The Risk Advisor's Survival Guide to Mold Exclusions

(Published in the Environmental Claims Journal, Winter 2003)

By: David J Dybdahl, CPCU, ARM, MBA
Senior Consultant, American Risk Management Resources Network

Steven J. Lemon
Attorney at Law, Jones Lemon Graham & Clancy

Risk Advisors Are Positioned To Be The Insurer Of Last Resort For Toxic Mold And Environmental Damages

Fear of toxic mold has created a storm of environmental damage claims with unprecedented frequency and severity. By fact, history and circumstance, risk advisors have been positioned to be the insurer of last resort for the uninsured environmental and toxic mold claims of their clients. In this paper we will discuss the trends that lead to this conclusion and present a simple loss prevention protocol that risk advisors can follow to avoid professional errors, acts and omissions claims in this area.

Damages from toxic mold have created unprecedented professional errors and omissions loss exposure for insurance and risk management advisors. Toxic mold claims are much more frequent than either asbestos or superfund claims. Insurance companies have taken the lessons learned from their dismal experience with asbestos and superfund claims and have moved proactively to exclude mold claims from all property and liability policies. To completely shut the door on their exposure to toxic mold claims, the professional liability underwriters are adding mold and even new pollution "related" damage exclusions to insurance agents' professional liability policies. With insurance available to cover environmental damages including covering mold as a pollutant on commercial accounts and the availability of buy backs for mold damages on homeowners insurance policies, the professional liability underwriters wisely did not want to become the insurers of last resort for the mold and pollution loss exposures the risk advisors were negligently leaving unaddressed in their customer base.

The new mold and environmental related damage exclusions on the risk advisor's professional liability policies are unusually onerous. Not only do they exclude claims for current activities, they exclude everything the advisor has done in the past that leads to an uninsured claim today. The professional liability insurance policies purchased by insurance agents, brokers and consultants cover the claims made against them during the policy period for professional errors and omissions. Each new professional liability policy purchased usually provides coverage for the new errors, acts and omissions made during the policy period, plus all of the prior acts of the insured. Therefore the new professional liability exclusions will also exclude everything the advisor has ever done in the past to leave a client unprotected for environmental and mold losses. Risk advisors can avoid potentially uninsured professional liability claims by following a five-step protocol that is designed to provide a high degree of professional service to the client and eliminate errors and omission claims from the unnecessarily uninsured environmental and mold losses of the client. Implementing the five-step process today can help erase the professional liability loss exposures from the past as well.

Toxic Mold Has Insurance Companies Running For Cover

The explosive growth in toxic mold damage claims in 2001-2002 has the entire property and liability insurance industry running for cover. As tens of thousands of property owners seek insurance recoveries to pay for expensive mold remediations, mold exclusions on new homeowners and property insurance policies are destined to force the transformation of many first party insurance claims into a new wave of liability claims against potentially liable parties. These property damage and personal injury liability claims will also likely be excluded by mold exclusions in the new liability insurance policies purchased by the defendants. Ultimately a significant number of these uninsured mold claims will find their way to the insurance advisors in the form of professional errors and omissions claims for leaving their clients uninsured for mold related damages. There is specialty environmental insurance and homeowner insurance to cover mold related damages available in the insurance market place. However insurance agents, insurance brokers, risk management consultants and lawyers that advise their clients on risk management issues have largely ignored these specialty insurance products in the past. The historic apathy of risk advisors towards environmental insurance in general and mold insurance products specifically, will leave tens of thousands of future mold damage claims unnecessarily uninsured.

Three Waves Of Toxic Mold Claims

Three separate waves of claims will be generated by the toxic mold damages storm. The first wave hit the property insurance companies' beach in the form of claims for the restoration of mold related damages with a healthy dose of alleged bad faith claims adjusting by the insurance companies and bodily injury as a result. When the first wave hit shore, the unsuspecting insurance companies writing homeowners insurance, especially in Texas, were swept off their feet. The mold claims were so bad for Farmers Insurance Company they wanted to surrender their license to do business and leave the state of Texas entirely. To regain their footing the insurance companies put in new mold exclusions to serve as break waters against the on coming waves of toxic mold claims. With an ocean of toxic mold claims around them, in virtually every state, new mold exclusions were added to all personal and commercial lines insurance policies on a nationwide basis in 2002.

Foreseeing the transformation of property damage claims into liability claims, the underwriting community actually built two breakwaters with their exclusions, one breakwater for property claims and one for general liability claims. The exclusionary breakwaters constructed by the insurance companies on homeowners, property and general liability policies will effectively shelter them from the oncoming waves. But these breakwaters will not protect insurers from claims made prior to the exclusions, new liability claims for losses that took place prior to the new exclusions taking effect or from the professional errors and omissions risk of the risk advisors that work with property and liability insurance policies. Thousands of personal injury lawyers have attended hundreds of seminars during the past four years where the words "Mold is Gold" are used. These lawyers are unlikely to let recently minted exclusions on insurance policies prevent them from finding the ultimate party to pay for their clients' damages. In the absence of a single deep-pocket insurance company, all they need to do is find a set of

defendants whose combined assets make it worthwhile to pursue legal actions against them. These damage recovery efforts are certain to create two more waves of toxic mold claims.

The second wave of mold claims is approaching shore but has not crested. Tens of thousands of uninsured mold-related damage claims on property and homeowners insurance policies will soon be transformed by plaintiffs' lawyers into liability claims for property damage and bodily injury. While mold exclusions on property insurance may prove to be valuable as the breakwater for the property insurance underwriters, the property insurance breakwater may protect one beachhead at the peril of others. The incessancy of the storm means the newly excluded wave of property insurance claims will simply be deflected to property damage and bodily injury liability claims in other industries. Farther down the shore is the responsible party beach, an as yet unaffected shore inhabited by contractors, home builders, roofers, plumbers, engineers, building inspectors, architects, building products suppliers, real estate professionals, landlords and similar classes of business who will be the targets of these deflected and now transformed property claims from the first wave.

Fresh from their experience in environmental damages from superfund and asbestos claims, the insurance companies wisely predicted the second wave of mold claims coming and built a second breakwater to protect themselves they added mold exclusions to liability insurance policies. Part of the energy from the second wave will be deflected back to sea by the general liability mold exclusion breakwater. That energy will not disappear, and neither will the persistent plaintiffs' lawyers who will find the breakwater's resistance to be nothing more than a signal to look elsewhere for weaknesses. This can be seen as the impetus for the coming third wave.

The second breakwater will not stop the liability wave from hitting the shore; it will just have less energy that it could have. Where insurance exclusions for mold do nothing to protect the responsible parties, it does make them less attractive as individual targets for damage recovery by personal injury lawyers. Assuming enough defendants can be assembled to create an attractive asset base, there will be personal injury lawyers available to pursue these damage claims on contingency. The threshold damages amount to bring an action on a contingency fee could be as low as $30,000 in some venues. With the average mold remediation claim being in $20,000 range, reaching the dollar threshold by adding in attorney fees, additional living expenses and medical monitoring is not that far away for many claims. With a long list of possible responsible parties for a mold damages case, assembling an attractive asset base, even if there is no insurance, will be relative simple for the personal injury lawyers. The second wave of mold damage claims will create uninsured liabilities for thousands of responsible parties. The record will show that many of these firms could have purchased environmental insurance covering mold related damages and this will be the beginning of the third wave.

The third wave of professional liability claims against risk advisors is just a swell off shore, barely noticeable to the casual observer. This wave is directly headed for the risk advisors that left their customers unintentionally uninsured against the mold damage storm. Broader in its base than the first two waves, it will pick up the energy that was deflected by the first two breakwaters.

The risk advisor professional liability beachhead sits between the two safe harbors constructed by the insurance companies for property claims and liability claims, totally unprotected from the storm. As the third wave approaches shore, the breakwaters constructed by the property and liability insurance companies will channel it to give it more height. In addition to the initial amount of energy (uninsured toxic mold property and liability claims) this wave started with, it has been amplified with legal expenses, personal injury and bad faith claims. As this swell approaches shore, observers will see that it consists entirely of uninsured claims seeking to reach as far ashore as possible in hopes of unleashing a great fury on some "liable" parties. There will be few safe harbors providing protection to risk advisors from the third wave. This wave threatens to wash over risk advisors who have very limited defenses, making its landfall as professional liability claims against them. Insurance agents and brokers, as well as risk management consultants and lawyers, all of whom advise their clients on issues of risk management and insurance, will be caught in this maelstrom for failing to advise, recommend and/or procure the proper insurance against mold and mold-related losses for their clients.

To avoid becoming subject to what is very likely to become, at least effectively, retroactively uninsured professional liability claims in the near future, risk advisors must immediately implement appropriate mold risk management protocols for their own professional services to build their own safe harbor from these claims. The environmental risk management protocol for risk advisors is a very simple five-step process that involves advising clients on the need for appropriate insurance, explaining gaps in existing coverage, if any, and then recommending, or offering to procure (depending on the relationship with the client) the necessary or appropriate insurance as it becomes is available. This same relatively simple loss control protocol can be used with equal success for all loss exposures. However we will focus our discussion on environmental damages and specifically on mold related damages.

There are five essential steps to implementing an environmental loss control protocol for risk advisors. These steps are:

1. Establish the scope of work to be undertaken on behalf of each client.
2. Advise clients about their exposure to loss by determining the environmental risks specific clients face.
3. Advise clients about insurance that is available and how the environmental exclusions in certain insurance policies can leave them uninsured for particular losses.
4. Recommend the purchase of and, if applicable, offer to procure for clients the appropriate insurance, as it becomes available in the market place.
5. Complete the work by providing clients with written statements, which will document the activities and the client's responses.

Insurance agents and brokers rarely utilize this simple five-step process to address their clients' environmental loss exposures. In practice, the vast majority of insurance agents and brokers assume step 1 is understood and usually just point out the new mold exclusion – without addressing steps 2, 3 and 4, which leaves the door wide open in most states for professional liability claim against them. Perhaps even more troublesome is that step 5 is not even considered by persons whose main responsibility is to manage losses through the proper use of written contracts.

Although the legal responsibilities of insurance intermediaries for their baseline professional standards of care can vary a great deal on a state-by-state basis, virtually every risk advisor desires to render good professional advice and assistance to their clients. Regardless of the legal responsibilities, implementing the above protocol makes sense from the business relationship standpoint alone. No risk advisor wants to break the news to a client that there has been a surprise uninsured loss and no advisors wants to stand unprotected against the third wave of mold damage claims.

As a precaution against such later claims, make certain that you follow three guidelines when preparing the completion statements noted in step 5. First, the completion statements must comport with the applicable established scope of work. Second, the completion statements must advise your clients that the extent and value of their coverage's will change over time and with alterations to their businesses. Third, the completion statements must advise your clients that you believe your work is completed and they have requested nothing further from you.

In the brief period since insurance agents and brokers began delivering "mold exclusions" to most of their clients (beginning in May of 2002), a significant number of the mold damage claims incurred by their clients already could be incurred professional liability claims, maybe not yet reported, but still working their way through the system. The dangerous progression of a mold damage claim to a professional liability claim is detailed in the following discussion of the 3rd Wave of mold claims.

The 3rd Wave Creates Unprecedented Professional Liability For Risk Advisors.

An unprecedented sequence of events and circumstances has positioned risk advisors to be the deep pockets of last resort for uninsured mold claims.

With the emergence of mold as a new "pollutant", the number of insurance buyers that are now exposed to uninsured "environmental" losses has increased dramatically from historical levels. As the chart below shows, the number of insurance buyers that are affected by the mold exclusions on an annual basis far exceeds the total number of insurance buyers that were affected by superfund and asbestos claims over the past twenty years. With the claims frequency in their customer base at much higher levels than either superfund or asbestos, risk advisors chances of having a client with an uninsured "environmental" loss have increased dramatically because of toxic mold claims.

Relative Number of Mold Losses

	Asbestos/20 years	Superfund/20 years	Mold/2 years
# of Firms* Affected	3000	5000	10,000,000**
# of Claims	500,000+	Less than 100,000	150,000 mold claims in 2002
$ Total Paid	$20 Billion paid to date	$26 Billion paid to date	More than $4 Billion paid
Future	$100 Billion /20 year	$26 Billion next 20 years	$76 Billion*** in total

*** More than $100,000 in loss exposure**
**** With mold exclusions on their insurance policies**
***** Insurance Litigation Reporter July 2001**

Mold damage claims when compared to asbestos and superfund claims create a stark contrast in the potential professional liability loss exposure of risk advisors. Not only are there dramatic differences in the number of clients that are affected by mold exclusions, there are important differences in the classes of insurance buyers that are affected by mold related losses and dramatic differences in the historical availability of prospective insurance to cover those losses. In combination, the frequency of newly excluded mold related claims in the face of prospective insurance availability in the market place for mold damages, increases the professional liability exposure of risk advisors for uninsured environmental damages and toxic torts to unprecedented levels.

In contrast to superfund and asbestos claims, mold claims are much more likely to focus on middle market businesses and homeowners. The risk advisors that provide services to these sectors will be in the middle of the fray as their clients are force to deal with expensive mold related losses.

The bulk of superfund and asbestos claims have been aimed at the largest companies in the United States. With the insurance brokerage consolidations of the 90's, the vast majority of these target companies ended up in the historical client base of a hand full of the largest insurance brokerage firms. Since there was very limited prospective insurance available to insure superfund and asbestos liabilities, the servicing brokerage firms never faced professional liability on a broad scale for the superfund and asbestos losses in their customer base. Superfund and asbestos claims missed the independent insurance agents and direct writers customers all together. While this was a very good thing for these insurance agents it also leaves them completely unprepared to discuss the environmental insurances that are available to cover mold related damages. This is just another factor that exacerbates their exposure to professional liability claims in this area.

The availability of prospective insurance covering mold related damages is also in sharp contrast to the availability of prospective insurance to cover asbestos and superfund claims. There was virtually no insurance available to cover superfund or asbestos claims in the 1980'as these topics were surfacing as risk management challenges. Therefore the risk advisors did not have the option or responsibility to advise their clients on the coverages available to deal with these loss exposures. Insurance for commercial insurance buyers covering mold as a "pollutant " under various environmental insurance policies is available for building owners, contractors and services providers. Combined with the availability of buy backs for mold damages on homeowner's insurance policies the risk advisors professional liability exposure for their client's uncovered mold damage claims has been supercharged with claims frequency and limited defenses.

Risk Advisors As The Insurers Of Their Client's Negligence

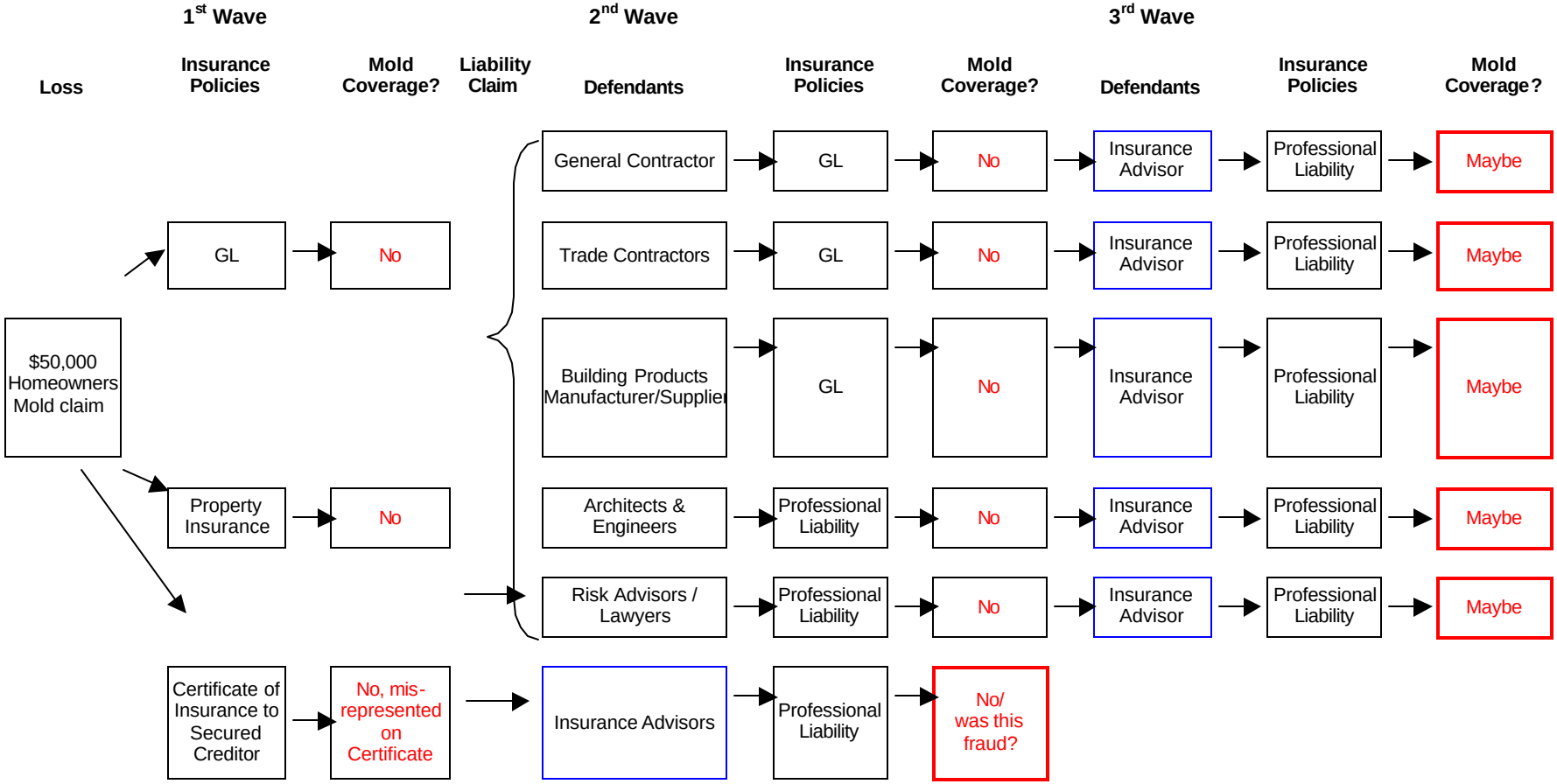
Risk advisors who have not implemented the five-step environmental risk management protocol could even become the insurer of last resort for the negligence of their clients. For example, construction defects that allow water intrusion in buildings often result in mold damage claims. These mold damage claims against the contractor could easily be transformed through the negligence of the insurance intermediary into a professional liability claim against the

intermediary for leaving their client uninsured. Environmental impairment liability insurance to cover the mold related damages of contractors has been available in the insurance market place since 2001 with minimum premiums as low as $2500. The professional standard of care required for insurance intermediaries in the state the contractor is domiciled in and how well the agent or broker implemented their five step environmental loss control protocol, will determine the degree to which the agent or broker will be responsible for the uninsured general liability claim of their client.

Risk Advisors Are Relatively Easy Targets.

As armies of well educated and coordinated plaintiff's lawyers bear down to recover damages and legal fees on tens of thousands of mold related damages cases, universal mold exclusions and limitations in new and renewal insurance policies will create a domino effect of successive claims into new classes of defendants. Ultimately a third wave of professional errors and omission claims being made against risk advisors for failure to procure the appropriate insurance for their uninsured clients. This sequence is shown in the following chart titled "The Domino Effect of an Uninsured Mold Claim."

Domino Effect Of An Uninsured Mold Claim from Property insurance to General Liability insurance to Professional Liability insurance



As the domino flow chart shows, one uninsured mold claim could easily affect five different risk advisors.

Risk advisors will have a relatively narrow set of defenses available to them in these future cost recovery actions. Advisors who have not implemented their own aggressive mold related claims risk avoidance protocols will be a relatively easy target for the plaintiff's bar. In the third wave of mold damage cost recovery efforts, the claims against the risk advisors will not be directly related to the damages created by the mold. Instead, the third wave of claims will be for professional errors and omissions in failing to advise their client on the need for appropriate insurance for mold related damages and for failing to procure this coverage. While the defendants in the first and second waves of mold damage claims have a wide array of viable defenses, failure to advise and failure to procure appropriate insurance is a well-established professional liability cause of loss for insurance agents and brokers. It will be easier for plaintiffs to secure damages from risk advisors that negligently leave their clients uninsured for toxic mold claims than it will be to prevail against the breakwaters set up by the insurance companies for the first and second wave of claims.

Are Risk Advisors Assets Destined To Be The Deep Pocket Of Last Resort?

A small but influential group of professional liability insurance and reinsurance companies were quick to forecast the logical progression of an excluded mold claim on a homeowner's insurance policy thru the second and third waves of cost recovery actions. In response, some of the professional liability insurance companies are adding new exclusions for mold related damages and even pollution related claims exclusions to the professional liability insurance written in 2003. This action has been taken by the professional liability underwriters years before the thousands of mold damage claims in the legal system today have even reached the second wave of claims for cost recovery.

With the emergence of separate mold and pollution "related" claims exclusions in the professional liability insurance policies of insurance practitioners and lawyers, there is a good chance that any professional liability claims made against risk advisors for leaving their clients uninsured for "environmental losses" will be retroactively and prospectively excluded from the advisors own professional liability insurance.

The availability of environmental insurance to cover mold related losses on commercial accounts and the buy backs offered on some homeowner's insurance policies has raised risk advisors professional liability loss exposure for uninsured environmental losses to new heights.

The environmental insurance market has been providing environmental insurance covering mold related damages for commercial insurance buyers at least since March 2002. In addition to the existence of a healthy and competitive market for environmental insurance covering mold damages and other indoor pollutants, the professional errors and omissions loss exposure of risk advisors is increased by the amount of information about this specialty insurance that is available on the Internet today. An Internet search in January 2003 utilizing the Google search engine for the words "mold insurance" produced one hundred and sixty three thousand hits. On the first page of the search results, the Environmental Risk Resources Association website is shown

listing "Mold related resources, find out how the environmental underwriters are responding to mold" in the contents line. The first link on the ERRA website listed the entire commercial insurance market for mold insurance. With Internet access and the ability to spell "mold insurance" any novice could identify the entire commercial mold insurance market with ten insurance companies selling the insurance within two minutes. The ERRA site also includes a directory of volunteer environmental insurance specialists that can be easily contacted for assistance. Because of the Internet, risk advisors will find it increasing difficult to create a successful defense utilizing the lack of general knowledge in the insurance market place as reason for failing to procure appropriate insurance for mold.

With weakened professional standard of care defenses making them an easy target for damages, and exclusions on their own professional liability insurance, risk advisors are positioned to pay far more than their share of mold related damages claims. In effect they are positioned to be the deep pocket of last resort.

Professional Standards Of Care, How Will Risk Advisors Be Held Liable For These Losses?

The client's uncovered loss may quickly become the risk advisor's loss when that insurance intermediary has failed to fulfill his or her duty to the client. The failure may be unintentional, it may be due to someone else's action or inaction, or it could arise from faulty practices – even well intended ones. The fact remains the same: Failure to fulfill one's duty to the client will leave the risk advisor vulnerable to payment of losses sustained by the risk advisor's client. Because the only way to fulfill one's duty is to understand the breadth of that duty, the question of the moment becomes this: What duty does the risk advisor owe to the client? Because the third wave is still far off shore we have to draw parallels to other references in the advisors standard of care

The question of a "duty" owed to a client assumes that the discussion has moved beyond whether the parties to a contract have fulfilled their legal obligations under that document. A "duty" to a client arises only when there is a relationship in which one party reasonably relies on another for assistance, support or advice. We know this relationship as one of agency, where the principal, in this case the client, relies on the expertise of the agent, or in our case, the insurance intermediary. As an Oregon court found, the failure to procure insurance on behalf of a client may amount to negligence, but there is no cause of action until the insured is able to plead the existence of an agency relationship, which gave rise to a duty. Serles v. Beneficial Or., Inc., 91 Or.App. 697, 756 P.2d 1266, 1269 (1988). In an agency relationship, the agent owes a duty to the principal to act in a professional manner and in the best interest of the principal. Once it is established that an agency relationship exists, the question of whether the agent has fulfilled his or her duty to the client is answered by comparing the agent's actions to the standard of care established for that particular type of agency relationship.

In some states the insurance agent or broker is considered to be a professional who has specific skills and knowledge in a specialized industry. This is why courts have found it reasonable for a client to rely very heavily on the insurance intermediary's advice and comments. At the same time, there is an understanding that not all relationships between clients and risk advisors are the

same. Therefore, the question of duty is based on the relationship, and the standard of care to be applied will vary based on the level of that relationship and the reasonableness of the client's reliance on the action or inaction of the risk advisor. While this may sound comforting to the insurance agent who feared claims from unknown quarters, the real concern is that the obligation is heavily based on the expectations, whether silent or spoken, of the client.

The standard of care to be applied varies not only according to the relationship, but also from state to state, because the question of liability for negligence is one of state law. A few states have established the agency relationship between insurance intermediary and client by statute. Oklahoma and Maine have done this, for instance. In most states, though, the determination is made based on the growing case law. Regardless of how the agency relationship is determined, the courts always make the next determination, answering the question "What is the standard of care owed to the client?"

Each risk advisor will be subject to the laws of the state or states in which he or she places insurance. Depending on the state, the applicable standard of care may be one of "reasonable care" or one of "fiduciary duty" to the client. As the wording implies, the fiduciary duty standard of care will require much more of the risk advisor. The "reasonable care" standard is one that is measured in the context of the profession. This standard compares the risk advisor's actions to those of other insurance intermediaries in the area and questions whether the agent acted according to the normal or established practices. If not, then the risk advisor will be found liable to the client.

The Internet will raise the standard of care over time as the information available to the intermediary takes on a more national versus local flavor. For example with the entire commercial mold insurance market being listed in the first page of results from a popular search engine, is it still a viable defense for a risk advisor that there is no reference to mold as a cause of loss in either the study guides for a state insurance agent licensing exams or in the course materials of the highly acclaimed Chartered and Property Casualty Underwriters course? The effect of the Internet in raising insurance intermediaries' standards of care is largely untested. However, it is certain to come up in the arguments of the third wave of mold claims.

The rising tide of cases is moving insurance professionals into the higher standard of care, that of fiduciary duty to the client. The most likely reason for this rise is the fact that insurance agents and brokers often establish themselves, for competitive advantage, as persons with expertise who will undertake more of the client's risk analysis than they have in the past. By taking a more active role in evaluating the client's risk, and therefore the client's perceived need for insurance, this insurance intermediary has placed himself or herself, literally, in the position of the client. By doing so, this risk advisor has assumed such an identity with the client that the obligation of that risk advisor has risen to the highest level. No longer will the insurance agent or broker be responsible to place insurance appropriate for the client's requested coverage, that risk advisor now must determine if gaps exist, if other potential losses could or should be insured, what policies are or are not available, and whether the coverage (or lack of coverage) would have any material financial impact on the client. Then, the risk advisor needs to provide the full information and advice to the client and do so regardless of whether it helps or hinders the risk advisor's own business prospects.

In several jurisdictions, notably New Jersey, Illinois and Missouri, the very fact that the relationship between insurance agent and client is not simply a contractual one gives rise to the highest standard of care. For these jurisdictions there is no need for a factual inquiry as to the applicable standard of care. Instead, once the agency relationship is established, the courts have found, as a matter of law that a fiduciary duty is owed by the insurance intermediary to the client. In such circumstances the determination of an agency relationship becomes quite critical and it is important to be fully advised of the applicable case law. See, State Security Insurance Co. v. Frank B. Hall & Co., 630 N.E.2d 940, 945 (Ill.App. 1st Dist. 1994); and A.G. Edwards & Sons, Inc. v. John R. Drew and the Daniel and Drew Company, 978 S.W.2d 386 (Mo.App. E.D. 7/31/1998).

A review of the cases in which courts have found insurance agents and brokers liable to their clients for failure to live up to the applicable standard of care shows that it does not matters whether the insurance intermediary is a international insurance broker placing millions of dollars of coverage for multi-national companies, a direct writer for an insurance company or a small independent agent. The standard of care is the same for each type of intermediary. As noted earlier, it is the relationship between client and intermediary, which establishes the obligation and duty.

The professional liability exposure for the direct writers and the independent agents is being elevated to unprecedented levels by mold and environmental damage claims in the face of ever increasing specialty insurance availability for these causes of loss. The third mold claims wave will hit these agents unusually hard unless they implement their own mold and environmental risk management protocols as we have suggested. The disproportionately high professional liability exposure for direct writing and independent insurance agents to the third wave of mold arises from four sources. First, because these agents insure homeowners and smaller commercial accounts they are disproportionately exposed to mold-related damages in their book of business. Second, these insurance agents' clients are not sophisticated professional buyers of insurance, therefore the agents' customers are more likely to see their agents as the only link they have to the world of insurance. Third, these same clients are much more likely to assume their agents know exactly what is needed to manage their risks – even if they have not expressed this by voice or pen. Forth, within the world of direct writers, where the insurance agent is an employee of the insurance company they sell products for, the agents' access to knowledge about insurance products that are not sold by the insurance company that employs them is restricted. With effectively the same professional standard of care owed to the customer as an international insurance broker with their knowledge sharing networks, specialty practice groups and wide access to insurance products, the direct writers and independent agents will need to work diligently, on an individual basis, to avoid the third wave of mold claims.

Actions of the client can affect the duty of care owed to the client. Simple acts by the client can lead to catastrophic results for the agent or broker. For example, if the client provides a stack of documents and says, "Here, this represents the work I do and the losses I need covered," then the risk advisor immediately has become obligated to fully understand the client's position and advise on what additional coverage may be required. In the case of Butler v. Scott, 417 F.2d 471 (10th Cir. 1969), a client entered into a contractual relationship with another party, and he

provided a copy of the contract to his insurance agent. The insurance agent was found liable for not advising the client to procure coverage for exposure relating to hold harmless provisions in the contract. The agent apparently failed to adequately review the contract and the client's overall insurance position. This means that the risk advisor's inaction in not placing new coverage can bring just as much liability as if that agent has procured the wrong policy or insufficient limits.

As noted before, a client's assumptions can be devastatingly damaging to an insurance intermediary. In one Florida case, an insurance agent was found liable to the insured for an uninsured loss sustained when the insured's grocery stores suffered tremendous losses resulting from a power failure following a hurricane. Most of the losses came from spoilage of perishable foods. Although the insured admitted it never advised the agent of any special need for coverage relating to perishable goods, the insured had requested coverage against perils such as "acts of God" and had received assurances from the agent that insured was "fully covered . . . and did not need any other coverage." The court found it important to note, "that in accepting the proposal [the insured] relied upon the agent's expertise and assurances that the policy would provide full coverage." Warehouse Foods, Inc., v. Corp. Risk Mgt. Services, Inc., 530 So.2d 422 (Fla. Dist. Ct. App. 1988). A parallel to mold damages would be failure to procure adequate insurance to replace the coverage that is being eliminated by the new mold exclusions in all standard insurance coverage's.

In another case of tremendous importance, an insurance agent was found liable for failure to procure the insurance coverage sought by the insured. While such liability may not be uncommon, what is of great consequence in this case is that the insurance agent was a third-party in a lawsuit and was found directly liable to the injured party – who was not even the insured! In Trahan v. Baileys Equip. Rentals, Inc., 383 So. 2d 1072, 1077 (La. 1980), the insured was told he was fully covered in a commercial auto liability policy, but the policy excluded use of vehicles at distances more than 50 miles from insured's business. When the insurer successfully denied coverage for an accident that occurred more than 50 miles distant, the agent was found liable for the uninsured loss, because he failed to advise the insured of the limitation in the policy. When the client found that he had no insurance to cover the losses related to property damage and severe injuries to a non-employee passenger in one of his trucks, he turned his wrath upon his insurance agent. In the end, the agent was liable to the client for property damages and to the unrelated passenger for physical injuries.

The facts to remember from this case are chilling. The insured never read the policy – he didn't need to because he reasonably relied on his agent's recommendation. The insured didn't say he needed to have his truckers covered if they drove more than 50 miles away – he didn't have to because he asked to be "fully covered" when he talked to his agent. The third party could collect damages from the agent even though no relationship existed between the truck passenger and the insurance agent – the determining factor was that the agent should have procured coverage for the foreseeable event of having a passenger riding in a truck while it was being driven in an area not covered by the policy. There are logical connections between this case and the second and third wave of mold claims. It is not difficult to imagine a claim against an architect for mold-related damages to a building she designed. When coverage is denied, because of a mold exclusion in the architect's policy, and the architect is found liable to the builder and various

third parties, the agent is very likely to be found liable to the architect for not advising of gaps in coverage, or of other available coverage's or for otherwise failing to procure the insurance expected, anticipated or needed by the architect. Further, the architect, who has been sued by the building's residents, who themselves have lost possessions and have been hospitalized because of exposure to toxic mold, will succeed in having the agent found liable for these damages as well – all because the agent should have foreseen that such losses were possible. In fact, it is possible that the building's residents will state claims directly against the insurance agent. Though fairly uncommon cases, third parties have succeeded in other claims against insurance intermediaries for failing to procure appropriate insurance that could have covered foreseeable losses. See, for example, Eschle v. Eastern Freight Ways, Inc., 128 N.J. Super. 299, 319 A.2d 786 (Law Div. 1974). The untested question here is whether a group of homeowners, through a homeowners associated, will make significant property, casualty or professional liability claims directly against the insurance agent or agents who failed to properly advise the building contractor of the contractor's exposure for mold claims or the available insurance to cover such claims. As these cases suggest, the legal option is available, the real question is just when the claims are going to be made.

In the Trahan case, and in fact in most cases, the extent of the risk advisor's liability will be capped at the policy limit(s) of the policy or policies that should have been in place. This could be of little consolation to commercial insurance buyers where the environmental insurance market including mold coverage is measured in the tens of millions of dollars. In certain circumstances, ones that depend heavily upon the facts, the insurance intermediaries' liabilities could extend well beyond the applicable policy limits. In one notable example, an insurance agent was requested to place insurance for a building contractor. The agent was told that this insurance was a necessary precursor to the contractor's ability to place a bid on a significant contract. When the agent failed to place adequate insurance, the contractor's bid was rejected (specifically for the failure to have adequate insurance), and the contractor succeeded in the claim against the agent. The damages were not contract damages or actual losses, but instead were consequential damages. The contractor was able to recover from the agent the amount he would have received in profits had he succeeded in gaining the construction contract. Riedman Agency, Inc. v. Meaott Constr. Corp., 90 A.D.2d 963, 456 N.Y.S.2d 553 (1982).

How do these cases involving spoiled groceries, lost bids on construction contracts and injuries to truck passenger's affect the insurance intermediary when they are advising clients on mold coverage? The simple answer is these cases reveal that the standard of care applied to risk advisors, even for matters outside their actual knowledge or outside the scope of their normal business, is higher than most advisors may realize. Risk advisors have to view the mold insurance issue from the client's point of view. A request for "full coverage" may mean more than the standard policy coverages and will require placement of new insurance policies from new carriers. If the insurance provider(s) cannot underwrite the risk(s), the risk advisor in most states will still have a duty to recommend the appropriate insurance and offer to assist in procuring it.

Where Did All These Toxic Mold Claims Come From? Is This For Real?

One of the state insurance agent associations recently ran an article in their newsletter regarding mold damage claims. The article was based on a survey of medical professionals that concluded the majority of medical researchers did not think there is a direct link between exposure to mold and bodily injury in humans. The article was promptly forwarded by an insurance agent to an association of contractors with a cover note suggesting everyone's problems with mold liability would soon be over. By implication, if the agent and the contractors just ignored the "mold issue" it would certainly go away.

Can insurance advisors or anyone else with a potential liability exposure to mold related damages follow the advice of the insurance agent? Only if there is a big cash prize somewhere for being a professional martyr. The science linking mold damages to bodily injury is weak. However these battles are being fought in the courtroom and there are winners and losers on each side of the argument. There are other arguments that say toxic mold kills people. No client will be satisfied with the insurance agent's news clip to serve as their sole line of defense if they have a claim. Regardless of the scientific backing, toxic mold claims are real for everyone involved with them.

There are more mold damages claims being made because there really is more mold in buildings than there was even ten years ago. There are also theories that some forms of mold harms humans and plaintiff's bar knows this. The root cause of an increasing amount of mold in buildings can be traced to a change in building materials and construction techniques over the last twenty years. There is much more "was wood/cooked wood/recycled wood" in the building products developed over the past twenty years. Mold loves to eat cooked wood, where the heating of the cellulose breaks down the cell walls making it easier for mold to digest the sugars inside the cell. The airtight construction of buildings also contributes to the frequency of mold damages. Although airtight construction is excellent for energy efficiency, it can create the ideal growing environment for mold if water gets inside the walls and cannot dry out. Entire buildings have turned into giant petri dishes for mold growth where food (cooked wood), water (trapped in walls that cannot breath), and temperature (places that humans find comfortable) are combined to grow mold in concentrations that make the building uninhabitable. Uninhabitable? In addition to the physical changes in construction, what caught the entire insurance industry by surprise was new science linking "toxic mold" to bodily injury. The plaintiff's bar saw the connection three years ago, more mold in buildings combined with bodily injury from exposure to "toxic mold" would create claims frequency with bodily injury severity, and there would be responsible parties with deep pockets, the perfect combination for a new legal cottage industry.

Conclusion

To avoid becoming the insurer of last resort for toxic mold even for their clients' negligence, risk advisors will need to implement their own environmental risk management protocol. We have previously presented a five-step process to accomplish this.

In conclusion we will comment on where we see the most chronic breakdowns in the five-step process risk management protocol. In specific reference to environmental damage claims

including mold related loss exposures we know that from practical experience the vast majority of insurance agent, brokers and consultants are neglecting to:

1. Advise their clients they have environmental loss exposures including mold related damage exposures. Advising a client about potential environmental damages will usually require specialized expertise. Exposure to losses due to mold damage is much easier to access. Anyone who owns, leases or sells property frequented by humans and animals, and anyone who builds, or provides any services or materials to those buildings has a mold loss exposure. This definition represents a good part of the American economy and includes at least fifty million insurance buyers.

2. Offer appropriate insurance to cover the environmental and mold risks faced by the client. This could be as simple as offering the buy back of sublimits on homeowner's insurance policies. On commercial accounts it will most likely involve the purchase of a customized environmental insurance policy. This is a much more complex undertaking. The environmental insurance market is constantly adapting to the demands of the market place. There are over one hundred different manuscript environmental insurance polices available, most can be adapted to cover toxic mold. Coverage is routinely provided for professional liability, bodily injury, property damage, restoration, defense and business interruption. The major constraint in this market will be minimum premiums which are today in the $3,000 range for a $1,000,000 policy. Accessing accurate information on environmental insurance can be a challenge. As a general rule, anything on a bookshelf will not present an accurate picture of the competitive fast paced world of the environmental insurance market. The Internet is a much better source of current information. A February 2003 search for "environmental insurance" produced 1,500,000 hits including many pages of environmental insurance underwriters and brokers. The website of the not for profit Environmental Risk Resources Association at www.erraonline.org contained a large library of environmental insurance topics including over 700 links to other websites with relevant content. This site also contains a directory of environmental insurance professionals that have volunteered their time to answer inquiries about environmental insurance.

We have noticed that risk advisors do routinely follow at least one of our recommended steps. Virtually all of them advise their clients that there is a new mold exclusion on the property and liability insurance policies they are selling. However, they virtually never complete the risk management process by first advising the client of the environmental risks they face, offering appropiate coverage and documenting the file.

The vast majority of risk advisors historically ignore the needs of their clients for specialized enviornmental insurance coverage. This is in spite of the fact information on environmental insurance and mold risk management is readily available for free on the Internet. There are also all of the traditional newletters, seminars and knowledge sharing networks that can be accessed. A word of caution here, not everything written about these subjects is accurate or even good advice. Remember the agent who sent the newsletter to the contractors association? Specialty environmental wholesalers can provide a wealth of knowledge and experience to assist in

completing the five-step process in a very time efficient and cost effective manner on commercial accounts. There is a healthy two billion dollar premium insurance market for commercial environmental insurance that will provide up to one hundred million dollars of insurance coverage on a single risk. If the risk advisor goes through our five-step process and the customer actually purchases a policy, the advisor will usually make money. In summary there is insurance product available, there is ready access to knowledge on how use the products and the finanacial incentives for the risk advisors are inline with the needs of the customer.

About the Authors

David Dybdahl is an independent insurance broker/consultant/expert with American Risk Management Resources, Network, LLC, in Middleton Wisconsin, specializing in environmental risk management and insurance. He has over twenty years of hands on experience in the brokerage of environmental insurance. He has placed environmental insurance on the decommissioning of nuclear weapons facilities and on the clean up of Chernobyl as well as hundreds of less famous places. His work today involves insurance placements, risk management consulting, and providing expert and fact witness services in cases involving environmental insurance. He has both bachelors and masters degrees in risk management and insurance from the University of Wisconsin-Madison and is the co-author of the Society of Chartered Property and Casualty Underwriters text on environmental insurance. The views and observations contained in this paper are his own and do not reflect the views of any other organization.

Steven Lemon is a founding member of the law firm Jones Lemon Graham & Clancy, located in Geneva, Illinois. The law firm has considerable expertise in insurance placement, coverage and development issues, and it represents numerous insurance companies based in Chicago, New York, London and other North American and European locations. Mr. Lemon's specialty is in environmental law, and his practice is enhanced by his degrees in chemistry and public policy and his prior work experience in private industry and the U.S. Environmental Protection Agency. He was an editor of the Harvard Environmental Law Review at Harvard Law School. This views expressed in this article are his own and are not meant to represent the views or positions of any other organization, public or private.

David J Dybdahl, CPCU, ARM, MBA
American Risk Management Resources Network, LLC
4901 Pine Cone Circle
Middleton, WI 53562
608 798 1427

dybdahl@armr.net

Steven Lemon, JD, MPP
Jones, Lemon, Graham & Clancy
28 North Bennett Street
Geneva, IL 60134-0805
630 208 0805

StevenL@JonesLemon.com