MOLD AND INSURANCE

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What is Mold?

Molds – a type of microscopic fungus – are found in virtually every ecosystem in every climate on earth. They have existed in the natural environment for hundreds of millions of years and humans have co-existed in the presence of mold and other fungi throughout the entirety of their evolution. Molds and other fungi are used in the production of everything from foods to medicines.

There are more than 100,000 species of fungi of which at least 1,000 are common in the United States. According to the Centers for Disease Control and Prevention (CDC), mold can be found almost everywhere, and will grow indoors where there is moisture. Some of the most commonly found species are Stachybotrys, Cladosporium, Penicillium and Aspergillus.

While some mold species can damage property if unchecked and some can affect people with allergies and immune deficiencies, exposure to mold only rarely results in health problems. Common health concerns arising from exposure to mold include hay-fever-like allergic symptoms, according to the CDC. Certain individuals with chronic respiratory disease may experience difficulty breathing when exposed to some molds, and people with immune suppression disorders or underlying lung disease are more susceptible to fungal infections.

The CDC states that "there are very few case reports that toxic molds (those containing certain mycotoxins) inside homes can cause unique or rare health conditions such as pulmonary hemorrhage or memory loss. These case reports are rare, and a causal link between the presence of the toxic mold and these conditions has not been proven". However, because some molds can be a problem for some people, the CDC along with other agencies such as Environmental Protection Agency (EPA) and Federal Emergency Management Agency (FEMA) advises homeowners to clean up mold growth as soon as it appears.

Mold may have been around approximately 400 million years, but its entry onto the litigation scene is relatively recent. According to reinsurance intermediary Guy Carpenter, there were at least 10,000 "toxic" mold cases filed in the United States and Canada in 2001, of which around half were filed against insurance companies for bad

faith (Exhibit 1). A report published in the Environmental Claims Journal in the Summer of 2002[1] described mold as a litigation "perfect storm" and attributed its escalation to a number of factors including a few high-profile plaintiffs, the ingenuity of the plaintiffs bar, intense media coverage and uncertain science.

The Economics of Mold

Before 2000, the few mold-related claims that insurers did see were generally handled for a few thousand dollars. In only two years, claims costs have skyrocketed. Today, homeowners claims can reach $100,000 or more and the cost of some commercial claims can run well into the millions. The typical homeowners mold claim now costs $15,000 to $30,000 to handle, compared with $3,000 to $4,000 for the average homeowners claim not involving mold.

The national cost of mold is difficult to track because most insurers don't separate mold from water damage claims, but the latest estimates clearly show that mold is a multibillion dollar problem for insurers and therefore for the policyholders. US insurers paid out at least $3 billion in mold-related claims in 2002, more than double the $1.3 billion paid the previous year.

Texas, which is widely recognized as mold's "ground zero," accounted for the majority of all mold claims. It is estimated that Texas insurance companies have paid out just under $4 billion for mold claims in the past three years. According to the Insurance Council of Texas, mold claims in the state grew from $420 million in 2000 to just over $1 billion in 2001 to $2.2 billion (for 227,000 claims) in 2002. A special study by the Texas Department of Insurance found that the number of such claims increased by 1,300 percent between the beginning of 2000 and the end of 2001 (Exhibit 2 and 3). Water damage losses as a percentage of total homeowners losses in the state also shot up between 2000 and 2002, clearly reflecting the impact of mold. TDI figures show water damage losses per policy increased by 320 percent from 2000 through 2002 (Exhibit 4). Claims and payouts peaked in July 2002 because newly introduced policies either limit or exclude mold as a covered cause of loss (Exhibit 5).

[1] *Randy J. Maniloff, "Mold: The Hysteria Among Us", Environmental Claims Journal/Vol. 14, No. 3/Summer 2002.*

Mold Publicity

Perhaps the most significant mold case to-date involved an award in excess of $32 million by a Texas jury that found the insurer guilty of bad faith, fraud and failure to disclose that mold had been found on the plaintiffs' property. None of the $32 million awarded to the homeowner was for bodily injury allegedly caused by the presence of mold. A state appeals court in Texas later reduced the award to $4 million plus interest and legal fees. Nonetheless the landmark case led to intense media coverage, which increased public anxiety over an unproven link between mold and human health.

Another case that generated enormous publicity was the $20 million lawsuit filed by television personality Ed McMahon against several companies in April 2002. The suit alleged that the insurer and adjusters inadequately handled remediation of mold following a burst pipe in McMahon's Beverly Hills, California home. McMahon also alleged that he and his wife suffered severe mold-related injuries as a result of the defendants' negligence and that mold infestation was a contributing factor in the death of their pet dog. The case has since been settled for $7.2 million.

Yet another high-profile case involved environmental activist Erin Brockovich who filed a lawsuit against the builder and former owner of her million dollar California home, alleging that construction defects led to the presence of high levels of mold which resulted in huge repair costs as well as health problems for her and her daughter.

As publicity over the mold issue has intensified, more mold claims have been filed in other states. In California, there has been a surge in water damage claims, both in terms of frequency and costs, reflecting the state's growing mold problem. Homeowners filed more than 114,000 such claims in 2002, representing one-third of all homeowners claims and payouts. According to the Insurance Information Network of California, water losses paid have been on a steady upward trend since 1997, rising 151 percent to $562.4 million in 2002 from $224.1 million in 1997 (Exhibit 6). The cost of the average water loss in California has surged by 33 percent since 2001 and is up 156 percent since 1998 (Exhibit 7). The numbers are also growing rapidly in Arizona, Florida, Illinois, Pennsylvania and Nevada.

Fears Reduced

The first media reports on the mold issue in 2000 and 2001 were characterized to a large degree by excitement bordering on hysteria. Vivid articles would frequently focus on unsubstantiated ill-health effects which mold was alleged to have caused, in effect warning every homeowner to fear for their families' lives. Since then the media frenzy has peaked, and there has been a marked shift in the content of media coverage.

By the end of 2002, press reports usually included recognition of the uncertain scientific basis for many claims of permanent injury from household mold, and urged people not to panic. The clear connection between the cost of mold claims and rising homeowners rates is now a part of most stories on the subject. More media is focusing on those who are profiting from mold fear, and there is more interest in better science. Seeking to avoid becoming the next Texas, some 40 state insurance departments have now approved mold exclusions and/or limitations on homeowners insurance policies. California passed the Toxic Mold Protection Act of 2001 to define permissible exposure limits for indoor molds and to develop new standards to assess, among other things, what health threat may be posed by the presence of molds. Most important, individuals are less susceptible to hysteria and more inclined to take action to clean up molds before they spread.

Commercial Lines & Mold

While the homeowners mold crisis may well have peaked in 2002, the migration of the problem to areas of commercial insurance has the potential to affect many more lines of business, such as commercial property, commercial liability, products liability, builders risk/construction defects and even workers' compensation (Exhibit 8). Insurers of apartments/condos/co-ops, office structures, schools, and municipal buildings face the prospect of rising claims, as building managers and owners, architects and engineers, contractors and sub-contractors come under legal fire.

Recent lawsuits highlight the potential for increased liability in the commercial arena. For example, several former employees of IBM recently filed suits, alleging that the company failed to protect them from toxic mold and related health exposures at its Research Triangle Park campus in North Carolina. Also in July 2003, employees of United Airlines filed a lawsuit against the city and county of Denver claiming their recurring respiratory

conditions and other health problems are the result of mold exposure at Denver International Airport. This suit, filed in the Denver District Court, is seeking class-action status and alleges that the city and county breached their "duty to maintain the airport in a reasonably safe condition" by "failing to correct the airport's poor environmental conditions despite having knowledge of such problems". Even though science is not yet able to fully evaluate health claims associated with mold, these legal developments are of increasing concern for owners of commercial buildings and their insurers.

Construction defect litigation related to mold is also on the rise. For example, in April 2003, Hilton Hotels Corporation filed a lawsuit against 18 companies and individuals over alleged construction defects in its $95 million Kalia Tower in Hawaii. The hotel opened in May 2001, but was forced to close in July 2002 because of mold infestation.

Claims arising from the September 11 terrorist attacks have referenced mold. A recent lawsuit filed by the Manhattan U.S. Attorney's Office accuses the insurer of refusing to pay clean-up and damage costs for a post office located near the World Trade Center site. The suit alleges that the building was hit by burning debris, causing fire and smoke damage, shattered windows, and water damage from the building's sprinkler system. The water damage caused mold to grow in the post office's walls, ceilings and air-conditioning ducts, the suit alleges.

Impact on Availability and Affordability of Insurance

The rise in mold claims has had a direct effect on homeowners premiums in the state of Texas and across the country. The price of the average homeowners insurance policy today is estimated at $569 (less than one percent of the median family of four's income nationally) (Exhibit 9). Although the average cost of coverage rose by just 2.3 percent in 2002 according to federal statistics, prices are expected to rise by 7 percent in 2003 and 9 percent in 2004 (Exhibit 10).

While many factors affect the cost of homeowners insurance, growth in the frequency and severity of mold claims has had a significant impact and this is threatening the terms of homeowners coverage, the widespread availability and affordability of which has helped propel homeownership rates to record highs in recent years. According to Insurance Services Office Inc, the average amount paid for each homeowners claim rose

to $4,168 in 2000, up 10.5 percent from $3,773 in 1999. The average amount paid for each water damage claim, which includes damage caused by mold, rose by 10.5 percent to $3,347 in 2000, up from $2,984 in 1999. As the loss situation has worsened, so the cost of homeowners insurance as a percentage of income has climbed substantially in certain states, and a further rise in mold claims will drive the price higher, making coverage less affordable for consumers.

The explosion in mold claims in Texas has driven up insurance premiums for that state's 3.3 million homeowners policyholders, who already pay the highest insurance premiums in the country - $1,288 on average in 2002, due to the state's exposure to a wide variety of costly natural catastrophes including tornados, hail, hurricanes and tropical storms. Even so, figures from the Texas Department of Insurance show that homeowners premiums have not kept pace with the paid loss ratio which has increased sharply since 1999 (Exhibit 11).

In many states, availability of homeowners coverage has also become a problem, as several insurers have announced new restrictions on the sale of homeowners insurance due to the mold problem. For example, in Texas the number of insurers writing homeowners coverage has been declining steadily and fell to 128 in 2001, down from 162 in 1997 and 276 in 1990 (Exhibit 12).

Construction Effect

Any lack of affordable homeowners insurance threatens to undermine one of the few sectors of strength in the United States economy – construction. Despite economic growth that slowed from 2.4 percent in 2002 to just 1.4 percent during the first three months of this year, an estimated 1.68 million new homes will be built in 2003 (Exhibit 13). New home sales are forecast to surge by 3.1 percent to an unprecedented 1.0 million in 2003, according to the National Association of Realtors (NAR). An additional 5.73 million existing homes will be sold - another record for the year.

However, the issue of mold has already delayed and even halted some home sales and new constructions, particularly in problem states like Texas, Florida and California, and this is putting jobs at risk. For example, construction of single-family homes supports about 750,000 jobs in those three states alone (Exhibit 14) and some $8 billion to $9

billion in wages in construction and related industries (Exhibit 15). Furthermore, condo construction in parts of California has come to a virtual stop because of a surge in construction defect litigation, which in turn has triggered a sharp increase in insurance costs for contractors (Exhibit 16). The problem is fast spreading to other mold hotspots like Arizona, Texas and Florida. In response, "right to cure" laws, which would give builders the right to repair defects before lawsuits get filed, have been passed in five states and are under consideration in 16 others.

Exclusions and Limits

Insurance departments in 39 states have already approved mold exclusions in homeowners insurance policies (Exhibit 17). Mold exclusions are also becoming increasingly common in commercial property and liability policies. Certain states also allow insurers to establish sub-limits (either as a percentage of the policy limits of as a fixed dollar amount) for mold remediation coverage. While some companies prefer to create an absolute exclusion, others exclude mold but offer an attachment to the policy, called an endorsement, which makes coverage available for an additional premium. Most companies have inserted clarifying language into their policies, providing a tighter definition of what is and what is not covered under the terms of the policy. In the course of the changes, a number of insurers have developed stand-alone policies to cover mold-related damage. All these steps are part of the ongoing effort to avert a full-blown crisis in availability and affordability of coverage and to ensure a stable and competitive market exists for both homeowners and commercial policyholders in the future.

Following are 17 exhibits which illustrate the key issues surrounding mold and insurance.

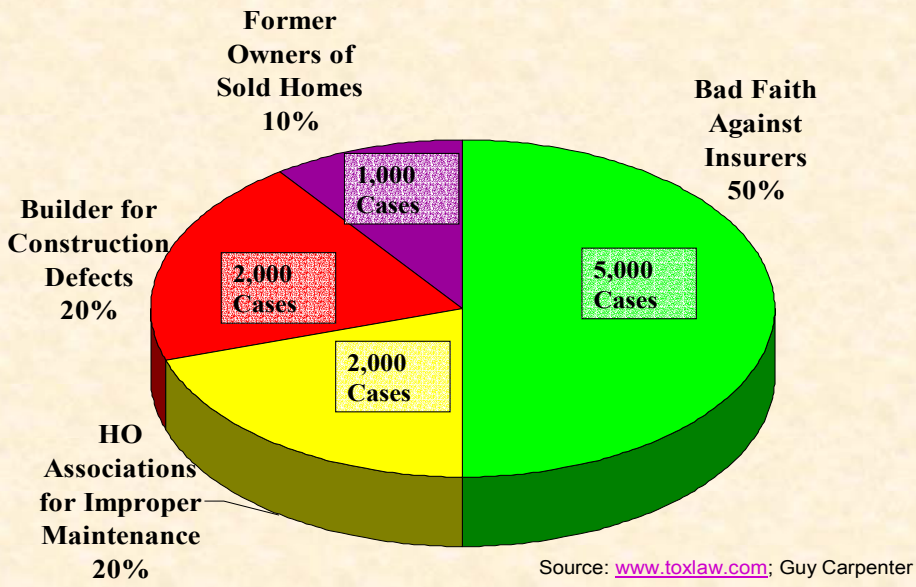
For additional information, see:

- Insurance Information Institute, www.iii.org
- Center for Disease Control, www.cdc.gov
- Environmental Protection Agency, www.epa.gov

- Federal Emergency Management Agency, www.fema.gov
- Conning & Co., www.conning.com
- Guy Carpenter, www.guycarp.com
- Insurance Council of Texas, www.insurancecouncil.org
- Texas Department of Insurance, www.tdi.state.tx.us
- Insurance Information Network of California, www.iinc.org
- National Association of Realtors, www.realtor.com
- Insurance Services Office Inc, www.iso.com
- National Association of Insurance Commissioners, www.naic.org
- A.M. Best, www.ambest.com

Exhibit 1

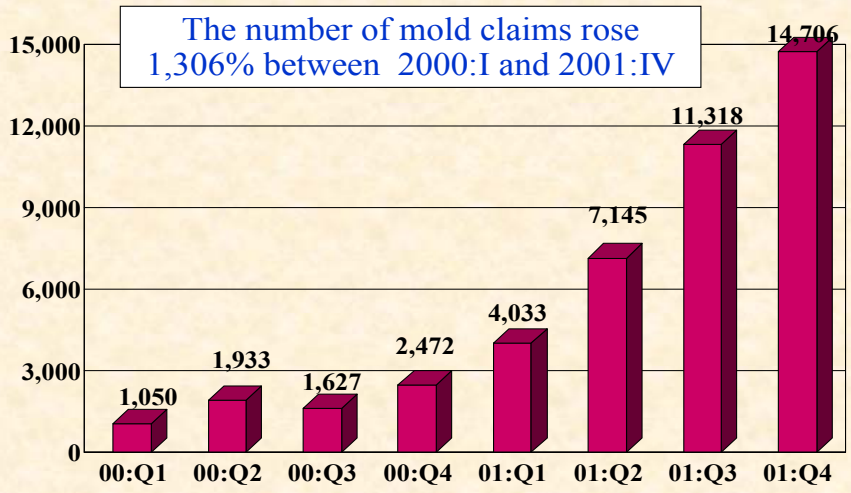
Documented Toxic Mold Suits



Source: www.toxlaw.com; Guy Carpenter

Exhibit 2

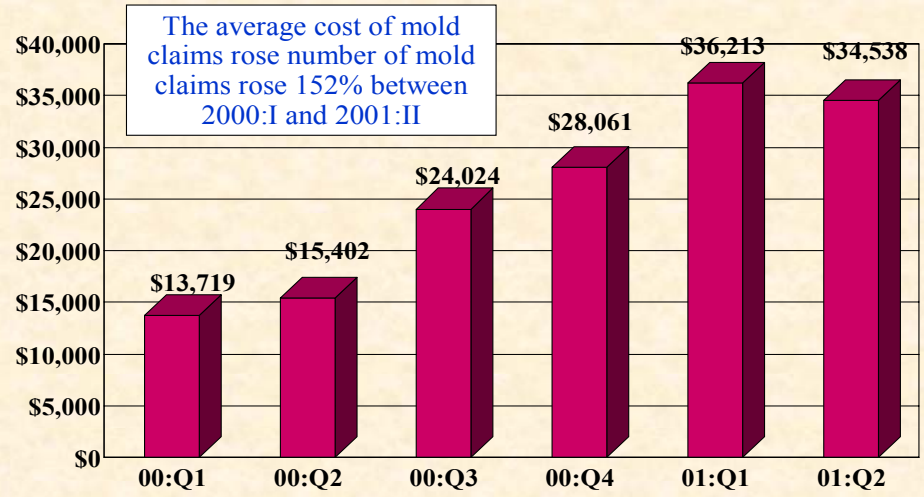
TX: Estimated Total Number of Mold Claims



Source: Texas Department of Insurance.

Exhibit 3

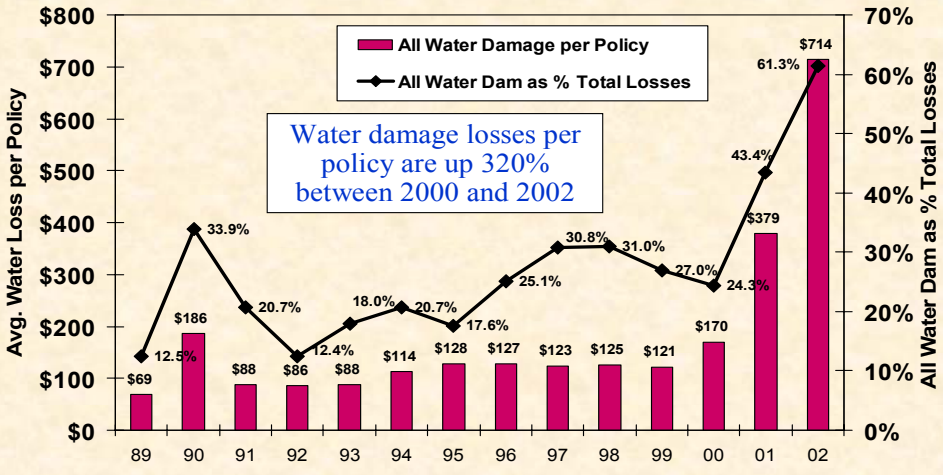
*TX: Average Cost Per Mold Claim**



*Includes loss and loss adjustment expenses.
Source: Texas Department of Insurance; Insurance Information Institute estimates.

Exhibit 4

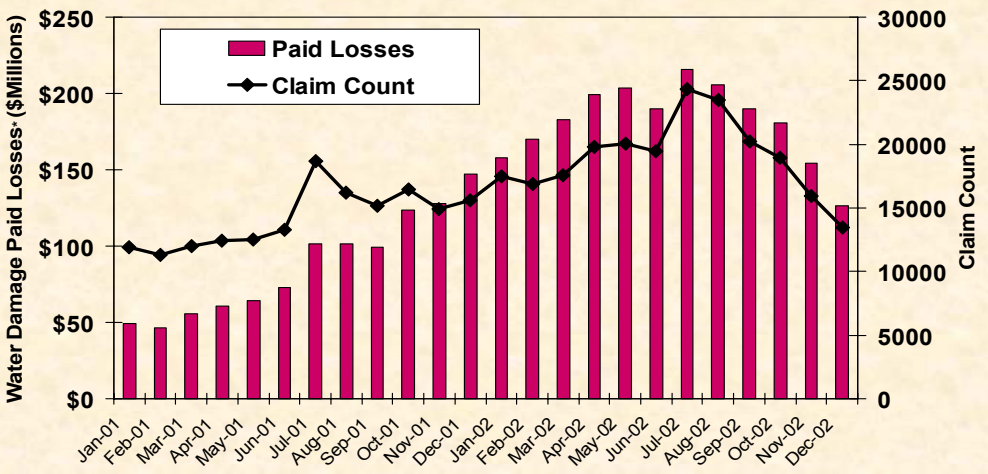
Texas HO: Per Policy Water Losses Have Skyrocketed



Source: Texas Department of Insurance; Insurance Information Institute

Texas: Mold Losses/Claims Are Finally Moderating*

Exhibit 5

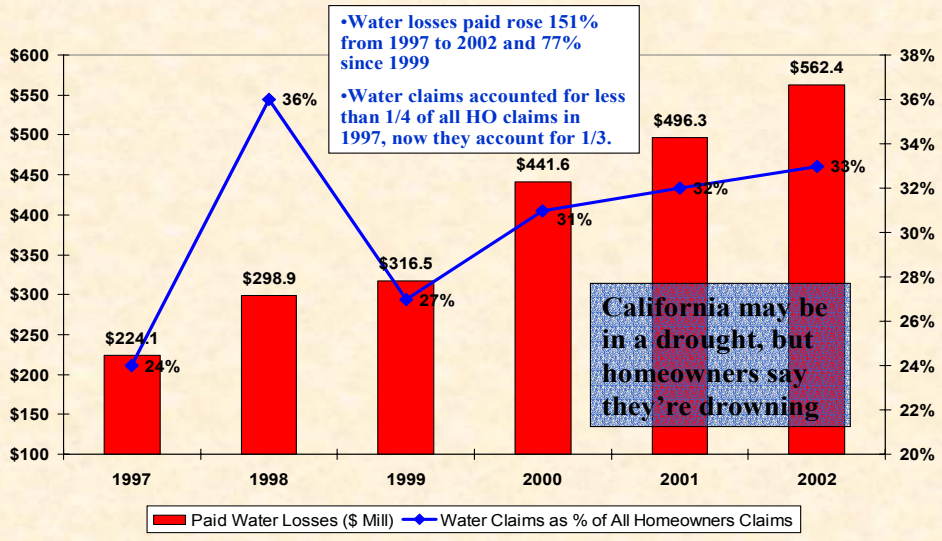


Source: Texas Department of Insurance; Insurance Information Institute

* Data are for TDI Cause 61: Discharge – Other Damage. Not all claims in cause 61 are mold and mold claims may also arise from other (non-water) causes of loss.

California: Surging Water Claim Frequency and Costs: Symptom of Growing Mold Problem

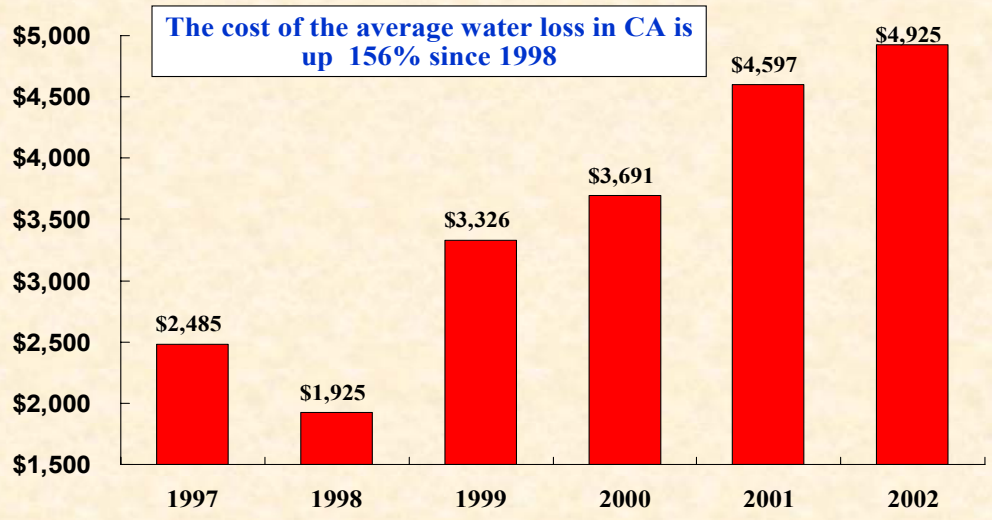
Exhibit 6



Source: Insurance Information Network of California; Insurance Information Institute

Exhibit 7

Sharply Rising Average Water Claim Cost in CA: Mold Symptom



Source: Insurance Information Institute based on data from the Insurance Information Network of California;

Exhibit 8

Mold and Commercial Insurance: the Next Battlefields?

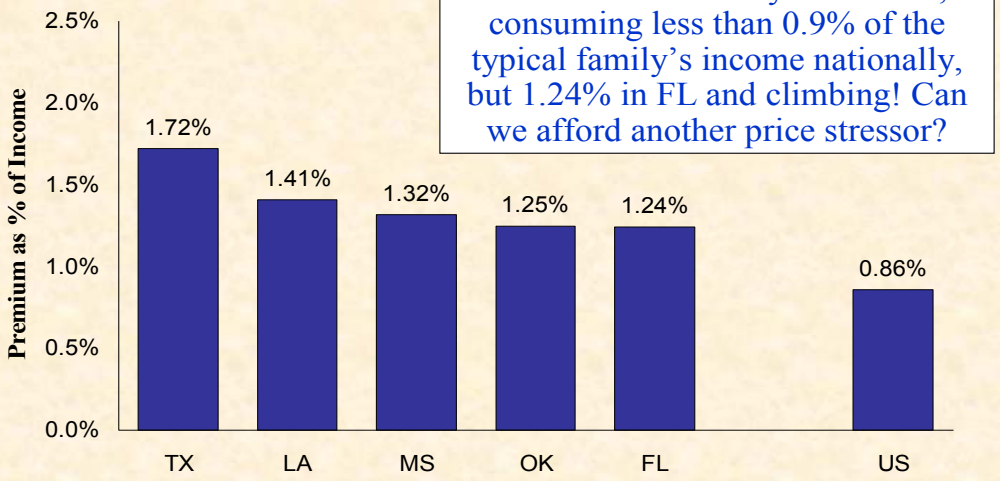
- Homeowners issue probably crested in 2002
- Migration to commercial area affects many lines:
  - Commercial Property Commercial Liability
  - Products Liability Builders Risk/Construction Defects
  - Workers Comp…(very little)
- Hot Spots:
  - Apartments/Condos/Co-ops Office Structures
  - Schools Municipal Buildings
  - Cars? (GM case in NC)
- Trend toward class actions since science doesn't support massive individual non-economic damages
  - Much more lucrative for trial lawyers to form class

Source: Insurance Information Institute.

Exhibit 9

States with Highest Premium/Income Ratios*

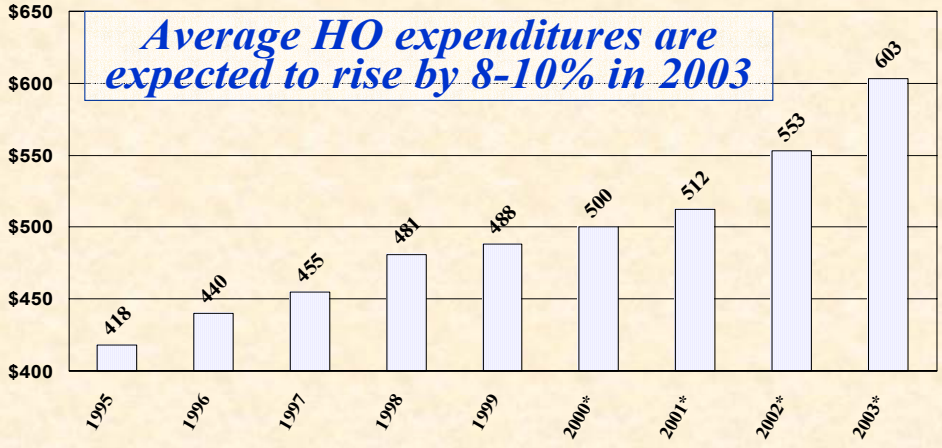
HO insurance is very affordable, consuming less than 0.9% of the typical family's income nationally, but 1.24% in FL and climbing! Can we afford another price stressor?



*As a % of the median family of 4's income, 1998.
Source: NAIC, Insurance Information Institute

Exhibit 10

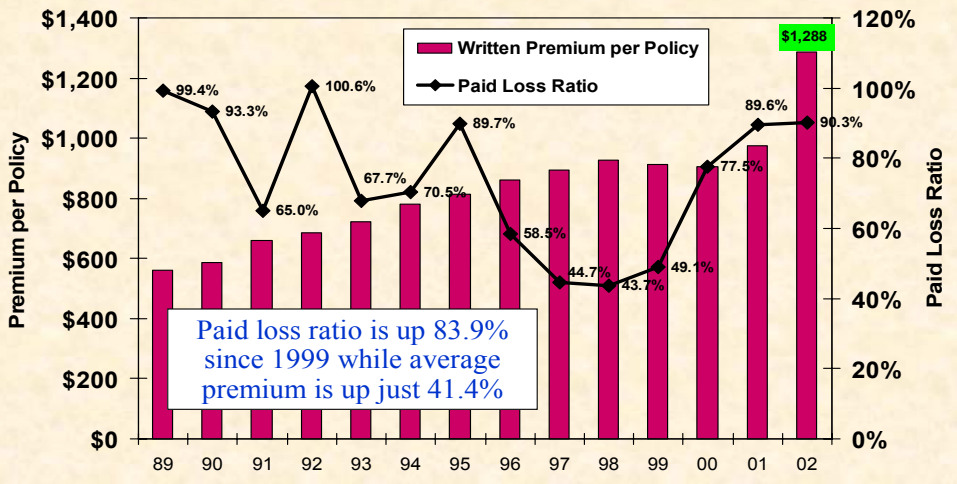
Average Expenditures on Homeowners Ins.: US



*III Estimates
Source: NAIC, Insurance Information Institute

Exhibit 11

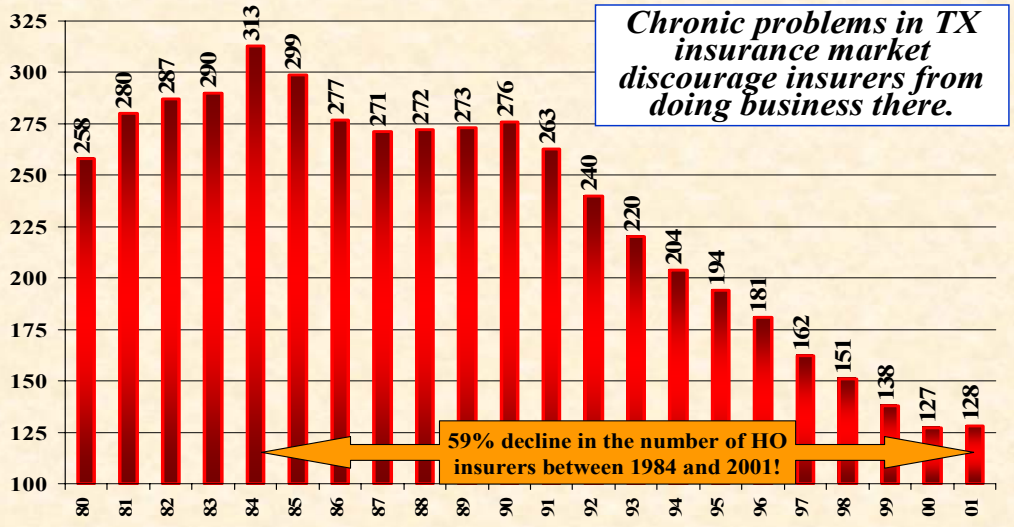
Texas HO: Paid Loss Ratio Up Sharply, Premiums Haven't Kept Pace



Source: Texas Department of Insurance; Insurance Information Institute

Exhibit 12

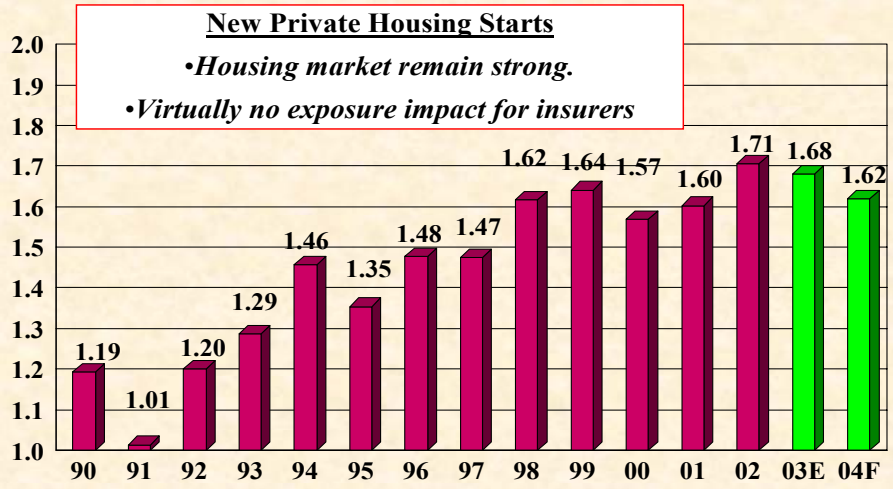
Homeowners Insurance Companies in TX (1980-2001)



Sources: A.M. Best; TX Coalition for Affordable Insurance Solutions.

Exhibit 13

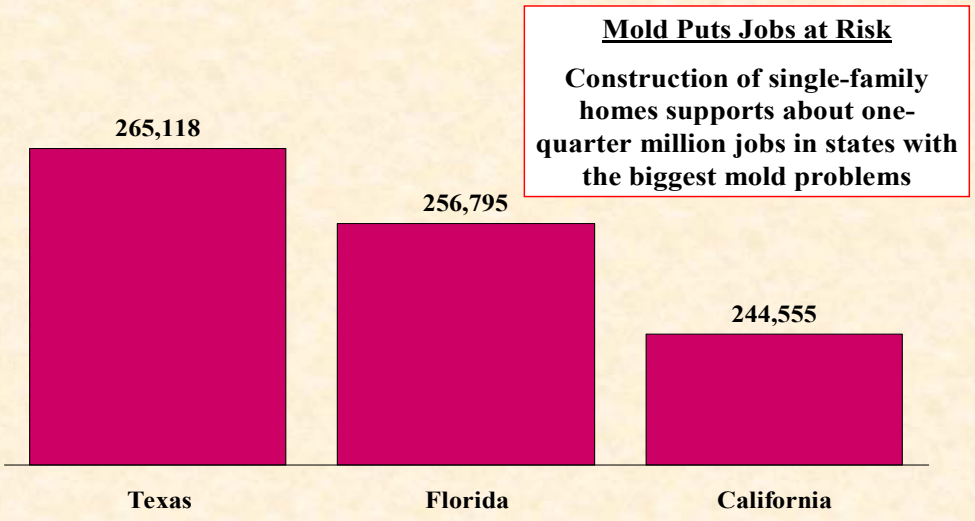
New Private Housing Starts
(Millions of Units)



Source: US Department of Commerce; Blue Chip Economic Indicators (5/03), Insurance Info. Institute

Exhibit 14

Number of People Employed in Construction of Single-Family Homes

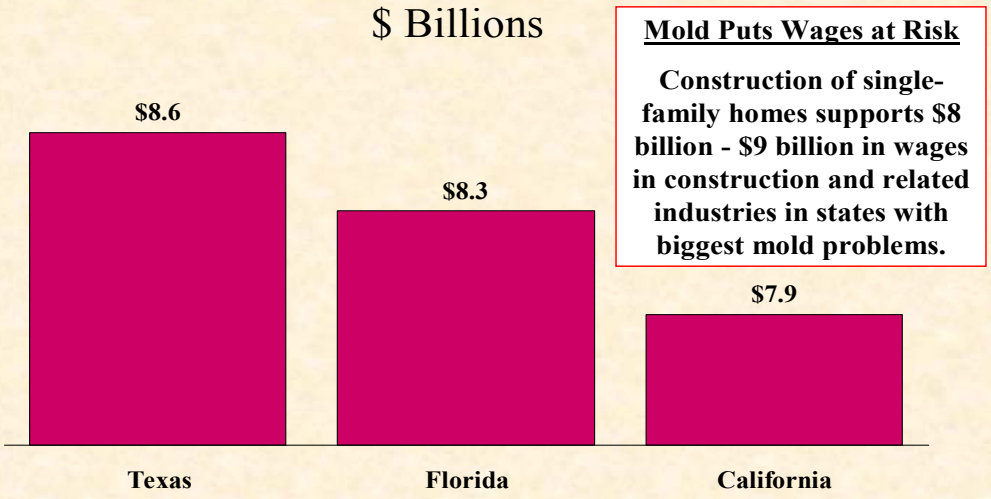


Source: National Association of Homebuilders, Insurance Information Institute

* Single family units, based on year 2000 construction figures

Exhibit 15

Billions in Wages Depend on Construction of Single-Family Homes

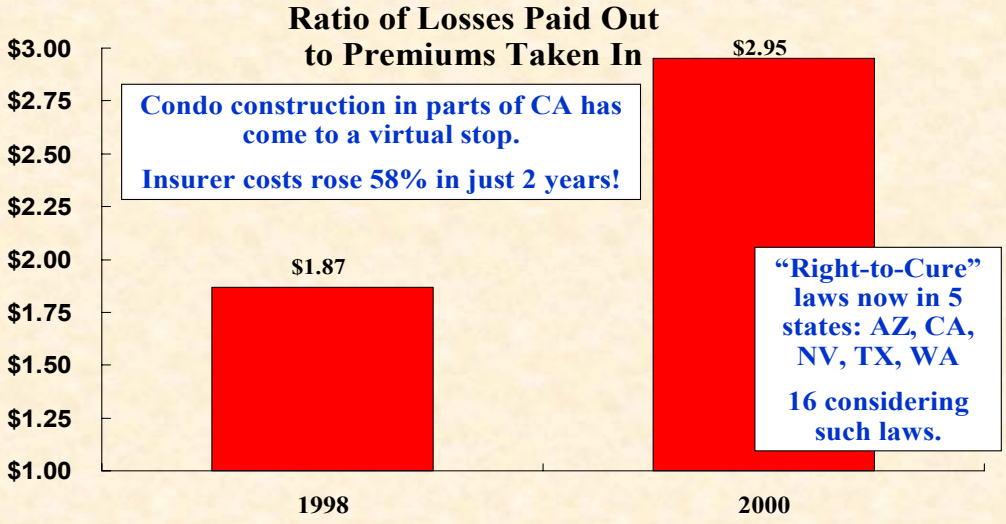


Source: National Association of Homebuilders, Insurance Information Institute

* Single family units, based on year 2000 construction figures

Exhibit 16

Construction Defect Litigation Destroying CA Condo Market

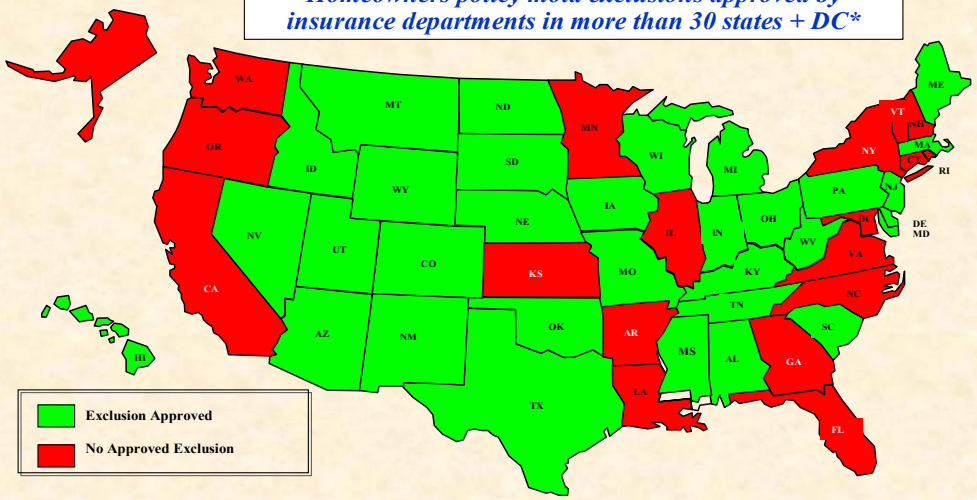


Source: ISO, Insurance Information Institute

Exhibit 17

ISO Mold Exclusions

Homeowners policy mold exclusions approved by insurance departments in more than 30 states + DC*



*As of July 29, 2002.

Source: Insurance Services Office