

If the doors of perception were
cleansed every thing would appear
to man as it is, infinite.

For man has closed himself up,
till he sees all things thro' narrow
chinks of his cavern.

—William Blake, *The Marriage
of Heaven and Hell*

Costly and time-consuming legal battles over mold are fast becoming the latest household curse. In the past several years, the United States has seen a dramatic rise in mold litigation, including some highly publicized stories involving the rich and famous. For example:

- At least \$300 million is at stake in a mold battle at 515 Park

Mold, SACRAMENTO BEE, Mar. 8, 2001, available at www.eco-vie.com/n_mold.html; Anastasia Hendrix, *Erin Brockovich Crusades Against Mold*, S.F. CHRON., Mar. 8, 2001, at A3, available at 2001 WL 3397262.

- Ed McMahon recently sued American Equity Insurance Company, two insurance adjusters, and several cleanup contractors for \$20 million last year, claiming that mold problems killed his dog and ruined his 8,000-square-foot mansion. Ann O'Neill, *Ed McMahon Sues Over Mold in House*, L.A. TIMES, Apr. 10, 2002, pt. 3, at 1. McMahon's lawsuit ended in a

difficult and expensive to remediate. Inspectors have to punch holes in walls and rip up floors to determine the extent of the infestation. In the authors' experience, it is not uncommon to see remediation bills that far exceed the property value of the structure. In some cases, remediation costs may even be double or triple the fair market value of the property. Remediation, however, is not the only type of damages that a plaintiff may claim.

From the defense standpoint, the three most common issues to address in mold claims involve (1) insurance coverage/bad faith, (2) construction defects, and (3) physical or personal injury. Physical injury claims often

Moldy Misperceptions and Plummeting Property Values

By Raymund C. King and Richard Barrett-Cuetara

Avenue in New York City, which is advertised as the most expensive building in the world. Richard Kramer, a real estate investor and resident of the building, filed a bad-faith suit against all those involved in the construction and sale of his \$10 million apartment, claiming his wife and three-year-old daughter are ill because of mold. Paul Tharp, *Ritzy Apartments Turn into Solid Mold*, N.Y. POST, Jan. 6, 2003, at 7, available at 2003 WL 5130808.

- Erin Brockovich, well-known for turning a toxic tort story into an Oscar-winning movie, sued the builder of her 5,200-square-foot home and its prior owner, claiming mold had sickened her family. Andrew LePage, *Environmental Activist Explains Dangers of Toxic*

\$7.2 million settlement. Jean Guccione, *Ed McMahon Settles Suit over Mold for \$7.2 million*, L.A. TIMES, May 9, 2003, pt. 2, at 1.

McMahon filed the lawsuit in April 2002, alleging that a plumbing pipe in his home ruptured in July 2001, flooding his den. Workers allegedly painted over the so-called "toxic mold" strain, known as *Stachybotrys chartarum*, and did not tell him about the mold. Soon afterward, McMahon claimed he and his wife got sick and their sheepdog, Muffin, developed respiratory illness and died. At their doctor's recommendation, the couple moved out of the home in September 2001. *Stachybotrys* was later discovered to have spread to McMahon's master bedroom.

Perhaps one of the most significant reasons why mold problems are vigorously litigated today is that mold is dif-

struggle with proving causation. Occasionally, however, significant physical injuries—regardless of the cause—will sometimes be sufficient to "jump over" the plaintiff's causation hurdle. One current trend observed by the authors is that many insurance companies are so fearful of the "uncertainty factor" in these claims that quick settlements often come about even without complete medical investigations. If the case does go to litigation, however, the plaintiff has an uphill climb.

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Personal Injury

The popular perception is that “toxic mold” can become airborne and poison an entire building. The verdict is still out in the medical community, however, and experts frequently testify on both sides of the controversy. Interestingly, officials from the Centers for Disease Control in Atlanta say that mold poses no permanent hazard to otherwise healthy people. In fact, many medical experts believe that mold has been shown to cause only respiratory problems similar to aggravated seasonal allergies and has no permanent effect. To date, there has been no well-supported scientific evidence to prove that mold exposure can cause brain damage or birth

defects, as has been claimed by a number of web sites and some media sources. Individuals with significantly weakened immune systems, however, such as HIV/AIDS patients or people taking anti-cancer medication, can develop pneumonia or other systemic infections from mold exposure.

The controversy surrounding personal injury claims is illustrated by a highly publicized Texas case, in which a jury awarded \$32 million to a homeowner, finding that the insurance carrier acted in an unfair, deceptive, and fraudulent way when evaluating a mold property damage claim. The plaintiffs had sued their insurance carrier for allegedly mishandling a mold claim resulting from a plumbing problem in their home. The Texas Court of Appeals subsequently reversed the

punitive damages originally awarded, which included \$5 million for mental anguish, but upheld the original \$4 million award for bad faith, and affirmed both the lower court’s exclusion of any medical “mold experts” and the dismissal of the plaintiff’s personal injury claims. *Allison v. Fire Ins. Exchange*, 98 S.W.3d 227 (Tex. App. 2002). Although the case focused on a bad faith insurance dispute and gained notoriety for the multi-million dollar verdict, of particular significance is the court’s refusal to hear testimony from medical experts on the plaintiff’s health claims allegedly caused by mold. The basis of this refusal was that the current state of medical knowledge regarding a connection between physical injury and mold exposure has not reached a consensus.

Plaintiff Melinda Ballard recently filed a response with the Texas Supreme Court to the defendant’s June 20, 2003, petition for review. *Fire Insurance Exchange v. Mary Melinda Ballard*, No. 03-0312 (Tex.). Farmer’s, the defendant insurance company, is now seeking a further reduction of the judgment to \$2 million. Although the decision in *Ballard* may have an overall chilling effect upon physical injury claims related to mold litigation, there is no question that with the subsequent disposal of the Ballard home and all its contents, the structure will become valueless.

It is only human nature to convert fear and worry into physical symptoms. Many are familiar with the “placebo effect” that occurs when a patient’s symptoms are cured after that patient is given a sugar pill (placebo) that he or she believes is medication. Conversely, a phenomenon called the “Nocebo effect” may occur when a patient actually experiences side effects or adverse physical symptoms when given the same placebo. Another example might be when an individual believes he or she is drinking contaminated water and develops symptoms, even though the water is later found to be not contaminated. Several investigators have associated the reporting of headaches,

memory loss, lack of concentration, and other similar nonspecific symptoms as evidence of brain damage caused by alleged mold exposure.

For mold claims asserting physical injury, the critical issues are typically damages and causation. Mold litigation is very expert-intensive and thus can rapidly become very “expert-expensive.” With the current public sentiment regarding mold and the insurance industry in general, “sympathetic” victims may have a significant effect on the outcome of a mold case. “Sympathetic” plaintiffs may include children, young educated adults with children, nursing home residents, and patients with compromised immune systems.

Construction Defects

Less controversial, but no less expensive, are property damage claims from mold. Mold litigation has targeted schools, apartment complexes, single-family homes, public buildings, commercial buildings, hotels, and health care facilities. The pleadings typically allege construction defects, but they may also raise negligent remediation, negligent environmental assessment, negligent HVAC repair, and even negligent architectural design claims.

Hilton Hotels Corporation recently filed a lawsuit over its Hilton Hawaiian Village Hotel at the Kalia Tower. *Hilton Suit Reveals More Mold Problems*, PACIFIC BUS. NEWS, Aug. 25, 2003, available at <http://pacific.bizjournals.com/pacific/stories/2003/08/25/story1.html>. The lawsuit involved not only 453 guest rooms but also the building’s 42,000-square foot spa and fitness center known as “Waikiki Spa.”

Hilton closed the hotel rooms at the \$95 million Kalia Tower because of mold contamination in late 2002 and reportedly spent \$55 million to remediate the mold problem. As a result of the mold contamination, Hilton then sued the contractors for construction defects in the guest rooms.

On August 7, 2003, Hilton filed another suit asserting that design and construction defects led to mold growth in the spa, which is operated

by Mandara Spa and Holistica Hawaii, Id. The lawsuit alleged the spa problems were discovered while guest rooms were being examined for mold. The spa was never closed, and it was unclear why the spa remained open after discovery of the defects. The hotel's lobby and meeting rooms also remained open during the 13-month guest room closure, although Hilton did not say mold problems were found in those areas.

Hilton alleged breach of contract, breach of fair dealing and express and implied warranties, negligence, and unjust enrichment against numerous parties, including the design firm, electrical engineering consultants, and numerous subcontractors. Apparently, the Kalia Tower's architect countersued Hilton for alleged nonpayment for its services. Hilton claims it paid the firm \$6 million and wants the money back. Regardless of the allegations and counterclaims asserted by the various parties, the fact remains the Kalia Tower was closed for approximately one year—a year of lost income to Hilton.

Diminished Property Values

When dealing with a toxic mold claim asserting damage to property, a practical "damages model" possesses two components that should be considered: (1) physical injury and (2) "diminution in value" to the real estate. If a plaintiff fails to establish a physical injury and the real estate has seen its value reduced because of the mold infestation, then the "diminution in value" component of the damages model may provide irrefutable evidence of damage.

From a purely economic perspective, the Kalia Tower's lost income during the year reduced the value of the hotel to its owner. From a commercial real estate standpoint, lost revenue represents a direct "hit" on the reversion value of the hotel. In many instances, the lost income, when viewed from an appraisal standpoint, could represent substantially more in lost value than lost income. For example, the lost net income to the hotel for a given year could be \$500,000, but

from an appraisal standpoint, that lost income could result in a reduction in the hotel's value of \$5 million, assuming a 10% capitalization rate ($\text{NOI}/\text{CR}=\text{V}$; i.e., $\$500,000/.10\% = \$5,000,000$).

In toxic mold litigation, the value of real estate, whether commercial or residential, is reduced secondary to the mold contamination and the remediation process. In other words, when the mold is remediated, the real estate asset, whether commercial or residential, will be reduced in value. The term of art for a reduction in value is called "diminution in value."

The "diminution in value" measure of damages applies in commercial and residential real estate. In the commercial context, whether a hotel, office building, shopping center, industrial building, strip center, or apartment complex, the concept remains the same: if the remediation of the toxic mold requires the subject property to be closed during the remediation process, then the entity will lose income during that period of time. Therefore, in an appraisal, the value of that asset will be reduced in applying a discounted cash flow analysis.

On the other hand, residential real estate is not income-producing property (other than rental property), and, therefore, the measure of damages is not based on a discounted cash flow model, but instead, on market sales of comparable properties. Simply stated, the subject property's value is lower because of the mold contamination.

The million dollar question in toxic mold litigation involving commercial real estate is: "How much is my property really worth?" Depending on which side a practitioner represents, whether an owner or an insurance company, each side must determine the value of the property in the ultimate quest to determine damages from the mold infestation.

The appraisal process is an elaborate function of finance, accounting, and mathematics. It is not an exact science. Because each piece of real estate is unique, many different types of value can be estimated for a single property. Three methods are used to

value real estate: the sales comparison approach, the income capitalization approach, and the cost approach. In valuing commercial real estate, all three approaches are used. Once the three values are finalized, the commercial real estate appraiser reconciles the values and determines the final value. See *THE APPRAISAL OF REAL ESTATE*, AMERICAN INSTITUTE OF REAL ESTATE APPRAISERS, ch. 3, at 43 (8th ed. 1983).

To arrive at a final value estimate, the appraiser reviews the entire appraisal to verify that the data used and the analytical techniques and logic are valid, realistic, and consistent. In addition, the data are reviewed for the authenticity and representation of pertinent market activity. Finally, the

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appraiser makes certain that the market evidence has been considered. To determine a final reconciliation of value, the appraiser reviews the accuracy of the three approaches to value, and uses his or her professional experience, expertise, and judgment in reconciling the valuation process. Public perception about a property's value also affects the valuation process. Ultimately, the appraiser's experience, discretion, and analysis of the three approaches to value determines the final value of the subject property.

Insurance Claims

Mold claims have also affected the insurance industry. To sustain the business of insurance, risk is allocated

among the insureds. But when many insureds file claims, or when some insureds file extremely large claims, the insurance premium is the only cushion to absorb the cost. Insurance premiums in several states have soared. Ignorance in the insurance industry about the proper evaluation and assessment of mold claims often leads to ineffective or improper assessments by claims adjusters and quick payouts to some entrepreneurial environmental testers, remediators, and industrial hygienists.

Even if medical technology cannot prove causation or even if society discovers that the degree of "danger" from mold exposure is more perceived than real, one thing is certain. When "mold misperceptions" begin to affect the property values of homes or businesses and cause families to be uprooted from their dwellings against their will, or to affect the cost of property insurance to the point that it is no longer affordable to buy a home or do business with real property, then the perception becomes reality. This reality may be the stimulus that initiates reaction from government, the insurance industry, the medical community, or all of them, in various ways:

- Government may attempt to
 - Regulate the insurance industry to provide affordable property insurance,
 - Assist homeowners and builders with funding for insurance coverage, and
 - Set environmental standards for "acceptable limits" of mold spore concentrations in public buildings.

- The insurance industry may
 - Raise insurance premiums,
 - Limit insurance coverage,
 - Stop offering coverage to a particular state or region, and
 - Find ways to subsidize mold or remediation coverage.
- The medical community will try to
 - Find ways to test specifically for all types of mold exposure,
 - Determine specifically the types of illnesses, if any, caused by mold,
 - Find ways to prevent mold-related illnesses, and
 - More clearly define the actual physical effects of chronic mold exposure upon normal as well as mold-sensitive individuals.

Comparison to Asbestos Cases

The mold situation bears some similarities to the asbestos litigation of the early 1960s, which arose when employers and building owners failed to warn employees of the dangers of asbestos inhalation. Remedial steps were not taken for years after much of the damage had already occurred. The resulting litigation led to the bankruptcy of several large national corporations. Very few companies took the asbestos claims seriously at first. Indeed, many paid a high price for ignoring the signs of an impending catastrophe.

Some similarities and critical differences between mold and asbestos litigation should be noted. When asbestos litigation first appeared, causation questions similar to those being asked in today's mold cases were also being asked. But perhaps the most critical difference is that asbestos is a manufactured product, while mold is not. Although mold may certainly result from the negligent construction of a building or HVAC system, it is not a product or component of a product. In contrast, asbestos was a valued component of a "product." The typical defendants in the asbestos cases were large corporations that possessed much data regarding asbestos and its

health effects, but typical mold defendants are builders or building owners that never anticipated mold infestation or adverse health effects.

Because buildings are not typically considered a "product," a theory of strict liability is usually not available as a means of recovery. Instead, "diminution in value," along with negligence, fraud, breach of contract, and bad faith, are usually viable theories of recovery in a typical mold case. In addition, most juries do not have the same sentiment for builders and building owners as they do for large corporations or insurance companies. In fact, the most significant mold cases to date have been directed at insurance companies and the means by which the mold claim or claims were handled.

The current popular perceptions about mold have also been exploited. Mold hysteria has created money-making opportunities for unqualified remediators and "mold experts," who are more than willing to perform unnecessary tests or tear down walls and ceilings without reservation, all at the homeowner's expense. Communication among the property owner, the environmental tester, and the insurance company is very important. In one of the authors' cases, an insured homeowner was requested to vacate her home after air quality testers discovered unusually high levels of mold in one of the guest rooms—until it was learned that her diabetic house cat and other pets were living in that room exclusively.

Conclusion

The lesson of history is to prepare for the future. The implications of a mold infestation must be understood through education, so that judgment is not encumbered by ignorance. Mold misperceptions can reduce property values. In the real world, perception becomes everything, and the mental and physical frustrations associated with the management and remediation of a mold infestation certainly compound the problem of plummeting property values. ■