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Insidious Mold Fraud

September/October 2003

By Barry Zalma, Esq., CFE

Mold has existed before humans and will probably outlast us but recent huge mold insurance claims have inspired fraudsters to make some quick money. Wiser fraud examiners and adjusters now have ways to preempt fraudulent claims. Mold was their friend.

The seven Houston, Texas, associates thought they had a perfect scheme. The perpetrators would purchase and insure several two-story homes. On random weekends, they would pretend to be away but would intentionally flood the homes with water hoses or by damaging water pipes. A plumber would repair the lines before an insurance adjuster arrived. The defendants would then file claims to obtain the full policy limits of the insurance coverage for their water- and mold-damaged homes and personal property along with additional living expenses. Some homes were flooded more than once.

They "cooked" at least one house by closing all the doors and windows and then turning on the furnace. The resulting heat and humidity from the evaporating water accelerated the growth of mold spores that exist naturally and harmlessly in all American homes.

The fraudsters — acting as innocent homeowners, independent sub-contractors, vendors and service providers — would repair the damage, and sell the homes to each other to repeat the process. An insurance adjuster eventually suspected fraud, the instigators were examined and charged. All pleaded guilty or were convicted on fraud charges. The scheme cost insurers, and ultimately policyholders, more than \$5 million.

Mold and fungi exist everywhere. The spores they release as part of their reproductive process can cause illness and injury and slowly rot buildings designed to withstand major earthquakes. However, until the end of the last century, damage caused to property and persons by mold, rot or other fungi occurred at constant levels. Insurers routinely denied claims for mold damage with impunity because they believed the exclusions were clear and unambiguous. They now find themselves defendants in multimillion-dollar bad faith suits. As a result of the recent popularity of mold claims, fraud perpetrators have jumped into the field.

The Houston fraudsters were inspired by a now famous case near Austin, Texas, in which the courts awarded a family a little more than \$4 million for mold damage in its house (although the house was purchased by the insured for \$250,000) and bodily injuries resulting from the alleged mishandling of the claims by the insurance company. (The original \$32 million verdict did not withstand appellate review.) Though there appeared to be no evidence of fraud by the insured in the Austin case, the Houston fraudsters and many others realized there was cash to be had from insurers fearful of being assessed similar huge bad faith verdicts.

Because prosecutors throughout the United States typically prosecute less than 3 percent of all fraudulent insurance claims, Texas insurers alone probably pay another \$30 million to \$50 million yearly in undetected fraudulent mold claims. Mold claims in Texas rose 1,306 percent between the first quarter of 2001 and the fourth quarter of 2002 and the frequency of mold claims per 1,000 policyholders rose 1,286 percent during the same period. Texas insurers paid out \$854 million in 2001, according to the Texas Department of Insurance, a 560 percent increase over the \$153 million in the previous year. Though Texas is the leader, similar statistics are growing proportionately in every state and Canadian province.

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Breaking down microexpressions during interviews (<http://www.fraud-magazine.com/videos.aspx>)

Cliff Lansley, Director at the Emotional Intelligence Academy and a keynoter at the upcoming *28th Annual ACFE Global Fraud Conference*, discusses the ways in which fraud examiners can use microexpressions to glean more information from their interview subjects. **View the video** (<http://www.fraud-magazine.com/videos.aspx>).

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