

**WHAT'S HOT IN
CONSTRUCTION RISK MANAGEMENT SEMINAR**

MOLD, THE NEXT ENVIRONMENTAL PERIL

Presented by

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Mr. O'Neill is one of four panelists for Monday's "What's Hot in Construction Risk Management?" seminar and is a copresenter for Miniseminar K, "Hard Market Risk Finance Alternatives." He has been involved in the construction insurance industry for more than 25 years. He is president of ACIG Insurance Agency, Inc., a construction-industry-owned insurance organization in Dallas. Mr. O'Neill is a frequent speaker for construction industry trade associations; he has spoken 10 times at the Construction Risk Conference and was a previous Words of Wisdom Award winner. His expertise lies in the areas of captive management, risk management, retention analysis, contractual risk transfer, development of specialized coverage, and risk funding programs. Mr. O'Neill has written many articles for construction industry publications, including AGC, CFMA, and *Engineering News Record*.

MOLD, THE NEXT ENVIRONMENTAL PERIL

***Michael J. O'Neill, CPCU, ARM
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- I. Ripe for Media Hype**
- II. Ed McMahon's Mold Litigation**
- III. Molds Impact on Pricing and Availability of Coverage**
- IV. Molds: A Fact of Life**
- V. Toxic Molds**
- VI. Homeowners Claims**
- VII. Commercial and Industrial Claims**
- VIII. Commercial General Liability Coverage**
- IX. Standard Pollution Exclusions**
- X. Non-Standard Pollution Exclusions**
- XI. Mold as a "Pollutant"**
- XII. Completed Operations Exception**
- XIII. CGL Policy Definitions**
- XIV. Applicable Trigger of Coverage**
- XV. Insurance Industry Response**
- XVI. Mold Prevention Procedures**
- XVII. Quality Assurance Program**
- XVIII. Pollution Liability Policies**
- XIX. Summary**

Notes

This file is set up for duplexed printing. Therefore, there are pages that are intentionally left blank. If you print this file, we suggest that you set your printer to duplex.

MOLD, THE NEXT ENVIRONMENTAL PERIL

Toxic Mold – Ripe for Media Hype

- **Over 8,000 “Toxic Mold” articles since 2000**
Insurance Information Institution – Nexis Search
- **“We’ve Got Killer Mold”**
New York Daily News, September 10, 2001
- **“Lurking, Choking, Toxic Mold”**
New York Times Magazine, August 12, 2001
- **“Haunted by Mold”**
New York Times Magazine, August 12, 2001

Toxic Mold – Ripe for Media Hype

- **“Beware Toxic Mold”**
Time Magazine, July 2, 2001
- **“Insurers, Builders Criticized Over Mold”**
Austin American Statesmen, June 27, 2001
- **“Insurers Blanch at Proliferation of Mold Claim”**
Wall Street Journal, June 3, 2001

Insurer Must Pay Family \$32MM
San Antonio Express News
June 11, 2001

2002 Headlines

- **“Mold Claims Soar”**
***Miami Herald*, July 29, 2002**
- **“State Farm Halts New Policies in Florida”**
***Tampa Tribune*, June 29, 2002**
- **“Can Toxic Mold Spoil a Stock Offering”**
***Business Week*, April 29, 2002**
- **“State Farm Won’t Write New Homeowners Policies in California”**
***Los Angeles Times*, April 23, 2002**
- **“Some Insurers Ending Coverage for Home Builders”**
***Minneapolis Star Tribune*, February 16, 2002**

2002 Headlines

- **“Ed McMahon Sues Over Toxic Mold Invasion”**
USA Today, April 11, 2002
 - Filed \$20MM suit against his insurance company and mold remediation contractor.
 - Says mold sickened him, his wife and their household staff.
 - Says mold killed the family dog.
 - Alleges breach of contract and intentional infliction of emotional distress.

Molds Impact on Pricing and Availability of Coverage

- Large ALAE costs (up to 100% of claim).
- Homeowners frequency/severity up by 1,300% to 1,800%.
- Texas mold costs \$854MM in 2001.
- Homebuilders (single and multi-family) affected.
- Real estate sales have been impacted.

Molds: A Fact of Life

- **Molds – members of a family of plants known as fungi – are everywhere in the world.**
- **Molds are in the air we breath.**
- **Molds are in the foods we eat, Bleu cheese, Roquefort Cheese.**
- **Mold are in the wines we drink.**
- **Molds play an important role as part of nature regeneration. Cleaning up dead or decaying materials.**

Molds: A Fact of Life

- **Molds have existed for more than 400 million years.**
- **Over 100,000 species have been identified.**
- **Molds – contain no chlorophyll, they reproduce thru spores.**
- **Mold growth needs**
 - **Food Source (virtually any organic substance)**
 - **Moisture**

Toxic Molds

- Toxic molds do exist and pose health risk.
- Toxic mold is a mold that regularly produces toxic compounds.
 - Stachybotrys Chartarum
 - Aspergillum
 - Alternaria
 - Acremonium
 - Cladosporium
 - Fusarium
 - Pennicium
 - And Others

Stachybotrys – Alleged Ill Effects

- Burning eyes
- Headache
- Nausea
- Nose bleed
- Allergic reactions
- Asthma
- Exhaustion
- Sinus infections
- Cognitive disorders
- Brain damage
- Cancer
- Death

Homeowners Claims

- **Texas jury awarded \$32MM against the homeowners insurance company, Farmers Insurance Group.**
- **Plumbing leaks led to mold infestation, including stachybotrys, a variety thought to be toxic.**

Homeowners Claims

- **Allegations against Farmers included:**
 - **Negligence**
 - **Negligent misrepresentation**
 - **Fraud**
 - **Breach of contract in failing to timely and adequately respond to the claim**
 - **Home was decontaminated, razed and rebuilt**
 - **Homeowners had sought \$100MM**
 - **Medical testimony was not allowed**
 - **Award of \$32MM included mental anguish and punitive damages**

Commercial and Industrial Claims

Is mold the next environmental peril?

- That is the question being asked by underwriters.
- Media attention will lead to more employee fears of mold-related health problems.

Commercial and Industrial Claims (cont.)

One high profile California case.

- Krant vs. Tulare County
- Lead plaintiff is a state district court judge.
- Allege defects in the HVAC system and curtain wall systems.
- Growth of stachybotrys and resulting serious bodily injury.

Commercial and Industrial Claims (cont.)

One high profile California case.

- **Over 100 county employees have filed suit against Tulare County.**
- **Allegations against the county include fraud and concealment.**
- **Other defendants include the construction manager, general contractor, various subcontractors and designers.**
- **Allegations against the construction defendants include construction defects, negligent construction and design.**

Commercial and Industrial Claims (cont.)

One high profile California case.

- **Illustrates the potential dangers of these mold suits.**
- **Built in 1988 - claim first alleged in 1998.**
- **Mold can develop over an extended period of time.**
- **Comparison to other long-trail claims, such as asbestos.**

CGL Coverage

- **As with most construction defect cases, litigation involves the contractors commercial general liability policy (CGL).**
- **Since mold claims involve the release of spores into the environment.**
- **These claims raise unique issues with respect to the pollution exclusion.**

Standard Pollution Exclusions

1973 language - exception for "Sudden & Accidental"

- f. **To bodily injury or property damage arising out of the discharge, dispersal, release or escape of smoke, vapors, soot, fumes, acids, alkalies, toxic chemicals, liquids or gases, waste materials or other irritants, contaminants or pollutants into or upon land, the atmosphere or water course or body of water; but this exclusion does not apply if such discharge, dispersal, release or escape is sudden and accidental.**

Standard Pollution Exclusions (cont.)

1988 Form - "Absolute Pollution Exclusion"

- f. 'Bodily injury' and 'property damage' arising out of the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants:
- (a) At or from any premises, site or location which is or was at any time owned or occupied by, or rented or loaned to, any insured;
 - (b) At or from any premises, site or location which is or was at any time used by or for any insured or others for the handling, storage, disposal, processing or treatment of waste;
 - (c) Which are or were at any time transported, handled, stored, treated, disposed of, or processed as waste by or for any insured or any person or organization for whom you may be legally responsible; or

Standard Pollution Exclusions (cont.)

1988 Form - "Absolute Pollution Exclusion" (cont.)

- (d) At or from any premises, site or location on which any insured or any contractors or subcontractors working directly or indirectly on any insured's behalf are performing operations:
- (i) if the pollutants are brought on or to the premises, site or location in connection with such operations by such insured, contractor or subcontractor; or
 - (ii) if the operations are to test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants.

Subparagraphs (a) and (d)(i) do not apply to 'bodily injury' or 'property damage' arising out of heat, smoke or fumes from a hostile fire.

As used in this exclusion, a hostile fire means one which becomes uncontrollable or breaks out from where it was intended to be.

Standard Pollution Exclusions (cont.)

1988 Form - "Absolute Pollution Exclusion" (cont.)

- (2) Any loss, cost or expense arising out of or any:
- (a) Request, demand or order that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants; or
 - (b) Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of pollutants.

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

Standard Pollution Exclusions (cont.)

1988 – Absolute Pollution Exclusion

- Terminology is misleading
- Coverage for certain "off-site" pollution releases
- Exception to the Exclusion for Bodily Injury or Property Damage within the "Products Completed Operations Hazard."

Pollution Exclusions

Other Pollution Exclusions

Non-Standard Exclusion – “Total Pollution Exclusion”

- f. (1) **‘Bodily injury’ or ‘property damage’ which would not have occurred in whole or part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time.**
- (2) **Any loss, cost or expense arising out of any:**
 - (a) **Request, demand or order that any insured or others test for, monitor, clean up, remove, contain, treat, detoxify or neutralize, or in any way respond to, or assess the effects of pollutants; or**

Pollution Exclusions (cont.)

Other Pollution Exclusions (cont.)

Non-Standard Exclusion – “Total Pollution Exclusion”

- (b) **Claim or suit by or on behalf of a governmental authority for damages because of testing for, monitoring, cleaning up, removing, containing, treating, detoxifying or neutralizing, or in any way responding to, or assessing the effects of pollutants.**

Pollutants means any solid, liquid, gaseous, or thermal irritant or contaminant including smoke, vapor, soot, fumes, acid alkalis, chemicals and waste. Waste includes material to be recycled, reconditioned or reclaimed.

Pollution Exclusions

Other Pollution Exclusions (cont.)

- **Broader in scope than the 1986 Pollution Exclusion.**
- **Applies to “Products-Completed Operations Hazards.”**

Mold as a “Pollutant”

- **The case law in this area is evolving.**
- **Contractor claims for defense and indemnity may be triggered by a direct action or as a subrogation action.**
- **Case law directly addressing mold as a “pollutant” is very scarce.**
- **One case - Stillman vs. Charter Oak Fire Insurance Co.**
- **The court was hesitant to classify airborne mold, fungus or other organisms as “pollutants.”**
- **1973 Exclusion - no definition of “pollutants.”**

Pollutant Defined

- **Advent of the 1986 Pollution Exclusion the term, “pollutant” was specifically defined.**

Pollutants means any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals and waste. Waste includes materials to be recycled, reconditioned or reclaimed.

Pollutant Defined (cont.)

- **Even with the addition of the definition of the term pollutants.**
- **Courts continue to quarrel with the issue.**
- **Keggi vs. Northbrook Prop. & Casualty Ins. Co.**
- **Case involved bacteria found in the water from the municipal water system.**
- **Court ruled that the pollution exclusion was intended to preclude coverage for environmental pollution and “not for all contact with substances that can be classified as pollutants.”**
- **Insureds will rely upon the Keggi case in arguing that naturally occurring mold, do not constitute the type of substances which are the target of the pollution exclusion.**

Construction Materials and Operations

- **Construction operations can produce fumes and vapors.**
- **Courts have reached varying results in determining if injuries caused by such emissions are within the pollution exclusion.**
- **One of the key issues is whether the substance is a “pollutant” under the facts of the claim.**

Construction Materials and Operations (cont.)

- **Wide disparity in court decisions as to what constitutes a “pollutant” makes it very difficult to guess how the mold issue will be resolved.**
- **Mold source usually results from an innocuous source (i.e., water, rather than some toxic or poisonous chemicals).**
- **Mold is a micro organism and does not really fit with substances that are defined as pollutants.**

The Pollution Exclusion – Products – Completed Operations Exception

- **Completed operations coverage is included as part of the CGL policy.**
- **Provides protection against liability arising out of services, materials or structures which contractors erect or install.**
- **Analogous to products liability for companies that produce or manufacture goods.**

CGL Policy Definitions

The CGL policy defines “products-completed operations hazard” as follows:

- a. **‘Products-completed operations hazard’ includes all ‘bodily injury’ and ‘property damage’ occurring away from premises you own or rent and arising out of ‘your product’ or ‘your work’ except:**
 - (1) Products that are still in your physical possession; or**
 - (2) Work that has not yet been completed or abandoned.**

CGL Policy Definitions (cont.)

b. 'Your work' will be deemed completed at the earliest of the following times:

- (1) When all of the work called for in your contract has been completed.
- (2) When all of the work to be done at the site has been completed if your contract calls for work at more than one site.
- (3) When that part of the work done at a job site has been put to its intended use by any person or organization other than another contractor or subcontractor working on the same project.

Work that may need service, maintenance, correction, repair or replacement, but which is otherwise complete, and will be treated as completed.

CGL Policy Definitions (cont.)

- Completed operations coverage is critical for a contractor since it provides protection for bodily injury and property damage arising out of the work once it has been completed.
- 1986 Pollution Exclusion regarded by the ISO and other insurance industry experts as not applying to completed operations exposures of contractors.

CGL Policy Definitions (cont.)

- **Tufco Flooring Case - Floor resurfacing completed two days before the damage was discovered, contamination of chickens at the processing plant with styrene from the resurfacing.**
- **Mold infestations arising out of leaks in buildings or defective equipment take place over time.**
- **It is most likely that bodily injury or property damage would not occur until after a contractor has completed the project or its work at the site.**

Applicable Trigger of Coverage

- **Some states, like Texas, follow a manifestation theory - the policy triggered is the one in effect when the property damage manifests.**
- **Other states notably, California, may allow a multiple trigger theory. All policies are triggered from the date of installation through discovery.**
- **Discover trigger - policy is triggered when discovery of damage is known.**

How will the insurance industry respond?

- The increase in mold related litigation may have a similar result as the asbestos litigation.
- Mold exclusions are being drafted and filed.
- No standard ISO mold exclusions have been developed yet.

Fungus Exclusion (Example I)

Section V. Exclusions is amended by adding the following exclusion to the policy:

This insurance does not apply to “bodily injury”, “property damage”, “personal injury”, “advertising injury” or any other loss, injury, damage cost or expense, including, but not limited to, losses, costs or expenses related to, arising from or associated with clean-up, remediation, containment, removal or abatement, caused directly or indirectly, in whole or in part, by:

- a. Any “fungus(1)”, mold(s), mildew or yeast, or
- b. Any “spore(s)” or toxins created or produced by or emanating from such fungus(l), mold(s), mildew or yeast, or

Fungus Exclusion (Example I) (cont.)

- c. Any substance, vapor, gas, or other emission or organic or inorganic body or substance produced by or arising out of any “fungus(l)”, “mold(s)”, mildew or yeast, or**
- d. Any material, product, building component, building or structure, or any concentration of moisture, water or other liquid within such material, product, building component, building or structure, that contains, harbors, nurtures or acts as a medium for any “fungus(l)”, mold(s), mildew, yeast, or “spore(s)” or toxins emanating therefrom,**

Regardless of any other cause, event, material, product and/or building component that contributed concurrently or in any sequence to that loss, injury, damage, cost or expense.

Fungus Exclusion (Example I) (cont.)

For the purposes of this exclusion, the following definitions are added to the Policy:

“Fungus(l)” includes, but is not limited to, Any of the plants or organisms belonging to the major group Fungi, lacking chlorophyll, and including molds, rusts, mildews, smuts and mushrooms.

“Mold(s)” includes, but is not limited to, any superficial growth produced on damp or decaying organic matter or on living organisms, and fungi that produce molds.

“Spore(s)” means any dormant or reproductive body produced by or arising out of any “fungus(l)”, “mold(s)”, mildew, plants, organisms or microorganisms.

ALL OTHER TERMS AND CONDITIONS REMAIN UNCHANGED.

Fungus Exclusion (Example 2)

This insurance does not apply to:

- 1. 'Bodily injury', 'property damage', 'personal or advertising injury' or 'medical payments' arising out of, resulting from, caused by, contributed to, attributed to, or in any way related to any fungus, mildew, mold or resulting allergens;**
- 2. Any costs or expenses associated, in any way, with the abatement, mitigation, remediation, containment, detoxification, neutralization, monitoring, removal, disposal or any obligation to investigate or assess the presence or effects of any fungus, mildew, mold or resulting allergens; or**
- 3. Any obligation to share with or repay any person, organization or entity, related in any way to items 1 and 2.**

Pollution Liability Policies

- These policies take on many forms, e.g., Pollution Legal Liability Insurance, Contractors Pollution Liability policy.**
- Need to address the definition of pollution conditions.**
- Amend the definition to include "mold".**
- One insurer offers a "Microbial Matter" Endorsement that modifies the definition of pollution conditions to include mold.**

Mold Prevention Procedures

- **Cannot eliminate the molds food sources from the construction project.**
- **Shift our attention to the other key ingredient for mold growth – “Moisture”.**
- **Prevent the exposure of interior building products to exterior conditions. Proper sequencing is the key.**
- **Proper design, construction and maintenance of the buildings mechanical systems.**
- **Maintain the integrity of the building envelope. Proper design, installation and maintenance of:**
 - **Doors**
 - **Windows**
 - **Parapet elements**
 - **Roofing systems**

Quality Assurance Program

- **Build the structure in complete compliance with plans and specifications.**
- **Correct any flaws or defects in the plans and specifications as respects water intrusion.**
- **Documenting the steps in the construction process, photographs, videos.**
- **Goal is a high-quality water tight building.**

Summary

- **Leading underwriters are focusing on mold exposures in their underwriting.**
- **Easier to exclude than to take the risk.**
- **Specialty underwriters will have the flexibility to develop an insurance product to address mold claims.**
- **Proceed carefully.**
- **Communicate the exposures, risks and insurance available to management.**
- **Institute detailed quality assurance standard for all projects to reduce the mold exposure.**