold cases, this means that if

the insured makes a claim involving a covered loss that could possibly result in mold contamination, the insurer should remediate the mold, advise the insured of the risks, and make a good faith effort to minimize those risks. If these standards and duties have been recognized and practiced within the insurance industry for a long time, then what explains the alleged failure of insurers such as those in *Ballard* and *Anderson* to live up to these obligations?

Part of the problem is that mold can spread very rapidly, but mold claims can take longer to investigate than other types of property claims. When investigating mold-related claims, questions regarding causation and ensuing damages add to the complexity of the claim, lengthening the claim adjustment process. For example, coverage issues need to be resolved, because many homeowners policies exclude mold from coverage; however, they do provide coverage for mold if it results from another covered loss. The extent of the damages may also take a long time to investigate—experts may need to be retained to establish air quality levels and locations of mold sources. Meanwhile, as coverage, causation, and damage issues are being investigated, mold which was at first visible and relatively easy to eliminate has since spread into the floors, walls, and ceilings, making remediation virtually impossible without totally razing the structure.

In these types of cases, massive damage can occur in a short amount of time. What appears to be a reasonable amount of time to investigate and settle the property claim from the insurer's point of view turns out to be "unreasonable" in the context of mold claims, because such extensive damage can happen so rapidly. For example, in *Nicholson v. Metro Property Management*, a family sued the management of their condominium for mold-related property damages and injuries. Plaintiffs alleged that the vacant unit above theirs was leaking. Management waited ten days before repairing the vacant apartment; in the meantime, moisture accumulated in plaintiffs' unit, causing mold growth. Plaintiffs immediately abandoned their unit upon discovery of the mold growth. They were exposed for only eleven days, at most. A jury awarded plaintiffs over \$200,000 in a lawsuit against the property management.

Although *Nicholson* involves a lawsuit by a tenant against a property management company, and does not directly address the issue of insurance coverage or claims handling, a harsh lesson can be learned from this case. It is important for insurers to be fully informed about mold, its potential for rapid growth, and the speed at which injury or property damage can occur. Given that knowledge, insurers must act quickly and resolutely to remediate damage and communicate with claimants.

Third Party Cases

In third party cases, plaintiffs typically argue that defects in the design or construction of a building caused water damage, resulting in the spread of mold. For example, the tenant of a building may have been plagued with water intrusion from any of a number of sources. Regardless of whether the first-party property policy covers such water damage, the tenant sues under theories of tort and con-

tract. Possible defendants include owners, property managers, construction contractors, maintenance companies, architects, engineers, and product suppliers. All of these defendants then turn to their liability insurers for defense and indemnification of the claim, and as with the first party claims, the damages can be enormous.

In *Munoz v. Henry Phipps Plaza South*, residents of an apartment complex sued property owners and managers for failure to respond to complaints regarding water leaks, failure to remediate before mold spread and caused harm, and failure to warn tenants about this harm associated with mold. The Complaint as filed sought over \$12 billion in compensatory and punitive damages. (This case was later settled for a lesser amount.) In *Darren Mazza v. Raymond Schurtz*, a family who was allegedly exposed to mold in their apartment sued property owners and managers for failing to address complaints of a leaky toilet and the presence of mold. A California jury awarded plaintiffs \$2.7 million for personal injuries including respiratory problems, headaches, and gastrointestinal problems.

The liability insurer faces two potential adversarial parties: one party is the plaintiff who is pursuing the underlying claim against the insured; the other is the insured himself if there is a coverage dispute. In either situation, the insurer faces potentially devastating verdicts similar to those discussed above in the first party cases. For example, many liability policies do not permit the insured to take any voluntary action without the consent of the insurer. In that case, if the insured wishes to warn the plaintiff about the hazards of mold, remediate the property, or relocate the plaintiff, it might be considered bad faith for the insurer to unreasonably withhold consent. In that case, the insurer may be found liable for all ensuing damages plus punitive damages. As another example, if the insurer denies coverage or issues a reservation of rights letter pending an investigation of coverage, and mold damage occurs in that period of time, the insurer could be ultimately liable for those damages. Again, because mold has the potential for rapid growth, it seems that the insurer literally cannot afford the luxury of investigating the underlying claim or any coverage issues fully before taking corrective action.

Moreover, in third party cases, the insurance adjuster is in an interesting and often compromising position. He represents the defendant-insured in an adversarial setting, but he also has valuable information concerning possible harm to the plaintiff from water damage. Is the insurer's duty to the insured, to defend the claim rigorously and to not disclose anything to the plaintiffs regarding the presence of mold? Or rather is his duty to the tenant, to fully warn of potential harm and to offer relocation and other remedial assistance until the lawsuit is resolved? There are no established answers to such conflicts.

Insurer Responses to the Problem of Mold

There have been many responses to the increase in mold litigation. Some insurers have stopped writing new business. For example, in Texas the major insurance companies announced that they will no longer

write new standard homeowners policies, because of losses due to mold damage arising out of plumbing leaks and other types of covered water discharges. Insurers had also petitioned for the removal of mold from policy coverage. In response to a potential availability crisis, Texas regulators proposed amending the standard HO-B homeowners policies and other dwelling policies by including a \$5,000 cap on mold and water damage, with the opportunity for homeowners to buy additional coverage. However, this proposal was modified by the Texas commissioner, who rejected the \$5,000 cap. Instead, policies will continue to cover removal of mold caused by covered water damage, but not expensive testing, treating, containing or disposal of mold beyond basic repairs. Also, if a policyholder ignores indications of a water problem, insurers could deny coverage for the mold claim. Finally, insurers must offer additional levels of coverage for mold in amounts of 25, 50, or 100 percent of existing policy limits.

The Florida Department of Insurance is also addressing the problem of mold coverage. The National Association of Insurance Commissioners and Insurance Services Office are also working to try to develop a uniform response to the mold problem. Finally, some courts are ruling that no coverage is afforded to mold under standard homeowners policies. In Utah, for example, a federal court ruled that mold damage is specifically excluded from coverage under the policy, despite the fact that the policy covers resultant damage from water discharge. "The claimed damage is mold," the Court held. "The proposed remediation is removal of the mold....The policy expressly excludes any losses that are caused by and result from mold. The "resulting loss" clause does not resurrect the excluded peril to provide coverage." *Shirley Cooper v. American Family Mutual Insurance Co., et al.*

Regardless of the decisions made by courts and regulators, so far this area is still very much unresolved and there are certain precautions that an insurer should take in response to the mold problem. The insurer should approach the problem from both the claims handling side and the underwriting side. To avoid bad faith claims and large punitive damage awards, insurers must respond quickly when faced with a mold claim. It seems that the insurance adjuster must take corrective action appropriate to the situation, even while an investigation is ongoing. Insurers need to be particularly responsive, communicative, and prompt when dealing with policyholders and claimants. Indeed, it may make sense to carve out a section of the claims department to specialize in this type of adjusting and claim service. Company audits of the staff should be conducted periodically to help ensure that policies and procedures are being followed. Mold claims personnel should be trained in all areas

regarding mold. They should be able to identify those conditions that could cause mold growth and act on those conditions promptly. They should establish clear and frequent communications with the claimant/insured. They should document all conversations and actions promptly and completely. Finally, they should be familiar with possible coverage defenses. These could include the economic loss doctrine, late notice, pollution exclusions, coverage triggers, the known loss doctrine, and exclusions such as the "owned property exclusion." There is as yet no consistent body of law that definitively establishes coverage rights and duties with regard to these potential defenses to mold claims.

In addition to training its own staff regarding mold claims, insurers should educate its policyholders (homeowners in the case of first party property insurance, and insureds in the case of third party liability insurance). The insurer should provide clear guidelines to the building owner/insured, so that the owner can take swift and sufficient action when notified of water damage by a tenant. There should be clearly communicated guidelines to the homeowner policyholder regarding responses appropriate in water damage situations.

In the area of underwriting, insurers must be aware of their own policy provisions and apply for and make revisions as appropriate given the rise in this type of litigation. Several insurers have already thought about drafting exclusions for mold-related damages into their property and liability policies. Some insurers may consider specifically listing mold as a "pollutant" within an absolute pollution exclusion. Insurers can include, expand upon, or clarify late notice provisions. In addition, insurers may want to identify the key states where plaintiffs are successfully bringing mold claims, and include a provision that any lawsuit involving the policy be brought in an insurer "friendly" jurisdiction. As another example, insurers may want to include some sort of limiting language, caps on amounts, or absolute exclusions for mold-related claims. Despite the various ways an insurer can approach the mold problem through its underwriting department, history has taught that plaintiffs can convince courts to reinterpret policy language so that coverage applies. Thus, an insurer's best efforts at developing clear, unambiguous policy exclusions for mold-related damage may ultimately be in vain in some jurisdictions. It is therefore wise for the insurer to maintain a capable claim staff to help minimize exposure to large mold-related damage awards.

Christine Fleming is a claims management consultant in the Boston office of Milliman USA.

2001 – The Year in Review

Richard S. Biondi, FCAS, MAAA

Prior to the catastrophic events of September 11, 2001, hardening of the P&C market and new asbestos forecasts were major impacting events of 2001. Focus has now shifted to concerns regarding a “major catastrophe.”

Several estimates of expected costs of this recent disaster range from \$30-\$70 billion. In contrast, Hurricane Andrew cost \$15.5 billion in 1992, or \$20 billion in 2001 dollars. As a result of Hurricane Andrew, a dozen insurers became insolvent, insurance prices skyrocketed and coverage became more restrictive. 2001 may be different. Larger insurers and reinsurers with ample surplus are responsible for paying most of the claims. These and other insurers have stated they expect to pay all claims out of their surplus funds even though none had anticipated such a catastrophe in pricing the insurance coverages they offer. Because they have not priced for it, industry representatives have expressed concern about covering future acts of terrorism (without an unlimited pot of surplus to draw from), and are advocating the government insure future terrorist acts.

As a casualty actuary, I have long been interested in pricing for catastrophes and also loss reserving for catastrophes. However, loss reserving before the event is generally not permitted. The reason often given is that if P&C insurers were permitted to set loss reserves in advance, these reserves would be deductions against income, offering insurers substantial income tax benefits. Further, the magnitude of catastrophic reserves would be large and require the government to scrutinize the reserves from each insurer and judge whether or not they were too high, yielding excessive tax deductions.

Because insurers can't set catastrophe reserves, they are discouraged from making adequate provision for catastrophes in rates. If they do include adequate provisions for catastrophes in rates, that provision flows to taxable profit in most years with no catastrophe. In years with catastrophes, losses are tax-deductible. But given the ways that tax carry-forwards and carry-backs work, there would be an overall taxable gain—the government then collecting much of the premium charged to cover catastrophes. Thus there is a disincentive to charge adequate premium to cover future catastrophes.

Following Hurricane Andrew, Florida found a reasonable solution to this problem. A hurricane catastrophe fund was established to cover future serious hurricanes. After Andrew, all property insurers began to charge a premium to cover future hurricanes. That premium was paid to the catastrophe fund. The cat fund accumulated those funds as a reserve for future hurricanes and deductibility of those funds was permitted by statute, as was investment income on the fund balance. The reason deductibility of the fund reserves was permitted, while deductibility of each insurer's reserves would not be, was that as there was only one fund for the entire industry, it could be practically regulated by government.

The Florida fund has been accumulating since 1992. If funds are insufficient, the cat fund has statutory authority to issue a maximum amount of tax-exempt bonds after an event to raise additional money to cover a catastrophe on a retroactive basis.

I feel establishment of a federal-level fund to cover any future terrorist attack would allow the private P&C industry to play a role in insuring future terrorist attacks and further make it unnecessary for insurers and reinsurers to exclude coverage. The industry role would be capped by the fund's finite limits. The government, as our protector against terrorist attacks, would step in if the fund is ever exhausted.

Estimated losses from 9/11 can be subdivided by coverage as: property (23%), business interruption (27%), workers comp (11%), liability (23%), life (14%), other (2%). Thus, a relatively small percentage surcharge applied to countrywide (or worldwide) insurance premiums for all major lines could accrue a very large fund to cover future acts. Obviously other fund considerations such as fund size, rules to assess for payments and allocating loss payments need to be addressed.

Major insurance events of 2001 seem grim—9/11, Anthrax and other acts of terror. Couple this with many P/C insurers having an unprofitable year and a bad year for investments. As we move ahead into 2002, my best wishes to our industry...one capable of surviving and thriving. We have done it before and can do it again.

[Reprinted with permission of *The Actuarial Digest* – Copyright 2001 – *The Actuarial Digest*]

Richard Biondi is a principal and consulting actuary in the New York office of Milliman USA.

Milliman Offices

ALBANY	HARTFORD	MILWAUKEE	SALT LAKE CITY
ATLANTA	HONG KONG	MINNEAPOLIS	SAN DIEGO
BERMUDA	HOUSTON	NEW YORK	SAN FRANCISCO
BOISE	INDIANAPOLIS	OMAHA	SEATTLE
BOSTON	IRVINE	PHILADELPHIA	SEOUL
CHICAGO	KANSAS CITY	PHOENIX	TAMPA
COLUMBUS	LONDON	PORTLAND, ME	TOKYO
DALLAS	LOS ANGELES	PORTLAND, OR	WASH., D.C.
DENVER	MELBOURNE	ST. LOUIS	

Internationally MILLIMAN GLOBAL

ARGENTINA	CHINA	JAPAN	POLAND
AUSTRALIA	COLOMBIA	KOREA	SPAIN
AUSTRIA	DENMARK	LUXEMBOURG	SWEDEN
BARBADOS	FRANCE	MEXICO	TRINIDAD &
BELGIUM	GERMANY	NETHERLANDS	TOBAGO
BERMUDA	INDIA	NEW ZEALAND	UNITED KINGDOM
BRAZIL	IRELAND	NIGERIA	UNITED STATES
CANADA	ISLE OF MAN	NORWAY	
CHANNEL IS.	JAMAICA	PHILIPPINES	

P&C Perspectives is published by Milliman USA's P&C Editorial Committee as a service to our clients. Additional copies are available through any of our offices. Articles or excerpts from this publication may be reproduced with permission when proper credit is attributed to the firm and the author.

Editorial Committee
Greg Graves, Chair

Because the articles and commentary prepared by the professionals of our firm are often general in nature, we recommend that our readers seek the counsel of their attorney and actuary before taking action.

Inquiries may be directed to:
Marsha Kuykendall, Editor
1301 Fifth Avenue, Suite 3800
Seattle, WA 98101-2605
(206) 624-7940
PCperspectives@milliman.com

P&C Perspectives

Current Issues in
Property and Casualty