

TEXAS MOLD – COVERAGE OR NOT

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Mold is not a new phenomenon in Texas or anywhere else. If mold was not present in the beginning, it existed soon thereafter. In fact, in Leviticus 14:33-47, the Lord warned Moses and Aaron about a leprous disease (mold), that He would put into the homes of the Israelites after they came into the land of Canaan. The Lord was very specific in describing the mold conditions and effects and even provided the Israelites with detailed plans of remediation which they were to follow specifically.

There are over 100,000 species of mold, most of which are apparently harmless to the general public. However, there are perhaps 20 or more species that may effect human health. These “bad” molds can grow rapidly under proper conditions which require moisture, oxygen, nutrients, temperature and time.¹ Moisture is the most important element, since mold will not grow without it even if all the other conditions are present. *Stachybotrys*, also known as “black mold,” is the most commonly recognized mold believed to produce mycotoxins which cause diseases. Science and medicine cannot reach agreements on the health effects of mold in homes. There are no universally recognized threshold levels to tell us conclusively how much or how long people must be exposed to specific molds to result in adverse health effects.² Nevertheless, it would seem that people around the country are becoming increasingly adverse to the presence of mold in their homes.

Even though mold is not a new phenomenon in Texas, Texas insurers have experienced an unprecedented expansion of mold claims against Texas homeowners policies during the past two years. Although losses attributed to mold and mold remediation under Texas homeowners policies are not reported separately under the required statistical submissions by insurance companies, mold-related losses apparently have increased by an even greater magnitude than that of water losses. For example, according to a compilation of losses released on July 31, 2001 by the Texas statistical plan, mold related losses jumped from \$9.1 million in the first quarter of 2000 to \$79.5 million in the same quarter of 2001.

On May 30, 2001, a Travis County, Texas jury returned a verdict for \$32 million in actual and exemplary damages in favor of the plaintiffs and against The Fire Insurance Exchange, a Farmer’s Insurance Group company.³ After hearing oral arguments for the plaintiffs’ motion for judgment and Farmer’s motion for judgment nov, the trial court ordered the parties to prejudgment mediation which failed, resulting in the court rendering a judgment on the verdict in October 2001. The *Ballard* case arose from Farmer’s alleged neglect of a water damage claim and mold related losses resulting in extensive property damages and alleged personal injuries to the homeowners. The Ballards attributed health problems they were experiencing to black mold that apparently developed as a result of plumbing leaks. The insureds had prevailed in an appraisal proceeding relating to their claim but alleged that Farmer’s had committed fraud in connection with the appraisal process. The jury found that Farmer’s had committed violations of the Texas Insurance Code and the Texas Deceptive Trade Practices Act as well as fraud in the appraisal process. Damages were awarded for the cost to replace the home, cost to remediate the home and replace its contents, past and future additional living expenses and the cost of appraisal. The jury also awarded exemplary damages in the amount of \$12 million, damages for mental anguish in the amount of \$5 million, and attorneys’ fees of almost \$9 million. Regardless of how the appeals courts rule in the future, the Ballard case, simply by its magnitude, has certainly served to bring great attention to mold-related damage and remediation.

The most commonly purchased Texas policy, the Texas Homeowners Form B (HO-B) has been a promulgated and standardized form providing the most expansive coverage in the United States for water damage and any ensuing mold and fungi losses. In addition, the homeowners insurance in Texas has been the most expensive in the United States due to its extreme weather-related losses and generous coverage for water damage losses. In spite of some dramatic rate increases, many Texas homeowners insurers have posted enormous underwriting losses prompting several of the largest companies to announce their intentions to stop writing new business in the state.

How did Texas insurers find themselves suddenly faced with such mold problems? The Texas Homeowner’s B (HO-B) provides an all-risk coverage based on replacement costs subject to exclusions. The relevant policy language is as follows:

SECTION 1 – PERILS INSURED AGAINST

COVERAGE A (DWELLING)

We insure against all risk of physical loss to the property described in Section I Property Coverage. Coverage A (Dwelling) unless the loss is excluded in Section I Exclusions.

* * *

SECTION I – EXCLUSIONS

f. We do not cover loss caused by:

* * *

- (2) rust, rot, mold or other fungi.
- (3) dampness of atmosphere, extremes of temperature.

* * *

We do cover ensuing loss caused by collapse of building or any part of the building, **water damage** or breakage of glass which is part of the building if the loss would otherwise be covered under this policy. (emphasis added)

Under HO-B, both the dwelling and personal property coverage are subject to exclusions for loss caused by “rust, rot, mold or other fungi.” In other words, mold in and of itself is not a covered peril in the Texas standard homeowner’s policy. However, this exclusion is subject to a loss provision that provides for coverage of an ensuing loss originating from water damage. It is water damage that apparently causes mold development and the need for costly mold remediation. It is water damage claims including ensuing damage that is causing the dramatic increase in loss on homeowner’s policies in Texas.

In the early-to-mid 1990s, losses from foundation damage began to cause problems with availability and affordability of homeowners insurance in Texas. As with mold, foundation damage has been an excluded peril in Texas homeowners policies. It is, however, covered if it is an ensuing loss caused by a covered peril, such as a plumbing leak. Nevertheless, many insurers tried to exclude foundation claims even when the damage amounted to an ensuing loss. In 1997, the United States Fifth Circuit Court of Appeals held that the Texas standard homeowners policy HO-B did not cover structural and cosmetic damage to a dwelling that results from a foundation shift, which was caused by a plumbing leak beneath the house.⁴ In the *Sharp* case, plaintiffs alleged that water leaking from deteriorated sub-surface plumbing beneath the house had caused their foundation to shift causing extensive structural and cosmetic damage to their home. Plaintiffs claim was filed under Coverage A which covered damage to the dwelling and included a strictly worded exclusion of foundation damage. Coverage B under the plaintiffs policy covered only personal property losses but included plumbing leaks as an enumerated peril which could result in a covered loss. The court held that it could not transfer exclusions under Coverage B, which applied to personal property, into exclusions under Coverage A, which applied to the dwelling or house, to create coverage for a loss that did not involve personal property.

The Texas Commissioner of Insurance, Elton Bomer, so strongly disagreed with the *Sharp* decision that he issued Commissioners Bulletin Number B-0032-97, in response, stating the Texas Department of Insurance’s position that there should be coverage under Coverage A (Dwelling) in the HO-B policy for accidental discharge damages.⁵ The Commissioner’s specific position is set forth below:

Since the Texas Standard Homeowners Policy Form HO-B (HO-B) was first promulgated in Texas, the policy has provided coverage for damage to the dwelling, including the foundation, resulting from the peril of accidental discharge, leakage, or overflow of water from within a plumbing, heating, or air conditioning system or household appliance. (This peril is referred to as simply “accidental discharge” in the remainder of this bulletin.) In 1978, because some companies were paying for these losses and some were not, the Board amended the HO-B policy to clarify that all losses to the dwelling, including the foundation, caused by accidental discharge were covered. The language and formatting for Coverage A (Dwelling), Coverage B (Personal Property), and Section I Exclusions in the current HO-B policy form was first adopted in 1990 by the former State Board of Insurance (Board) upon the recommendation of the Board-appointed Advisory Committee for a Readable Homeowners Policy. Since the 1990 adoption, the Department has consistently interpreted the HO-B policy to provide coverage for losses to the dwelling, including the foundation, caused by accidental discharge. It is the Department’s position that under all risk coverage, as provided under Coverage A (Dwelling) in the HO-B policy, there is coverage under the policy when one of the

exclusions in the Section I Exclusions is qualified by the terms of the policy (*i.e.*, all risk coverage) to provide coverage where the otherwise excluded peril is itself caused by a covered peril. For example, if accidental discharge, which is a covered peril under Coverage A (Dwelling) all risk coverage, causes settling, cracking, bulging, shrinkage, or expansion of the foundation (settling, cracking, etc. is an excluded peril under Section I Exclusions) the damage to the foundation is a covered loss. The Department believes that any analysis of whether there is coverage for losses to the dwelling, including the foundation, under the HO-B policy form must include consideration of the nature and intent of “all risk” coverage, as provided under the Coverage A (Dwelling) provision of the policy.

In *Safeco Ins. Co. v. Balandran*, the Texas Supreme Court agreed with Commissioner Bomer’s analysis and seemingly put an end to the dispute by ruling that foundation losses were covered in the HO-B policy if the damage ensued from a coverage water loss.⁶ The *Balandran* Court made it clear that water damage from an accidental discharge is a covered peril, and any ensuing loss is therefore covered as a consequence of such coverage even if such loss is separately excluded. The *Balandran* Court apparently believed that the reason for the ensuing loss provisions was to clarify that certain excluded losses (foundation and mold) will not be excluded if they result from covered perils. The application of *Balandran* opened the door wide open for the expensive remediation claims for foundation and mold damages.

The solutions to these problems from the standpoint of the insurance companies would require amendment of the HO-B policy form to restrict or exclude mold coverage or the introduction of new policy forms with restricted or excluded mold coverage. After consideration of the position of the staff of the Texas Department of Insurance, consumers and companies, the Texas Insurance Commissioner, José Montemayor, issued his Official Order No. 01-1101 on November 28, 2001, which restricted coverage available for mold testing, remediation and related costs.⁷ Pursuant to the Commissioner’s Order, the Texas Department of Insurance issued new mandatory amendatory endorsements that still provide coverage for remediation of mold under most homeowner’s, dwelling and renter’s policies, provided that such coverage will be limited to losses resulting from “sudden and accidental discharge, leakage or overflow of water or steam if the sudden and accidental discharge, leakage or overflow of water or steam loss would otherwise be covered under the policy.” The extent of coverage for remediation is limited and does not cover remediation that would be “beyond that which is required to repair or replace the covered property physically damaged by water or steam.” The amendatory endorsements were effective January 1, 2002 on an optional basis and will be mandatory on January 1, 2003.⁸

An industry response for several of the larger insurers has been to make application to the Commissioner for approval of national forms. In 1997, the Texas Legislature amended Article 5.35 of the Texas Insurance Code to give insurers more flexibility from the standard forms of homeowner’s policies. Senate Bill 1499 gave the Texas Commissioner of Insurance discretionary authority to adopt policy forms and endorsements used by national insurers or adopted by a national organization of insurance companies. For purposes of the statute, national insurers are those which do business in 26 or more states and maintain minimum annual premiums for residential property insurance of \$750 million in the aggregate for all states. On March 8, 2002, Commissioner Montemayor adopted the first national form to be used in Texas. State Farm’s homeowner’s policies, officially known as HO-W, excludes coverage for mold testing and remediation but offers the insured an option to buy back the coverage. The HO-W policy does offer limited basic mold coverage if it is necessary to repair water damage which is sudden and accidental. The HO-W policy uses the term “sudden and accidental” for all water damage, whereas the HO-B policy uses the term “accidental discharge” for all water damage other than mold damage. The HO-W policy also excludes coverage for foundation damage but also offers it as a buy back endorsement.

Allstate and Farmer’s have subsequently received approval for use of more restrictive HO-A forms providing coverage for specified perils. These forms exclude the mold coverage but specify amounts for remediation.

It is impossible to know at this time whether any of these changes will stem the tide of losses recently incurred by Texas homeowner’s insurers, or whether the new policy forms will, in fact, provide homeowners with adequate coverages. However, it is more than likely that additional policy forms will be proposed and adopted. Pricing and underwriting will be heavily scrutinized by the insurers, regulators and consumer groups. Undoubtedly, the Governor of Texas (running for re-election in November 2002) and the Houses of the Texas Legislature (next convening in January 2003) will be weighing in with their respective proposals.

Endnotes

1. Andrew W. Campbell, M.D., *Diagnosing Mold-Related Illness*, April 2002 (paper delivered at State Bar of Texas CLE: "Trying the Black Mold Case").
2. *Questions and Answers on Stachybotrys Chartarum and Other Molds*, National Center for Environmental Health, March 9, 2000 (available at <http://www.cdc.gov/nceh/asthama/factsheets/molds/default.html>).
3. *Ballard v. Fire Ins. Exch.* (2001 WL 883550, unpublished).
4. *Sharp v. State Farm Fire & Casualty Ins. Co.*, 115 F.3d 1258 (5th Cir. 1997).
5. Texas Department of Insurance, Commissioner's Bulletin No. B-0032-97 (Aug. 1997) (available at <http://www.td.state.tx.us/commish/b-0032-7.html>).
6. *Safeco Ins. Co. v. Balandran*, 972 S.W.2d 738 (Tex. 1998).
7. Texas Department of Insurance, Commissioner's Order No. 01-1105 (Nov. 2001) (available at <http://www.tdi.state.tx.us/commish/multi/co-01-1105.html>).
8. Texas Department of Insurance, Endorsement No. HO-162A-Homeowners Amendatory Endorsement (effective January 1, 2002).