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TOXIC MOULD – AN INSURANCE PERSPECTIVE

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Mould litigation is becoming of particular interest to insurers as they react to the potential for successful claims against insurance companies for mishandling water damage claims, and to the potential for successful punitive damage claims advanced by victims of mould exposure.

*Ballard v. Fire Insurance Exchange*¹ was a case of an insurer mishandling a water damage claim. In that case, the court held that the insurer had breached its duty of good faith and fair dealing to Melinda Ballard and committed deceptive business practices in connection with the Ballards' claim. In *Ballard*, a plumbing leak was not properly fixed and several months later hardwood floors in the Ballard home started buckling. The Ballards filed a claim with their insurer, but the insurer refused to replace the sub floor and mould grew. Eventually the house was rendered uninhabitable due to mould infestation.

A Texas jury awarded the Ballards \$32,000,000.00 in damages. The insurer appealed and the Third District Court of Appeals reduced the award by \$17,000,000.00, upsetting the \$5,000,000.00 award for mental anguish and the \$12,000,000.00 award for punitive damages. In the end, damages of \$15,000,000.00 were upheld on appeal.

The number of mould claims in the United States is on the rise. One major insurer in the United States reported a dramatic increase in the frequency of mould claims as follows:

| Year | No. of Claims |
|------|---------------|
| 1999 | 12 |
| 2000 | 499 |
| 2001 | 10,000 |

It has been estimated that of the 10,000 claims, 5,000 are against insurance companies for acting in bad faith, 2,000 are against home owners' associations for improper maintenance, 1,000 are against former owners of sold homes and 2,000 are against builders for construction defects.²

Given that some 10,000 mould suits are "piling up" in the U.S. and given that the Americans are significant "consumers" of litigation, we can anticipate some spill over into Canada. Some recent Canadian developments in relation to mould litigation are as follows:

- A mycologist in Halifax did a study of mould contamination in Atlantic province schools and found that about half of the schools he examined had mould contamination. However, only about 10% had mould problems that would be a health concern;³
- Mould in schools in Ontario is so significant that the regional municipality of Ottawa-Carleton commissioned a report on health concerns related to portable classrooms. The report states

that several school boards in southern Ontario have found as many as 90% of their portable classrooms contain mould growth. In the Ottawa-Carleton Catholic School Board 31% of the portables contained mould;

- In British Columbia, mould contamination has been raised in numerous “leaky condo” cases;
- A \$2 billion class action lawsuit was commenced against the Dufferin-Peel Catholic School Board in Ontario. The class was not certified;⁴
- In Ontario, a tenant in an apartment building commenced an action alleging contamination due to mould causing health problems. In that case, class certification was also denied;⁵
- In Calgary, the Alberta Court of Appeal building was closed as a result of mould infestation.

As a result of the proliferation of litigation relating to mould, insurers face exposure to claims on both a first party and a third party basis.

FIRST-PARTY CLAIMS

The Insuring Agreement

The typical Homeowner’s Policy is an “all risks” policy which insures against: “all risks of direct physical loss or damage to the property insured” except as excluded.

Where the grant of coverage is under a specified perils policy, the loss or damage will typically need to arise from an occurrence, caused by or resulting from, a “covered cause of loss”.

Is the mould the cause of the property damage, or is it the effect of some other cause? If it is an effect, then is it damage arising from a cause that is a “covered cause of loss”?

Be wary of declining claims where the loss claimed arises concurrently from a covered cause and an excluded cause. The Supreme Court of Canada, in *Derksen v. 539938 Ontario Ltd.*, recently made clear that it is for the insurer to clearly exclude liability in the policy wording if it does not want to cover loss arising from concurrent causes.⁶

In the United States, insurers have drafted language for insurance contracts specifically designed to address multiple causation. The language generally is contained at the outset of the exclusion section of the policy. An example of such wording is:

We do not insure for loss caused directly or indirectly by any of the following. Such loss is excluded regardless of any other cause or event contributing concurrently or in sequence to the loss.

In *Derksen*, the Supreme Court of Canada suggested the following wording:

We do not insure for such loss regardless of the cause of the excluded event, other causes of the loss, or whether other causes acted concurrently or in any sequence with the excluded event to produce the loss.

Canadian insurers would be wise to adopt “concurrent cause” language such as that suggested above to limit exposure for mould claims on a first party basis.

Exclusions

Some of the typical exclusions that may eliminate coverage are as follows:

1. **Fungi Exclusion**

This form shall not insure:

- (a) loss or damage consisting of or caused directly or indirectly, in whole or in part, by any “Fungi” or “Spores” unless such “Fungi” or “Spores” are directly caused by or directly result from a peril otherwise insured and not otherwise excluded by this policy;
- (b) the cost or expense for any testing, monitoring, evaluating or assessing of “Fungi” or “Spores”.

The wording of this Fungi and Fungal Derivatives Exclusion excludes damage caused directly or indirectly by fungi. Fungi may be defined as follows:

“Fungi” includes, but is not limited to, any form or type of mould, yeast, mushroom or mildew whether or not allergenic, pathogenic or toxigenic, and any substance, vapour or gas produced by, emitted from or arising out of any “Fungi” or “Spores” or resultant mycotoxins, allergens, or pathogens.

In this example, the exclusion provides an exception where the mould is “directly caused by or directly result[s] from a peril otherwise insured and not otherwise excluded”. If the escape of water from a plumbing apparatus in the building is a peril specifically insured under the policy, then damage arising from the resultant mould may not be excluded.

To the extent that a mould infestation can be shown to be directly caused by a covered cause of loss, this exclusion should not operate to exclude that damage. To the extent that mould damage can be shown to be directly caused by excluded perils, the fungi exclusion should operate. Thus, the key issue is causation.

2. **Contamination Exclusion**

An example of a contamination exclusion is as follows:

This policy does not insure against loss or damage caused directly or indirectly:

- (a) by dampness of atmosphere, dryness of atmosphere, extremes or changes of temperature (except as heretofore provided), heating, shrinkage, evaporation, loss of weight, leakage of contents, crushing, rust or corrosion, exposure to light, wet rot or dry rot, contamination, change in flavour, or colour or texture or finish, moths, rodents or vermin (but this exclusion shall not apply to loss or damage caused directly by fire, lightning, smoke, windstorm, hail, explosion, strike, riot, impact by vehicles or aircraft, freezing, sewer backup, leakage from fire protection equipment, rupture of pipes or breakage of apparatus not excluded hereunder, vandalism or malicious acts, theft or attempt thereat, or accident to a transporting conveyance).

This exclusion contains a broad range of types of damage and some vary significantly from one another. However, it can be generally said that they are types of damage which occur over time and often through natural phenomena. There is general skepticism as to whether or not mould would fit within the definition of “contaminant” within this type of exclusion.

U.S. case law makes it clear that “contaminant” in a pollution exclusion is meant to refer to perils that could be broadly dispersed in the environment. It is clear that the word “contamination” in the above exclusion is not being used in that manner. Mould is a naturally occurring substance that causes damage over time.

3. **Other Exclusions**

There are other exclusions that may be applicable such as the “faulty workmanship and/or design” exclusion. This is often considered in the context of leaky building cases. Moreover, there is a possibility that the “pollution exclusion” may be applicable if it is drafted very broadly. However, in general terms, it seems unlikely that a Court will consider mould as pollution particularly when one looks at the common form of the pollution exclusion.

THIRD PARTY CLAIMS – LIABILITY COVERAGE

If history is any indicator, it appears as though we will have more litigation on the liability side than the property side.

Professionals such as architects or engineers will look to their errors and omissions policies for coverage when they are pursued by others for construction defects. In addition, contractors and subcontractors will look to their commercial general liability (“CGL”) policies for coverage.

The Insuring Agreement

The typical insuring agreement of these policies states:

We will pay those sums that the insured becomes legally obligated to pay as compensatory damages because of “bodily injury” or “property damage” to which this insurance applies ... This insurance applies only to “bodily injury” and “property damage” which occurs during the policy period. The “bodily injury” or “property damage” must be caused by an “occurrence” ...

Property Damage

CGL policies also define the terms “property damage”. A typical definition of “property damage” is as follows:

“Property damage” means physical damage to, or destruction of, or loss of use of tangible property.

In view of the fact that the insuring agreement will always be construed broadly in favour of the insured, it is likely that mould damage will fall within the definition of “property damage”. It is interesting to note that the typical definition of property damage includes loss of use and there is a significant likelihood that physical damage may be limited in the sense that it cannot be seen (as it is often within wall cavities and floor spaces) but mould may result in a loss of use of “tangible property” if the premises are rendered uninhabitable.

Bodily Injury

We have already seen that it is likely that a third party claim for mould damage to a building will be considered “property damage”. The more difficult consideration is whether a CGL policy will respond to a claim for “bodily injury” arising from mould growth.

Proving a loss arising from bodily injury caused by mould may prove to be difficult due to the significant amount of expert evidence required to establish a causal link between medical symptoms and mould related illnesses.⁷

In the U.S., there is authority on both sides of the issue. In some cases, the Courts have rejected the argument that mould can cause bodily injury. On the other side, we have seen cases where the Court has accepted that there was a causal link between the presence of mould and illness in a given case.

In Canada, there is no case which fully explores the causal link between mould exposure and “bodily injury”. However, there are interesting statements in a couple of Canadian cases which indicate that the Court may be pre-disposed to make the connection.

For example, in a Canadian criminal case decided on March 27, 2003⁸, the Court considered the application by the accused for a change of venue because the accused was concerned with unmanifested health concerns arising from the alleged presence of mould in the Newmarket Courthouse where he was to be tried. The accused did not allege that he had a particular sensitivity or health condition making him apt to be adversely affected by the alleged environmental problems in the Courthouse. The Courthouse had undergone remediation due to the presence throughout the building of toxigenic mould known as *Stachybotrys Chartarum*. Of interest to us are the comments of the judge respecting the presence of *Stachybotrys Chartarum*. He said:

Stachybotrys Chartarum, also known as *Stachybotrys atra*, is a type of mould that has been known to have a negative impact on human health....While not all black moulds are of the toxic variety, at higher levels of concentration *Stachybotrys* is a known contaminant with known toxic effects including the following: the allergic rhinitis (cold like symptoms), dermatitis (rashes), sinusitis, conjunctivitis and aggravation of asthma. Some related symptoms are more general and include an inability to concentrate and fatigue.

In the result, the Ontario Court did not allow the accused’s application for a change of venue, citing expert reports indicating that the environmental conditions were normal. Nevertheless, the Court also noted that building employees continued to make health-related complaints of unknown origin.

Another decision of an Ontario Court involved the claim of Sharon Ann Mariani for damages arising from certain deficiencies or latent defects in the construction of her home purchased from the Defendants, John and Anne Lemstra.⁹

The Court held that the Lemstras were liable in negligence for fraudulent misrepresentation arising from their claim in the listing agreement that the house was “well built”. The Court held that, “the proliferation of mould itself has conclusively rendered this house dangerous to inhabit”. It is not clear whether the Court is referring to health-related danger as it does not discuss the evidence, if any, in this regard.

As claims advance, we will see if the Courts are prepared to classify mould related illnesses as “bodily injury”. By analogy, in the asbestos litigation in the early 1990’s, we saw the Court requiring “a present and diagnosable disease”¹⁰ to trigger coverage for bodily injury. In other words, a fear of potential injury is insufficient.

Exclusions

We have to recall that the insuring agreement is always construed broadly in favour of the insured and exclusions are construed narrowly against the insurer.¹¹

With this in mind, we will examine a couple of the potentially applicable exclusions.

(i) Pollution Exclusion

A common exclusion from coverage under a CGL is for loss arising from the release of “pollutants”.

There are no Canadian cases considering the applicability of the pollution exclusion to mould damage. Academically, however, the generally held belief is that mould will not be classified as a “pollutant” as a matter of construction: it does not share the characteristics of the other substances included in the definition of “pollutant”. Also, old CGL wording only triggers the pollution exclusion if

there is a “release of a pollutant *into or upon land, the atmosphere or a body of water*”. The old exclusion wording does not address the release of harmful substances in an indoor environment.¹²

This academic theory has been supported by a recent decision of the Ontario Court of Appeal in *Zurich Insurance Company v. 686234 Ontario Limited*¹³ which strongly suggests that a Court considering the applicability of the pollution exclusion to a mould claim would be likely to find that the exclusion does not apply. In *Zurich*, the Ontario Court of Appeal considered the applicability of the pollution exclusion to a carbon monoxide leak from a faulty furnace. The case turned on the definition of “pollutant”. The Zurich policy defined “pollutant” as any “solid, liquid, gaseous or thermal irritant or contaminant including smoke, vapour, soot, fumes, acids, alkalis, chemicals and waste”. The Court considered the American jurisprudence concerned with the definition as well as Canadian law respecting the interpretation of insurance policies. The conclusion was that the definition of pollutants ought not be given a strictly literal interpretation when to do so would expand the scope of the exclusion far beyond the drafting intent which was to exclude coverage for damage caused by broadly based environmental pollution.

There is little authority in the U.S., as well. One U.S. District Court case¹⁴ held that mould damage fell within the pollution exclusion, but the exclusion in the subject policy contained a definition of pollutants which specifically included bacteria and fungi. Another U.S. case dealing with an insurer’s liability for damages for personal injuries arising specifically from mould damage, and the applicability of the pollution exclusion thereto, held that personal injuries caused by mould were covered under the insured’s CGL and not excluded under the pollution exclusion because “fungus” does not come within the definition of “pollutant” in an absolute pollution exclusion.¹⁵

(ii) Own Product and Own Work Exclusions

Mould damage claims will typically arise in connection with completed projects since it will take some time after completion for the mould to negatively affect the structure. Because of this, it is possible that some or all of the damage resulting from the mould infestation can be excluded under either an “own-product” exclusion or a completed work exclusion in the CGL policy of a contractor or subcontractor.

The rationale for these exclusions is that such risks are business risks of the insured and that providing coverage for them would be tantamount to providing coverage in the form of a performance bond for work performed by the insured.

One of the limitations of these exclusions is that they often “add back” coverage for resultant damage.

There are a couple of cases out of the U.S. which illustrate that the “own product” exclusion, in the right circumstances, will operate to exclude coverage for damages arising from a mould infestation. For example, in *Leverence v. United States Fidelity*,¹⁶ a builder of prefabricated homes was sued by the occupants for bodily injury and remediation costs arising from mould infestation in the buildings. The allegation was that the buildings were retaining excessive moisture due to faulty design of the walls and roofs, poorly selected materials and poor construction practices. The Wisconsin Court of Appeal ruled that the policy plainly excluded the cost of repairs to the builder’s “own product”.

Similarly, in *Radenbaugh v. Farm Bureau General Insurance Co.*¹⁷ the “own product” exclusion operated to prevent the vendor of a mobile home from being indemnified by his insurer for the cost of remediation to the home which became damaged by mould flowing from the vendor’s bad advice. In that case, the plaintiff was the purchaser of a mobile home constructed by the vendor. The purchaser wanted a concrete basement under the home and hired a contractor for that purpose. The vendor gave the purchaser’s contractor bad advice which, when followed, affected the quality of

the foundation by allowing water ingress through the foundation and eventually mould contaminated both the basement and the home itself. The purchaser sued the vendor. The vendor's insurer refused to indemnify or defend the insured, relying on the "own-product" exclusion in the policy. The Court held that the "own-product" exclusion would only exclude from policy coverage the costs associated with repairing the mobile home itself but not for those relating to the remediation of the basement. The basement was not the insured's "own-product". The *Radenbaugh* case illustrates a typically narrow construction of an exclusion clause in favour of the insured by limiting the exclusion to damage for loss occurring precisely to the insured's (product) contribution to the whole project.

DID THE DAMAGE OCCUR WITHIN THE POLICY PERIOD?

On the assumption that the claim is one for property damage and hence the difficult problem of causation is not really in issue, and on the assumption that there is no applicable exclusion, an insured may tender the defence of a mould claim to the insurer for further action. At this point in time, there must be an analysis of whether the damage occurred "during the policy period".

This opens up a Pandora's box of further issues as it requires one to establish when the damage occurred.

This is not readily determined when mould is not present on the exterior walls of the building. Mould is usually contained within the inner wall cavities and it has been present for a period of time before appearing on exterior walls (if it ever does).

The Courts in Canada have struggled with what is known in legal terms as "trigger theories" to attempt to define when losses actually occur. The four possible "trigger theories" are as follows:

1. The Exposure Theory: when the property was first exposed to the condition that ultimately caused the property damage, the loss occurred. Any further deterioration is simply a manifestation of the damage. As a result, the policy that would apply is the one that was in effect when the first exposure occurred;
2. The Manifestation Theory: the damage occurred when it was first apparent. The policy that would apply is the one that was in place when the insured first knew or should have known of the damage;
3. The Continuous or Triple Trigger Theory: the damage occurred over the period of time encompassing the initial exposure to the condition that caused the damage, to the time that damage became manifest. Any, and all, policies in effect during that range of time would apply to the loss; and
4. The Injury-in-Fact Theory: the loss occurred when the damage actually occurred, and therefore, any and all policies in effect while damage occurred, and kept occurring would apply.

A recent significant case dealing with the trigger theories is the Ontario Court of Appeal case called *Alie v. Bertrand*.¹⁸ *Alie* involved the long-term deterioration of residential concrete foundations due to the inclusion of an inappropriate substance in the concrete mix. The entire foundations needed replacement. Conceptually, the *Alie* court decision instructs persons charged with the burden of determining when damage arose to view the four "trigger theories" as really all applications of the Injury-in-Fact Theory. One should determine at what point or points in the process of deterioration the property damage occurred, and coverage under a particular policy should be triggered if damage occurred during that policy period.

In view of the *Alie* decision, the Court is likely to take a broad view of coverage and in certain circumstances, it is possible that coverage will be “spread out” over a number of different terms. This raises the possibility of entering into cost sharing agreements with various insurers to spread the burden of defending a mould related claim.

In British Columbia, insurers have wrestled with this problem for some time as it relates to the leaky condo litigation and insurers are universally adopting a “time on risk” analysis for dealing with these claims. It will be interesting to see if this process continues as mould claims are advanced.

CONCLUSION

So far we have not seen a proliferation of mould litigation in Canada. However, insurers in Canada may soon be faced with an onslaught of both first party and third party claims for mould infestation if the American experience is any indicator.

In respect of first party coverage, we anticipate that insurers will take a proactive and defensive position in respect of policy wordings to eliminate the problem with concurrent causation. This will limit coverage on a first party basis. To the extent those modifications are not made, there is a significant prospect that insurers will fall victim to the Court’s willingness to construe policy language in favour of the insured and against the insurer.

In respect of third party claims, we can anticipate a spate of claims relating to property damage and a corresponding liability to insurers to defend insureds in relation to those claims. In particular, contractors and subcontractors will likely be the victim of a number of claims for property damage relating to mould infestation.

In relation to claims for bodily injury, we believe that claimants face a significant hurdle in relation to proof of “bodily injury” which will make these types of claims less prevalent than they are in the United States. However, there is a possibility of further claims being advanced for bodily injury once the law in this area has developed and catches up with the desire to proceed. In recent times, the American Courts have remarked that the law is ahead of the science in respect of bodily injury claims and we anticipate that this will remain the case for some time in Canada.

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¹ No. 99-05252 Tex., Travis County Dist. Ct. June 1, 2001.

² Boeck T. and Bolduan L., “Mold: What are the Underlining Exposures?” Paper presented to the Defence Research Institute: Mold Conference, April, 2002,

³ “Aging Schools,” online: CBC Street Cents <<http://www.cbc.ca/streetcents>>

⁴ *MacDonald v. Dufferin-Peel Catholic District School Board*, [2000] O.J. No. 5014 (Sup. Ct.)

⁵ *Taub v. Manufacturer’s Life Insurance* (1999), 40 O.R. (3d) 379 (Ont. Ct. Gen. Div.), aff’d (1999) 42 O.R. (3d) 576 (Ont. Div. Ct.)

⁶ *Derksen v. 539938 Ontario Ltd.* [2001] S.C.C. 72

⁷ F. Fung, M.D. “What is Mould All About?” Paper presented to the Defence Research Institute: Mold Conference, April, 2002

⁸ *R. v. Diguseppe* [2003] A.C.W.S.J. LEXIS 2314, 121 A.C.W.S. (3d) 664 (Ont.C.J.)

⁹ *Mariani v. Lemstra* (2003), 120 A.C.W.S. (3d) 693, A.C.W.S.J. LEXIS 1313 (Ont. Sup.Ct.)

¹⁰ *Privest Properties Ltd. v. Foundation Company of Canada* (1991), 56 B.C.L.R. (3d) 88 (S.C.)

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- ¹¹ *Reid Crowther & Partners Ltd. v. Simcoe & Erie General Insurance Co.* (1993) , 13 C.C.L.I. (2d) 161 (S.C.C.)
- ¹² J. Robert Black and Sean Lerner, “Toxic Mold – Legal Principles as they Relate to Property,” Paper presented to the Canadian Litigation Counsel Conference , Mold: The Emerging Enemy
- ¹³ *Zurich Insurance Company v. 686234 Ontario Limited* (2002), 62 O.R. (3d) 447 (Ont. C.A.)
- ¹⁴ *Lexington Ins. Co. v. Unity/Waterford-Fairoaks Ltd.* (2002) US Dist. Lexus 3594
- ¹⁵ *California Capital Insurance Co. v. Sacramento Partridge Pointe, et. al.*, No. 00AS0996, Calif. Super., Sacramento Co.
- ¹⁶ 462 N.W. (2d) 218 (Wis.App. 1990)
- ¹⁷ [2000] MI-QL, 1121 (Mich.App.)
- ¹⁸ *Alie v. Bertrand and Frere Construction Co.* [2002] O.J. No. 4697 (C.A.)