

REAL ESTATE UPDATE
OCTOBER 2004

Property Owners To Swallow A Toxic Pill - Insurance Coverage May Offer No Relief To Property Owners In Mold Litigation

While panic and alarm are not warranted, the time is now for real estate owners, developers, lenders and borrowers to begin to pay attention to toxic mold and their potential liability for property damage or personal injury. Though the nationwide mold discussion chronicles back to 1995, when the Centers for Disease Control linked a cluster of child-deaths in Cleveland to black mold, new momentum is pushing the toxic mold issues to the forefront. Verdicts have fallen on the shoulders of insurance companies and property owners alike, leaving them to bear costs associated with the multi-million settlements. A rash of recently published articles heralding an impending public health crisis and a litigation explosion have appeared in *New York Magazine*, *The New York Times*, *Time Magazine* and *the Wall Street Journal*.¹ There are experts on every side of the issue claiming either that mold does not cause illness or that mold litigation is going to be as costly as asbestos litigation. It is undeniable that the mold debate is highly controversial, but it is still questionable whether mold litigation is going to take off in New York. While the debate lingers on, recent multi-million dollar verdicts and settlements make a thoughtful discussion on mold timely.

Currently there is no coverage for mold in most of today's standard insurance policies. It is available for purchase, but typically at exorbitant prices. Obtaining mold coverage is advisable in certain, but not all, circumstances. This article will address the factors that real estate owners, developers, lenders and borrowers should consider when assessing their exposure to mold litigation and whether or not to purchase mold liability coverage.

Assessing the Threat of Toxic Mold Liability

Toxic mold, *Stachybotrys chartarum* or black mold, naturally grows in indoor environments where there is constant moisture; it can grow on material with a high cellulose and low nitrogen content, like fiberboard, gypsum board, paper, dust, and lint.² Mold cases typically arise when a leak, water damage, excessive humidity, condensation or flooding give way to a condition that supports the growth of mold that, in turn, causes property damage or personal injury. Claims usually allege negligence, strict liability, implied and express contract, constructive eviction, breach of contract, and/or nuisance.³ Property owners can also be found liable on a theory of constructive notice where they should have known of the defect.

Mold-related illness claims may be more difficult to prove. Mold can be distinguished from other injury-causing toxins, like asbestos, for reasons that make mold liability lawsuits potentially less damaging. First, the CDC and the bulk of scientific research have been unable to prove a causal link between mold and the injuries complained of by plaintiffs.⁴ This makes liability more difficult to prove. Second, unlike asbestos, mold-related illnesses have a shorter latency period, illness is usually immediately apparent, and any injury is usually not as severe or permanent. Third, there are currently no federal or state regulations regarding safe or unsafe levels of mold.⁵ Finally, unlike asbestos, mold was never a useful product created by a manufacturer that contained a harmful toxin so proving liability becomes more tenuous.⁶

¹ Williams, Alex. *Spore War*, NEW YORK MAGAZINE, Mar. 8, 2004 at 42; Mark Yagerman & Joel Simon, *Got Mold?*, NEW YORK LAW JOURNAL, Jul. 10, 2002.

² *Questions and Answers on Stachybotrys chartarum and other molds*, Centers for Disease Control, <http://www.cdc.gov/nceh/airpollution/mold/stachy.htm>.

³ Yagerman, *supra* note 1.

⁴ CDC, *supra* note 2.

⁵ Margolis, Kevin D. *Mold Is Here to Stay*, THE NATIONAL LAW JOURNAL, Jun. 12, 2003.

⁶ Stewart, William F. *Mold and You: An Introductory Guide to Mold Claims for Insurance Professionals*, MEALEY'S LITIGATION REPORT: INSURANCE, vol. 15, iss. 46, Oct. 9, 2001.

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Given the lack of a clear standard for assessing mold-related claims, defeating a mold liability suit is not a sure thing. In recent years, there have been significant, multi-million dollar verdicts and settlements for mold-related property damage and personal injuries. In late 2003, one of the nation's largest real estate investment trusts, Archstone-Smith, settled a class action suit where an improperly executed renovation of the building's heating, ventilation and air-conditioning system allowed harmful mold to spread throughout the building.⁷ All class members' damages were awarded in the settlement, including: a portion of their rent obligations; \$3,000 to each in 'aggravation damages'; and 2.5 times actual expenses for certain medical conditions.⁸ In their [2004?] filings with the Securities Exchange Commission, Archstone-Smith admits that the total repair, settlement and related costs in the case could reach \$25 million.⁹

Property owners have also been forced to outlay significant sums on mold abatement or defending mold litigation suits. One of the world's largest hotels, the Hilton Hawaiian Village, expects to spend \$55 million to rid 453 rooms of potentially dangerous mold.¹⁰ In the Fall of 2003 in New York, Bianca Jagger, Mick Jagger's former wife, became a 'toxic avenger' and sued her landlord for \$20 million for mold damage and personal injury in her Park Avenue apartment.¹¹ The results of this suit are pending.

Fearing a debilitating litigation boom, insurance companies have caught on and more than thirty-five states, including New York, have successfully lobbied insurance regulators to permit insurers to exclude mold coverage in their policies.¹² Increasingly, insurance contracts now contain mold exclusions, cap payments or offer mold coverage as an add-on to general coverage. Partially as a result of the insurance companies bowing out and partially as a result of a more aggressive plaintiffs' bar, property owners are increasingly being named as defendants.¹³

Real Estate Transactions & Response to Mold Litigation

In addition to the recent litigation, the nature of real estate transactions has also changed with the rise or threat of mold litigation. Lenders and buyers should be cognizant of whether mold is a potential issue when inspecting a building; this is a fact-specific inquiry that should take into consideration the location of the property, the climate, and the extent of successful mold litigation in that jurisdiction's courts.

Another new development in real estate transactions is that lenders are increasingly requiring borrowers to institute operations and management programs for mold management at their facilities and continuously verify that they are in compliance with training maintenance and routine inspections.¹⁴ However, lenders have not gone so far as to require mold coverage as a routine condition to funding a loan. In any event, the threat of mold litigation should not be overstated with regard to its effect on real estate transactions. As long as parties pay attention to the likelihood of mold becoming a problem and determine how to share the risk, mold need not be the downfall of a real estate transaction.

⁷ Doris, Tony. *Mold Class Action Results in Multimillion-Dollar Settlement*, MIAMI DAILY BUSINESS REVIEW, Nov. 26, 2003.

⁸ *Id.*

⁹ *Id.*

¹⁰ Margolis, *supra* note 5.

¹¹ Williams, *supra* note 1, at 42.

¹² Amon, Elizabeth. *As Toxic Mold Suits Grow, Insurers Go*, THE NATIONAL LAW JOURNAL, Oct. 25, 2002.

¹³ Perrone, Patrick J. *Property Owners Must be Vigilant about Mold*, REAL ESTATE WEEKLY, Dec. 19, 2001.

¹⁴ Margolis, *supra* note 5.

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What to Consider When Mold is Found

In the event of a mold discovery, prompt remediation of contaminated materials and infrastructure repair are the most important primary response for property owners. After recognizing the need for remediation, a property owner must consider a few additional factors. First, there are no federal, New York State or New York City regulations for remediation, but the New York City Department of Health and Mental Hygiene guidelines can provide a helpful framework.¹⁵ Second, in addition to there being no regulations, there is also no certification process for remediation specialists, so property owners should take caution in selecting such professionals. A remediation specialist should have adequate technical background and experience and should, at the very least, be a certified industrial hygienist experienced with mold who carries adequate errors-and-omissions insurance.¹⁶

Whether or Not to Purchase Mold Coverage

Property owners should determine whether their current insurance will provide coverage in the event of a mold claim. Unfortunately, there is no easy litmus test. Whether coverage for a mold claim is excluded by the terms of a policy is a daunting process, one with which the courts have been struggling. A successful claim for coverage will require that the insured prove, *inter alia*, that the loss occurred during the coverage period, that there is no mold exclusion and, if there is a pollution exclusion, that it does not bar coverage. Even where coverage is found, property owners could be held liable under owned-property exclusions. Property owners should pay particular attention to the exclusions in their insurance policies and anticipate insurers' defenses. For example, if there is a pollution exclusion, the insurer will likely argue that mold is a pollutant permitting the insurer to deny coverage.¹⁷ However, a 2003 New York Court of Appeals decision makes this defense more tenuous for insurers by requiring that the exclusion be unambiguous in its application to mold before an insurer may deny coverage based on such pollution exclusion.

¹⁸ Property Owners should also be cognizant of "business risk" and "owned property" exclusions, as well as "trigger of coverage" definitions. Waiting for a judicial determination of coverage may not be palatable for some property owners who will prefer to protect themselves by procuring the coverage. If a property owner anticipates being susceptible to a mold claim, purchasing mold coverage should be considered. The best time to think about buying mold coverage is during a renovation or other development when the property owner or developer can oversee and assess the risk that may be lurking behind the walls.

Owners Can Pre-Empt Exposure to Mold Litigation

Real estate professionals - property owners, lenders, and borrowers - should realize that mold need not necessarily be an impending public health crisis or a litigation explosion. Property owners can manage the risk of mold and prevent litigation by (1) sharing the mold risk in real estate transactions, and (2) developing policies and procedures for dealing with leaks and mold in practice.

¹⁵ *Guidelines on Assessment and Remediation of Fungi in Indoor Environments*, New York City Dep't of Health & Mental Hygiene, Bureau of Envi. & Occup. Disease Epidemiology, <http://www.nyc.gov/html/doh/html/epi/moldrept1.html>.

¹⁶ Margolis, *supra* note 5.

¹⁷ U.S. courts are currently split on whether the absolute pollution exclusion applies when injuries result from exposure to indoor toxic pollutants. Stewart, *supra* note 6; See, Belt Painting Corp. v. T.I.G. Insurance Co., 100 N.Y.2d 377 (New York 2003) (New York Court of Appeals finds in favor of insured because pollution exclusion did not clearly and unequivocally exclude a personal injury claim arising from indoor exposure to the insured's stripping and painting work in an office building).

¹⁸ *Id.*

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Property owners should have a realistic handle on the threat of mold litigation. The verdict and settlements numbers may be staggering, but considering the reality of the situation, mold litigation is largely preventable. Early detection and rapid response to potential mold-causing conditions are the key to preventing costly liability. Property owners should take care to ensure that tenants report leaks, that building managers take leak reports seriously, and that they act quickly to remediate the conditions. One way to do this is to include an information disclosure statement in a lease which will put tenants on notice for potential mold growth and requires them to disclose any leaks or water damage.¹⁹ Well-informed tenants, maintenance personnel and management, coupled with well-documented maintenance and inspection can halt potentially dangerous and costly mold situations in nearly every case.

Herrick, Feinstein's Insurance practice has significant experience advising property owners about their insurance needs and can provide guidance to owners navigating through the insurance procurement process. For further information about mold litigation, or any other insurance litigation related issues, contact Elliott Kroll, (212) 592-1494 or ekrol@herrick.com, or Carl Schwartz (212)592-1416 or cschw@herrick.com.

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¹⁹ Stewart, *supra* note 6.