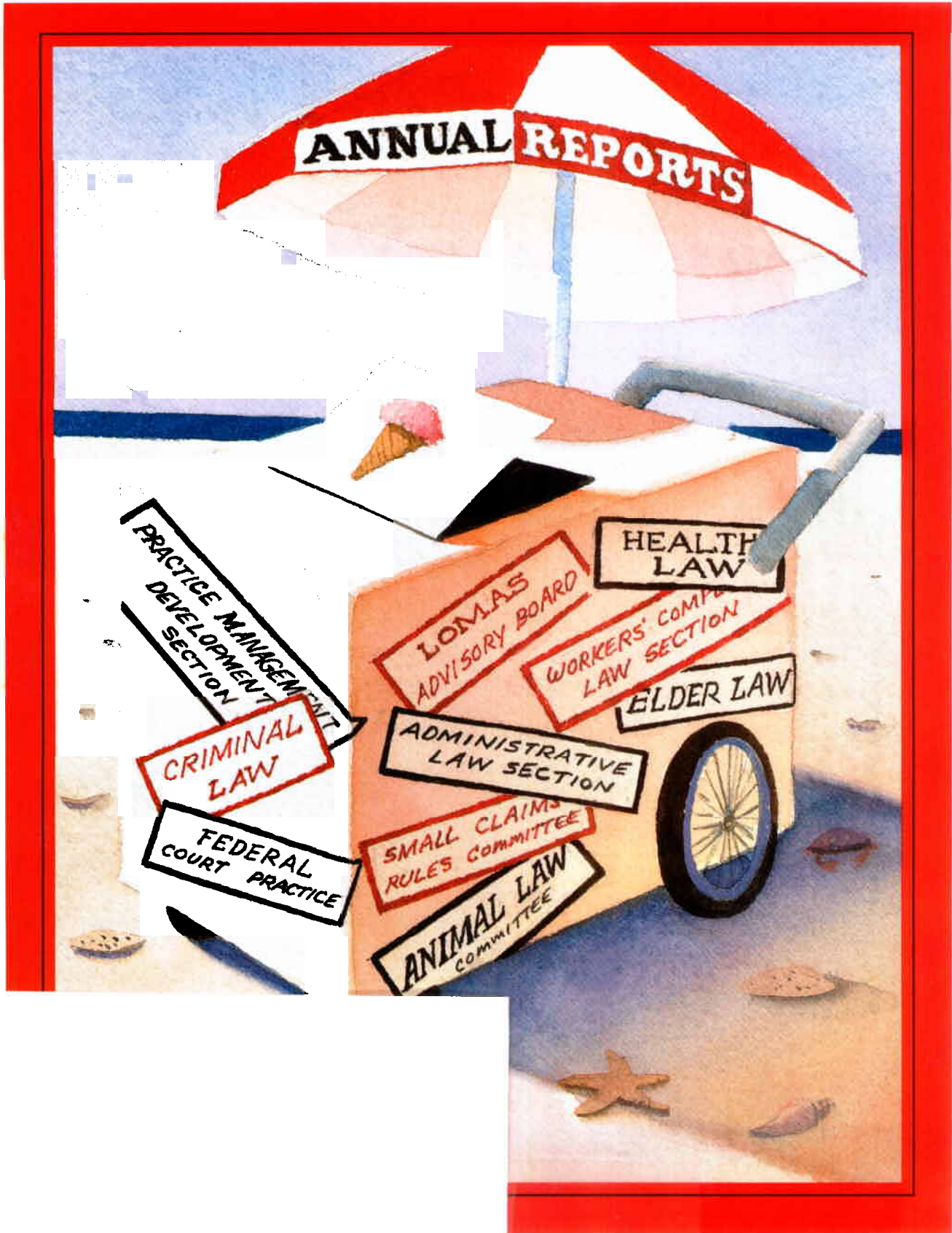


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# Recovering “Stigma” Damages in Mold-related Construction Defect Cases: Making the Property Owner Whole

by Robert Alfert, Jr., Harry W. Collison, Jr., and George W. (Trey) Tate III

**M**old-related lawsuits arising from construction defects are proliferating. Perhaps it is a byproduct of creative lawyers seeking recovery for clients in a field of progressive science; or perhaps more likely, the proliferation of these suits relates directly to Florida’s weather patterns over the last decade.

For several years in the late 1990s, Florida experienced severe drought, and only with the recent torrents of rain from 2001 to the present, magnified by the unprecedented 2004 hurricane season, have property owners truly confronted significant exposure to mold-related damages and injury. Weather patterns also have coincidentally corresponded with the advent of cheaper and more quickly installed construction materials, such as one-coat stucco systems, the success of which remain debatable in humid climates like Florida’s.

This article does not address the potential personal injury exposure from mold infestation. Instead, this article focuses on how the property owner can be made whole in the property damage context by permitting an award of “stigma” damages when the property will still suffer a diminution in value after remediation. It is the authors’ thesis that Florida law has failed to keep pace with the dynamics mold cases present, and does not provide sufficient guidance in this evolving context.

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## Typical Property Damage Scenario

Consider the following hypothetical (though that term is used loosely since cases of this sort can be found throughout Florida). A property owner built a luxury garden apartment complex in the late 1990s, during a period of drought in Florida. The construction plans contained standard details for moisture protection, including wall cavity membranes and flashing, and specified newer building envelope materials. Unfortunately, the subcontractors responsible for many of the waterproofing elements did not adhere to the specific standards of their trade and the quality of the construction, therefore, was below average. After certificates of occupancy were issued, this luxury garden apartment complex was in high demand in a booming housing mar-

ket, and quickly reached a rental stabilization rate in excess of 95 percent.

Several years of heavy rain started soon thereafter. While some tenants noted water leaking into their units, management and tenants assumed that the problem was related to the windows. Maintenance crews would address the problems as they arose, mostly adding new beads of caulking to the window perimeters. What maintenance workers did not know was that the problems were far more pervasive. Water was not entering through the windows, but instead, through the decorative stucco bands surrounding the windows. While some water made its way through the windows, most of the water entered into the dark recesses of the wall cavity. Eventually, this constant water intrusion disintegrated the waterproofing membranes, the sheathing, and even structural members. The water also allowed mold to germinate. The owner was unaware of these consequences until after the damage had been done and minor repairs could not correct the problem. Like cancer, the degradation occurred from within, and the outward manifestation of the problem came to light too late.

Ultimately, management had to vacate the units due to safety concerns from mold and structural failure. The extensive television and print media coverage of the apartment closure spawned the kiss of death for a property owner: mold exposure lawsuits from personal

injury claimants. These types of suits have arisen from enterprising lawyers seeking recovery for their clients allegedly experiencing health complications attributable to mold exposure. As a result, the owner is left with a deteriorated building and significant exposure to its former tenants. No one will touch this project. Forensic building specialists offer conflicting opinions on the genesis of the problem and how to remedy it. Architects are reluctant to prepare remedial plans; higher-end contractors are reluctant to perform the remedial work. The exposure is too significant and sends insurance costs skyward.

Following a costly remediation, the absorption rate necessary to attain stabilization is lowered. Tenants will not move in at the same pace. Neighboring apartment complexes "negative-sell" the project, advising prospective tenants not to consider moving into the competing project because of the fear that mold may not have been fully eradicated. Consequently, prospective tenants with young children hesitate from renting at the project, further damaging potential rental income. Worse yet, potential purchasers of these investment-grade projects either become nonexistent, or wield the specter of mold like the Sword of Damocles, attempting to leverage the lowest possible purchase price. Real estate market data suggests quite clearly that this property will never regain full market value even after full remediation. The property carries a stigma in the marketplace that cannot be erased by simple remediation.

Florida law affords the impacted property owner an opportunity to seek full redress for the costs of remediation and for other consequential damages, such as lost income. Less clear, however, is whether the property owner can also recover the diminution in market value that is directly attributed to the stigma.

### Status of Florida Law and Recommended Direction

The Florida Supreme Court in

*Grossman Holdings, Ltd., v. Hourihan*, 414 So. 2d 1037 (Fla. 1982), has adopted §346(1)(a) of the Restatement (First) of Contracts (1932) for property damage resulting from construction defects. The policy behind the Restatement is set forth in the comment on §346(1)(a) and reads in part:

The purpose of money damages is to put the injured party in as good a position as that in which full performance would have put him; but this does not mean that he is to be put in the same specific physical position. Satisfaction for his harm is made either by giving him a sum of money sufficient to produce the physical product contracted for or by giving him the exchange value that that product would have had if it had been constructed. . . . Sometimes defects in a complete structure cannot be physically remedied without tearing down and rebuilding, at a cost that would be imprudent and unreasonable. The law does not require damages to be measured by a method requiring such economic waste.

The Restatement provides two rules for measuring damages caused by construction defects.<sup>1</sup> These rules are used by Florida's courts to fulfill the goals enunciated in the Restatement. The first rule is known as the "diminution in value" rule. Under the diminution in value rule, the property owner is compensated for the difference in value of the property before and after the injury. The second rule is the "restoration" rule. Under the restoration rule, the property owner is compensated for the cost of repairing the property and restoring it to its condition prior to the injury.<sup>2</sup> Typically, Florida courts have allowed recovery under either the restoration rule or the diminution in value rule, but not both; though few, if any, reported decisions have presented facts warranting the logical application of both rules.<sup>3</sup>

In applying the rule, the courts generally determine which method will result in a lower damage figure and use that method.<sup>4</sup> The reason for using the method that will create a lower damage award is to prevent a so-called windfall for a property owner. For example, if a vacant piece of land were strip-mined, the cost of returning it to its original condition would be prohibitive, but

the decrease in value might be minimal if it was located in an isolated area. Awarding the cost of repair in that instance could create a windfall for the owner, because the owner could simply sell the land and reap the large profit provided by the repair costs. Conversely, if a piece of property were damaged in a manner that would cost \$10,000 to repair, but would result in a lowered value of \$25,000 if left unrepaired, then the court will only award the \$10,000 to repair the home, assuming that the repair will restore the owner to the condition they were in prior to the injury. That flawed assumption is the source of the problem.

Returning to the apartment complex hypothetical, assume that the value of the apartment complex would have been \$20 million if there had been no defects and no damage. Assume further that the cost of repairing the damage and cleaning out the mold is \$6 million and that the value of the damaged property prior to repairs would be \$12 million. Under those circumstances, the court would award the property owner \$6 million for the cost of repairs, rather than the \$8 million for the property's diminution in value. The problem in this case, and many others, however, is that repairs alone will not make the owner whole. As a consequence of the stigma associated with the mold, the owner will be left with an apartment complex that is worth less than the original value.

Florida law is still developing in the area of "stigma" damages. The topic was addressed in a recent decision by the Fifth District, *Orkin Exterminating Co., Inc., v. Delguidice*, 790 So. 2d 1158 (Fla. 5th DCA 2001). In *Orkin*, a homeowner purchased a termite protection plan which required Orkin to treat for termites and to repair any termite damage done to the house. Despite the treatments provided by Orkin, the house was seasonally plagued by termites for seven years, with the expectation that they would continue to infest the house in every year to come. The jury awarded the

property owner damages that included, among other things, an award for stigma damages for the diminished value the house would have based on termite infestations. In overturning the jury's stigma award, the appellate court relied on a clause in the homeowner's contract with Orkin that specified that repair was the exclusive remedy. The court stated that in order to recover damages for stigma, the homeowner would need to make a showing that repairing the property would be impractical or would result in economic waste to avoid the application of the exclusive remedy clause, leaving open the possibility that evidence of stigma damages could be properly presented to a jury under the right circumstances.<sup>5</sup>

In our apartment hypothetical, the only way to truly remove the stigma of mold contamination would be to tear down the complex and start over. Since that approach would be substantially more expensive than remediating the complex, it would be economically wasteful to do so and the court will not allow damages based on the cost of tearing down the complex and starting over. In that circumstance, where the property owner can present competent evidence regarding the diminution in the market value of the property due to the stigma caused by the mold, the jury should be allowed to entertain stigma damages.

Recently a Seminole County trial court denied a motion in limine seeking to preclude evidence of stigma damages.<sup>6</sup> The Seminole court case arose from myriad building deficiencies in the newly constructed Sheriff's Operation Center, an approximate \$14.4 million facility. The alleged damages to the facility exceeded \$6.5 million, and included approximately \$1.5 million in postremediation building devaluation attributable to stigma from, among other things, mold and increased operating costs. One of the defendants moved to exclude the devaluation evidence and damage claim, citing to the *Grossman Holdings* case, which it narrowly construed to permit either restoration

## The approach taken by the Georgia courts for discounting the effect of stigma damages runs contrary to well-established Florida precedent in the eminent domain context.

cost or the building devaluation, but not both. The case settled immediately after the trial court summarily denied the motion.<sup>7</sup>

A more equitable approach has been approved in several other jurisdictions.<sup>8</sup> In *Marchesseault v. Jackson*, 611 A.2d 95 (Me. 1992), the Maine Supreme Court allowed for the award of stigma damages when a home, as repaired, did not have the same value as it would have had it been built properly the first time. In *Marchesseault*, the plaintiff contracted to have a foundation built for a house. The foundation was built defectively, and the plaintiff was forced to have another contractor repair the damage. The only way to completely repair the damage would have been to demolish the foundation and rebuild. The plaintiff chose to repair the foundation to the greatest extent possible without demolition. The finished product, however, had a lower market value than it would otherwise have had if the foundation was properly constructed. The court ruled:

In many cases the repairs fully correct the defects caused by the contractor's breach and the award of damages based on the cost to complete or repair makes the injured party whole. In other cases, however, notwithstanding remedial measures undertaken by the injured party, there remains a diminution in value of the property. In such a case, awarding only the costs of remedying the defects will not fully compensate the owner for the damages suffered by him.

The overriding purpose of an award of compensatory damages for a breach of contract is to place the plaintiff in the same position as that enjoyed had there been no breach.

The approach taken by the *Marchesseault* court reflects the goal of the Restatement by placing the property owner in the same position he would have been in had there been no injury to the property without the economic waste of rebuilding. Despite the apparent fairness and wisdom of this approach, its reasoning has not been universally accepted. In two recent appellate decisions, Georgia courts have explicitly ruled that stigma damages are prohibited.

In *Ryland Group v. Daley*, 537 S.E. 2d 732 (Ga. App. 2000), a homeowner sued its contractor for numerous construction defects associated with the construction of the home. The jury awarded the homeowners \$70,000, \$30,000 of which was for the decrease in market value associated with the stigma of a home that had undergone substantial construction repairs. In overturning the jury's award of \$30,000 for stigma damages, the court determined that stigma damages were too remote and speculative in nature and were predicated "upon a future loss that may or may not be sustained depending on the sensibilities of some future buyer and whether, in fact, the repaired defects are disclosed to such future buyer and, in fact, generate the anticipated 'stigma.'"<sup>9</sup>

*Hammond v. City of Warner Robins*, 482 S.E. 2d (Ga. App. 1997), involved another suit by a homeowner. In *Hammond*, methane gas from a landfill migrated underground and contaminated the water table and soil beneath a homeowner's property, making it difficult for her to refinance her property and according to her expert, lowering the value of her property. The court denied her claim for stigma damages based on the decrease in value to her property, ruling that "stigma damages to realty, in and of itself, is too remote and speculative to be a damage."<sup>10</sup>

The approach taken by the Georgia courts for discounting the effect

of stigma damages runs contrary to well-established Florida precedent in the eminent domain context, the core of which is the valuation of real estate and damages to market value. In *Florida Light & Power v. Jennings*, 518 So. 2d 895 (Fla. 1987), the Florida Supreme Court ruled that “[a]ny factor, including public fear, which impacts on the market value of the land taken for a public purpose may be considered to explain the basis of an expert’s valuation opinion.” With regard to the specific issue of contamination, the Florida Supreme Court has also stated that “[e]vidence of contamination is relevant to market valuation and is admissible upon an adequate factual predicate.”<sup>11</sup> It appears then that Florida may be more open to the reality of the financial impact of stigma damages to a property than its neighbor to the north. What the Georgia decisions apparently overlooked—or perhaps the claimants did not present a convincing case—is that real estate appraisers routinely evaluate market value diminution attributable to a myriad of factors, including the stigma of mold-infected properties. This analysis simply is not fraught with the speculation that troubled Georgia courts.

### **Appraisal Approach to Evaluating Stigma Damage**

In the development and reporting of value estimates, a real estate appraiser licensed in the state of Florida is required to comply with the Uniform Standards of Professional Appraisal Practice (USPAP). USPAP Standards Rule 1-4(e) states that “an appraiser must analyze the effect on value, if any, of the assemblage of the various estates or component parts of a property and refrain from valuing the whole solely by adding together the individual values of the various estates or component parts.”<sup>12</sup> Conversely, it is inappropriate simply to subtract the cost of remediation from the estimated market value of a property unimpaired in order to reach a conclusion of value for the property in its impaired condition if other fac-

tors are also being recognized by the market.

USPAP Advisory Opinion 9 (AO-9) defines environmental stigma as “an adverse effect on property value produced by the market’s perception of increased environmental risk due to contamination.”<sup>13</sup> AO-9 states that “when the appraiser addresses the diminution in value of a contaminated property and/or its impaired value, the appraiser must recognize that the value of an interest in impacted or contaminated real estate may not be measurable simply by deducting the remediation or compliance cost estimate from the opinion of the value as if unaffected (unimpaired value).”

A real estate appraiser must recognize that remediation costs, changes in highest and best use, and increased risks may impact the value of properties that are impaired. Generally, the technique utilized to estimate damages to a property suffering from stigma is first to estimate the market value of the property, as if unimpaired, and then to estimate the market value of the property, as impaired. The differential can reflect not only the cost of remediation, but also lost rents, loss of use, and stigma damages. Ap-

praisers also are trained and capable of analyzing market data in order to estimate the presence of stigma within an impacted property. In *Jennings*, the Supreme Court of Florida held that the impact of public fear on market value of property was admissible without independent proof of reasonableness of fear.<sup>14</sup> Appraisers have historically provided expert testimony relative to impacts to real property interests such as damages created by proximity to petroleum pipelines, natural gas lines, airports, expressways, electrical power facilities, etc. Recognizing and measuring mold stigma impact upon real property interests is consistent with appraisal theory and practice.

Recent appraisal research has indicated that stigma relative to mold and water intrusion is not found in all segments of the real estate market. Research data indicates that the probability of stigma impacting real property increases in relationship with the investment grade associated with the asset. For example, the level of stigma potentially present in a low-grade income property is significantly different than the level of stigma found in high-grade institutional invest-

ment property. Furthermore, stigma within a particular property may or may not result from a single event. Generally, stigma results from multiple events that collectively result in the market's perception of increased risk for the impaired property. For example, the simple presence of mold may or may not result in stigma. However, recent studies indicate that a series of events such as water intrusion into the building envelope, tenant lawsuits, workers' compensation claims, news media publicity, the vacating of the building to accommodate remediation, the magnitude of the remediation, the remediation of mold and the reasonable probability of disclosure in either the future leasing or sale of the property can result in a significant impairment of a property's market value, including future value.

Current research and case studies indicate that stigma damages are more than just the market's perception of fear. Reductions in sale prices are also attributed to a number of significant and easily measurable cost changes. For example, transaction costs may increase due to the necessity to conduct indoor air quality testing. Contamination concerns can also result in costly real estate transaction delays. The net operating income of impaired properties can be negatively impacted by tenants leveraging the property's negative perception to obtain lower lease rates, tenant avoidance resulting in increased vacancy and increases in operating costs particularly related to such items as insurance and increased preventative maintenance. Recent sales indicate that lower prices for impaired properties also occur within the market, not only due to reduced net operating income and earning potentials, but also increased overall capitalization rates. A key factor that influences the level of an overall capitalization rate is the market's perception of risk. If the market perceives increased risk associated with the investment in and ownership of impaired property, then increased overall capitaliza-

tion rates will be reflected by the market. Sales data indicates that in fact, overall capitalization rates for impaired properties are higher than overall capitalization rates for unimpaired properties, thus confirming the market's recognition of stigma. All of these factors must be evaluated to ensure that an injured property owner is made whole.

## Conclusion

Given the ample evidence of the impact that stigma has on a property's value, it is inequitable to fail to award stigma damages to property owners suffering the stigma of mold damage. The only way to meet the Restatement's goal of putting the property owner in the position they should have been in is to adopt the "Maine" approach and to award both the cost of repair and the diminution in value between the property, as repaired, and the value that the property should have had had it never needed repair. These two types of damage are distinct, not mutually exclusive, and therefore both should be recoverable on a sufficient showing of proof. □

<sup>1</sup> For a comprehensive overview of all damages available in construction defect cases, see *Measure of Damage in Property Loss Cases*, 76 FLA. BAR. J. 32 (2002)

<sup>2</sup> *United States Steel Corp. v. Benefield*, 352 So. 2d 892 (Fla. 2d D.C.A. 1977).

<sup>3</sup> One exception is *Callihan v. Turtle Kraals, Ltd.*, 523 So. 2d 800 (Fla. 3d D.C.A. 1988). Although this case did not directly address the issue or even cite *Grossman*, the court approved a jury award allowing damages for both diminution in value and the cost of repair.

<sup>4</sup> *United States Steel Corp.*, 352 So. 2d at 894-5. See also *Orkin Exterminating Co., Inc., v. Delguidice*, 790 So. 2d 1158 (Fla. 5th D.C.A. 2001).

<sup>5</sup> In its analysis of the remedy clause, the court analogized to the holding in *Rezevskis v. Aries Ins. Co.*, 784 So. 2d 472 (Fla. 3d D.C.A. 2001) (holding that a "repair or replace" clause in an insurance contract did not obligate an insurance carrier to compensate the car owner for the diminution in value caused by the "market psychology that a vehicle substantially damaged in an accident, even though 'fixed,' is not as valuable as one that has not been in an accident."). See also *Siegle v. Progressive Consumers Ins. Co.*, 788 So. 2d 355 (Fla. 4th D.C.A. 2001).

<sup>6</sup> See *Seminole County, Florida v. Fluor Enterprises, Inc., et al.*, 18th Judi-

cial Circuit, Case No. 00-CA-1469-15-K. Unfortunately, the basis for the court's ruling was not articulated.

<sup>7</sup> Order Denying Diprema Construction Corporation's Motion in Limine Regarding Diminution in Value, *Seminole County, Florida v. Fluor Enterprises, Inc., et al.*, 18th Judicial Circuit, Seminole County, Florida, Case No.: 00-CA-1469-15-K.

<sup>8</sup> Several other jurisdictions have also recognized that damages for both diminution in value and costs of repair can be awarded in certain circumstances. See *In Re: Paoli Railroad Yard PCB Litigation*, 35 F. 3d 717 (3d Cir. 1994); *Berry v. Armstrong Rubber Co.*, 989 F.2d 822 (5th Cir. 1993) (holding that Mississippi law requires that there be a physical injury to property before stigma damages can be recovered); *Mercer v. Rockwell Int'l Corp.*, 24 F. Supp. 2d 735 (W.D. Ky. 1998) (holding that Kentucky law requires that there be a physical injury to property before stigma damages can be recovered); *Terra-Products, Inc., v. Kraft General Foods, Inc.*, 653 N.E.2d 89 (Ind. 1995); *Wade v. S. J. Groves & Sons Co.*, 424 A.2d 902 (Pa. 1981); *W.G. Slugg Seed & Fertilizer, Inc. v. Paulsen Lumber, Inc.*, 214 N.W.2d 413 (Wis. 1974);

<sup>9</sup> *Ryland*, 537 S.E.2d at 739.

<sup>10</sup> *Hammond*, 482 S.E.2d at 428.

<sup>11</sup> *Finkelstein v. Dept. of Transportation*, 656 So. 2d 921 (Fla. 1995).

<sup>12</sup> *Uniform Standards of Professional Appraisal Practice and Advisory Opinions*, the Appraisal Foundation (2004 Ed.).

<sup>13</sup> *Id.* at 145.

<sup>14</sup> *Jennings*, 518 So. 2d at 898.

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