Stopping the growth of mold claims

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Since the year 2000, there have been more than 8000 articles written on the mold issue and I'm not likely to add anything to what has already been said. Nevertheless, PIA members have asked for an resource kit explaining how the Insurance Services Office Inc. endorsements impact mold coverage in the various lines of insurance.

Proximate cause

A mold claim normally begins with some type of water damage. For example, water damage may occur due to a windstorm, plumbing leak, fire, flood, poor construction, etc. It is generally understood that once the proximate cause of a loss has been determined, any ensuing damage from an unbroken chain of events set in motion by the proximate cause will be deemed to be loss resulting from the proximate cause. If the proximate cause of loss is a covered peril, then ensuing damage also is covered, unless it is specifically excluded. If the proximate cause of loss is an excluded peril, then ensuing damage also is excluded, unless an exception is made to cover specific ensuing damage.

Consider the application of proximate cause to a fire and the coverage of a fire policy. When a fire occurs, the firemen are called to put it out. No offense to the firemen, they're just doing their job, but their effort results in substantial collateral damage. Besides the hundreds of gallons of water they dump on the structure, they also may damage the structure with an ax to get to the fire source.

Because the policy requires the insured "to use all reasonable means to save and preserve property at and after the time of a loss," the insured has no choice but to let the firemen do their "saving" damage. There's no reason to despair, though, as the theory of proximate cause places the water damage and ax damage under coverage reserved for the peril of fire. Mold damage from the firemen's water would just be an extension of the proximate cause chain of events.

Suppose water intrudes into a structure due to shoddy construction of the roof. This cause of loss is excluded in most policies, so the ensuing damage from mold would likewise be excluded. Again, the theory of proximate cause eliminates the entire chain of events when begun by an excluded cause of loss. However, the policy may specify ensuing loss that is covered despite the excluded proximate cause, as in the case of fire damage following an earthquake.

1991 HO edition

A very interesting incongruity occurs in the 1991 edition of the ISO Homeowners Program. While the theory of proximate cause for mold claims is uninhibited in the HO-2 broad-form peril policy, it runs into obstacles in the HO-3 special perils policy. In the context of Coverages A and B, ensuing loss from a covered peril is expressly covered by the HO-3 policy unless the ensuing loss is otherwise excluded or excepted. If a plumbing system
were to discharge water, causing damage, any ensuing loss would be covered except one that was excluded elsewhere in the policy. Since mold is excluded, mold damage is not covered as an ensuing loss.

How can it be that the HO-2 policy provides better coverage than the HO-3 policy under the same circumstances? The ISO says it inadvertently dropped the coverage from the HO-3 policy in the 1991 edition, but I can't see that it was ever there, at least, going back to the 1984 edition. Changes in the 2000 policy edition create a separate excluded category for mold, fungus and wet rot (fungus is new to the exclusion). Added is an exception to the exclusion expressly stating that damage from mold, fungus and wet rot, caused by an accidental discharge of water, is covered if it is hidden and the water discharge did not emanate from a sump pump or gutters (as neither of these are covered when water discharges from them).

[I still believe the HO-3 coverage is inferior to the HO-2 coverage with regard to mold under the 2000 edition, but I will keep silent, lest I plant the seeds of "denial" in the minds of some adjusters.]

**Neglect**

Coverage for mold under the theory of proximate cause can be frustrated by the insured's lack of compliance with, at least, two policy provisions. There is the General Exclusion for the insured's neglect of property at and after the time of loss. Second, in the Conditions section of the policy, there is the duty to protect property from further damage. However, the costs incurred to protect the property are considered covered expenses according to the policy terms, relieving the insured of the monetary burden of compliance.

If the insured does not take reasonable action to prevent the growth of mold after covered water damage has occurred, there will be no coverage for damage caused by the mold. To preserve coverage for mold, the insured must promptly remove the water to eradicate the environment that promotes its growth. The expenses incurred to remove the water will be covered by the policy.

**The endorsements**

Now that we understand the theory of proximate cause and the policy provisions that determine coverage in property policies, we're ready to see how the new ISO endorsements affect that coverage.

**Personal lines.** The ISO 2000 Homeowners Program has three endorsements that insurers may use to control mold exposures. The HO 04 27 endorsement is intended to be used with the HO-3 and HO-5 forms, the HO 04 26 is used with other than the HO-3 and HO-5 forms, and the HO 04 28 is used with the HO-4 and HO-6 forms that have been endorsed with special form perils. Separate endorsements (i.e., the HO 04 31, HO 04 32 and HO 04 33 endorsements) accommodate jurisdictions that have not yet approved the 2000 program, but are still using the 1991 program (only Connecticut and Minnesota).

The objective of the ISO endorsements is to limit Section I—Property Coverages for ensuing "fungi, wet or dry rot, or bacteria" damage resulting from a covered cause of loss and place an aggregate sublimit on Section II—Liability Coverages for liability arising out of the presence of "fungi, wet or dry rot, or bacteria." Notice the inclusion of "bacteria" in these limitations; insurers don't necessarily need a personal lines "terrorism" exclusion to control the anthrax contamination exposure.

The Section I limitation is accomplished by first excluding "fungi, wet or dry rot, or bacteria," then making two exceptions to the exclusion to restore limited coverage. The first exception isolates two perils of proximate cause that are treated without a sublimit. "Fungi, wet or dry rot, or bacteria damage" resulting from fire or lightning is covered to the full extent of the property limits. No doubt, state laws that mandate the inclusion of the Standard Fire Policy provisions inspired the ISO to make this exception.
The second exception introduces an additional coverage that offers a choice of sublimits in the amount of $10,000, $25,000 or $50,000 for damage caused by "fungi, wet or dry rot, or bacteria." This is an aggregate policy sublimit; it is the most the policy pays, regardless of the number of locations insured or the number of claims made during the policy period. Also, included in the chosen sublimit are the costs of tearing out covered property to gain access to the "fungi, wet or dry rot, or bacteria," as well as the costs to remove it and test for its absence. In order for this additional coverage to apply, the damage caused by the "fungi, wet or dry rot, or bacteria" must result from an otherwise covered proximate cause (except for fire or lightning, which is addressed separately in the first exception). On the other hand, the limitation under this exception would not apply (i.e., it would be covered to the full extent of the property limits) to direct damage from a covered peril that resulted from "fungi, wet or dry rot, or bacteria."

Under Section II coverage, a liability sublimit is established for an "occurrence" that involves exposure to "fungi, wet or dry rot, or bacteria." This sublimit, which is offered in the amount of $50,000 or $100,000, applies in the aggregate for all losses during the annual term of the policy, regardless of the number of occurrences, insureds, locations or claimants.

The ISO also has introduced a similar endorsement in its Dwelling Program for use with the property coverages (DP 04 22) and another endorsement to be used when the dwelling policy has been endorsed with liability coverages (DL 24 71). In addition, the ISO makes available a total exclusion endorsement (DL 98 17) for "fungi, wet or dry rot, or bacteria" under its Personal Umbrella Program.

Commercial lines property. The ISO has implemented a limitation of coverage for "fungi, wet or dry rot, or bacteria" in much the same way as it did in the homeowners and dwelling programs. However, the exclusion and additional coverage is not offered by means of endorsement, but is incorporated into the 2002 perils forms without option. Like the personal lines endorsements, the commercial forms first exclude damage from "fungi, wet or dry rot, or bacteria," then make two exceptions that restore coverage for ensuing damage 1) from fire or lightning, without a sublimit, and 2) from a "specified cause of loss" or flood (if endorsed), with a sublimit. The built-in sublimit of $15,000 is an aggregate policy amount that is neither increased by multiple properties insured nor multiple claims made during the policy period. For additional premium, this sublimit can be increased as high as the property limit by using the Changes—Fungi, Wet Or Dry Rot, Or Bacteria (CP 04 31) endorsement. Also, the endorsement can be used to designate the sublimit as an aggregate for each premises or location.

The Building And Personal Property Coverage Form (CP 00 10) includes an additional coverage, titled Increased Cost Of Construction. While this coverage pays the increased costs incurred to comply with the enforcement of an ordinance or law in the course of rebuilding damaged property, it does not cover such costs involving contamination by pollutants. The 2002 edition of this form adds to the exclusion similar costs incurred due to the presence of "fungi, wet or dry rot, or bacteria."

Since the commercial perils forms are used with time element forms, as well as property forms, the additional coverage for "fungi, wet or dry rot, or bacteria" also addresses its application to business income and extra expense coverages. Whether the damage from "fungi, wet or dry rot, or bacteria" prolongs the period of restoration attributed to a covered proximate cause (for example, the time it takes to restore property from a water discharge), or the period of restoration is attributed only to the ensuing damage from "fungi, wet or dry rot, or bacteria," the period of restoration is limited to 30 days (they need not be consecutive days). For additional premium, the CP 04 31 endorsement may be used to step this coverage up to 60, 90, 120, 150 and 180 days.
Commercial lines liability. Only a few courts have rendered decisions on the effectiveness of the pollution exclusion in the commercial general liability policy to exclude coverage for mold claims. Case law on this exclusion is far from settled at this point in time. On the other hand, various property damage exclusions in the CGL policy may get more certain enforcement by the courts.

In the meantime, the ISO is not leaving the matter to chance. Two CGL endorsements have been created to either exclude liability for "fungi or bacteria" (GL 21 67) or limit liability for "fungi or bacteria" (GL 24 25). The CG 21 67 endorsement excludes, under Coverage A, bodily injury or property damage that would not have occurred "but for" the exposure to "fungi or bacteria" in a building or structure, as well as the costs to remove "fungi or bacteria" and test for its absence. A separate exclusion also is applicable to Coverage B—Personal and Advertising Injury Liability, in case someone alleges that contamination by mold is an "invasion of the right of private occupancy." However, by exception, the contamination of food products by "fungi or bacteria" is not excluded.

The GL 24 25 endorsement allows an insurer to specify an aggregate liability sublimit for bodily injury (including medical payments) and property damage arising from exposure to "fungi or bacteria" in a building or structure. It is implied that the costs to remove "fungi or bacteria" and test for its absence are contained within this sublimit.

Rating. The personal lines endorsements carry no rating adjustment for the basic limits, but increased limits are subject to additional premium. The commercial lines endorsements are on a "refer to company for rating" basis.

Commercial property and general liability are not the only lines that the ISO has introduced special provisions for "fungi or bacteria." Other commercial lines coverage parts and the businessowners package policy are getting similar treatment. What seemed like an out-of-control exposure a few months ago is now getting some predictability with new policy provisions, additional premium and some protection against the big "bad faith" verdict.

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