No. 04-1104

IN THE SUPREME COURT OF TEXAS

RICHARD FIESS and STEPHANIE FIESS,
Plaintiffs-Appellants,

v.

STATE FARM LLOYDS
Defendant-Appellee.

On a Question of Law Certified by the United States Court of Appeals for the Fifth Circuit Cause No. 03-20778

POST-SUBMISSION BRIEF OF J. RALPH CHOATE AND JANICE G. CHOATE AS AMICUS CURIAE IN SUPPORT OF **APPELLANTS FIESS**

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Dated: July 12, 2005

SUPPLEMENTAL CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that in addition to those persons listed in Plaintiffs-Appellants' Certificate and the Certificates of Amicus Curiae, the following listed persons have an interest in the outcome of this case. These representations are made in order that the judges of this Court may evaluate possible disqualifications or recusal:

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I.
STATEMENT OF INTEREST

Like the Fiesses, Ralph and Jan Choate are State Farm Lloyds policyholders who suffered a water loss that led to mold. Also like the Fiesses, the Choates reported their loss to State Farm. And as was true with the Fiesses, State Farm initially agreed to cover the Choates' loss.

The most striking difference between the Choate and Fiess claims, however, is State Farm's position on the ensuing-loss clause. In the *Choate* case, where the coverage dispute has taken a back seat to the extra-contractual claims, State Farm representatives readily admitted that the HO-B policy covers mold ***that ensues from a covered loss, such as a water leak***. They likewise admitted that the mold caused by the Choates' water leak was considered a covered ensuing loss.

The most striking similarity between the Choate and Fiess claims, on the other hand, is State Farm's apparent lack of candor in judicial proceedings. When the Choates learned that State Farm had taken in the *Fiess* litigation a position that is wholly at odds with State Farm's own employees' testimony in the *Choate* litigation, the Choates were obliged to reveal this contradiction to the Court. Further, the Choates are concerned that should State Farm prevail in these certified-question proceedings, it may then attempt to change its position in the *Choate* litigation and to distance itself from its own employees' testimony, when they admitted the Choates' mold loss was covered as an ensuing loss.

II.
ISSUE PRESENTED

State Farm admitted in the *Choate* litigation that the Texas Homeowners Form B policy (HO-B) covers mold that ensues from a covered loss, such as a water leak. Should State Farm be permitted in the *Fiess* litigation to take a position that is contrary to its own interpretation of the ensuing-loss provision in the *Choate* litigation?

III.
STATEMENT OF FACTS

In approximately 1988, Ralph and Jan Choate purchased homeowners insurance from State Farm for their Flower Mound, Texas residence. In 2001, while their Homeowners Form B (HO-B) policy was in effect,[1] the Choates discovered a leak in their indoor terrarium, which had spilled water and organic matter, including dead leaves and fish, into several rooms of their home. The Choates reported their loss to State Farm, who persuaded the Choates to participate in the State Farm Premier Service Program and to allow one of State Farm's pre-screened and qualified "premier" contractors to remediate the loss.

The "premier" contractor's shoddy work, coupled with State Farm's mishandling of the claim, resulted in delays that led to mold and ultimately destroyed the Choates' home. Today, the Choates' home is gutted to the studs. State Farm paid what it contends were policy limits and walked away.

When the Choates sued State Farm, State Farm for the first time asserted the "mold exclusion" as a defense, despite the fact that it had never previously reserved its rights to deny coverage on that basis.[2] Interestingly, however, State Farm's employees acknowledged under oath that State Farm treats mold resulting

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[1] *See* Choates' State Farm Insurance HO-B policy in effect in 2001 (attached at Tab A).

[2] The *Choate* case, currently pending in the Dallas Division of United States District Court for the Northern District of Texas, is styled *J. Ralph Choate and Janice G. Choate v. State Farm Lloyds*, Civil Action No. 3:03-CV-2111-M.

from a covered loss — such as a water leak — as covered under the HO-B policy. More particularly, State Farm admitted that the mold in the Choate home that ensued from a water leak was covered by virtue of the ensuing-loss provision.

In addition, documents currently subject to Protective Order in the *Choate* case further illuminate State Farm's own interpretation of the ensuing-loss clause. In particular, statements in State Farm's internal Mold or Other Fungi Claim Reference ("MOOF Manual") further bolster the Choates' estoppel argument, as well as provide extrinsic evidence of the ensuing-loss provision's meaning. Therefore, on July 11, 2005, the Choates filed a motion seeking leave from the Northern District of Texas to lift the protective order for purposes of providing excerpts from State Farm's MOOF Manual to this Court. Counsel for the Choates conferred with State Farm's lawyers in the *Choate* case about their proposed motion, and State Farm opposes the Choates' efforts to lift the protective order. Interestingly, Christopher W. Martin, counsel for State Farm in the *Feiss* appeal, is also co-counsel in the *Choate* case.[3] Should the Northern District of Texas lift the protective order that now shields the MOOF Manual from disclosure, the Choates promptly will submit excerpts from that Manual to this Court by way of a supplemental filing.

[3] *See* Defendant's Notice of Appearance of Co-Counsel, identifying Christopher W. Martin as co-counsel for Defendant State Farm in the *Choate* litigation (Appendix at Tab B).

IV.
SUMMARY OF THE ARGUMENT

State Farm Lloyds should not be permitted to take contrary positions on the interpretation of the ensuing-loss provision of the HO-B policy in cases that are pending at the same time within the same federal judicial system. Because State Farm has admitted in federal-court proceedings that the Texas HO-B policy provides coverage for mold that ensues from an otherwise covered loss such as a water leak, State Farm should be judicially estopped to assert a contrary position. In other words, State Farm should not be allowed to conveniently change its interpretations of key policy provisions according to its needs in each case. In any event, should the Court find the ensuing-loss clause to be ambiguous, the Court should consider State Farm's admissions as extrinsic evidence of the meaning of the clause.

V.
ARGUMENT AND AUTHORITIES

A. State Farm Has Admitted in Other Litigation that the HO-B Policy Covers Mold Ensuing from a Covered Loss.

In the *Choate* case, a State Farm adjuster and her team manager both testified that State Farm has always treated mold resulting from a water loss as covered by the ensuing-loss clause.

For example, when adjuster Arlene Padilla testified in *Choate*, she acknowledged that 50-75 percent of the mold claims she handled ***were caused by water leaks, and State Farm acknowledged coverage on all those claims***:

> Q: Can you give me an estimate as to what percentage of your cases between 1998 and 2002 would have been mold related?
>
> A: Roughly speaking, probably 10 to 20 percent.
>
> Q: And of those, how many would you guess began as water claims that turned into mold claims?
>
> A: Approximately, a half to three-quarters.
>
> Q: Did you have any understanding as to how that happened, that the water claim would turn into a mold claim?
>
> A: Usually, as we were investigating the water damage and we'd be -- begin the process of doing the repairs, there was mold found.
>
> * * *

Q: Are you aware of any claims in which a claim began as a water claim, turned into a mold claim and State Farm subsequently denied coverage for the mold?

A: I'm not aware of any.

Q: In the cases that you handled or the claims you handled, they were all covered?

A: ***Yes, they were. They were handled as a covered loss.***[4]

Similarly, Arlene Padilla's boss, team manager John Eden, testified that mold ensuing from a water loss is covered:

Q: Are you aware — and again, I'm speaking in general terms — of situations in which you have a loss in one particular area but you then have an ensuing loss to other areas of the home in general?

A: In general?

Q: Yes.

A: If you have an immediate direct loss in one area, depending upon the cause of loss, yeah, you could have an ensuing loss somewhere else.

* * *

Q: Would the situation where a water claim results in mold growing in other parts of the house also be an example of an ensuing loss?

[4] *See* September 2, 2004 Testimony of Arlene Padilla at page 18, line 16 through page 19, line 8; and page 19, lines 14 through 21 (attached at Tab C) (emphasis added).

A: I don't -- you'll just have to take a look at the facts of each case on that with -- as far as whether or not that would be connected.

Q: And I'm not specifically referring to the Choates. I'm speaking more in general terms. Wouldn't you agree it is possible — in that it has in fact happened in State Farm's experience — that a water claim has led to a mold claim which has been considered an ensuing loss?[5]

A: ***I would agree that we have had water claims that have turned into mold claims.***

Q: And would you agree that those mold claims are handled as part of the initial water claim? In other words, it's not treated as a separate claim. It's just a loss resulting from the initial claim?

A: ***We have handled those as a covered loss with that claim, yes.***

Q: Would you agree that with respect to the Choate home when mold was discovered, at least initially the mold that was remediated was handled as an ensuing loss?

A: ***Yes. We handled that as a covered loss with this claim.***[6]

Mr. Eden further agreed that in order for there to be funds available to pay for the claims that State Farm owes, State Farm has an obligation to its policy-

[5] The em-dashes in this quote are provided for clarification.

[6] *See* October 1, 2004 Testimony of John Eden at page 26, line 22 through page 27, line 6; and page 27, line 13 through page 28, line 11 (attached at Tab D) (emphasis added).

holders to not waste State Farm's money by paying for losses that are not covered.[7] In other words, State Farm would not have paid for the Choates' ensuing mold loss had State Farm not believed that loss to be covered.

B. State Farm Should Be Judicially Estopped from Asserting a Position in the *Fiess* Litigation That Is Contrary to a Position It Has Taken in the *Choate* Litigation.

Judicial estoppel holds that a party who has made a sworn statement in a pleading, a deposition, oral testimony, or affidavits in a judicial proceeding is judicially estopped from maintaining a contrary position in a subsequent proceeding.[8] Unlike ordinary equitable or quasi-estoppel, "[j]udicial estoppel may be invoked by strangers to the record in the former proceeding."[9] The doctrine "is not strictly speaking estoppel at all but arises from positive rules of procedure based on justice and sound policy."[10] The doctrine is based on public policy that prohibits a litigant from maintaining inconsistent positions in separate judicial

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[7] *See Id.* at page 25, lines 7 through 12 (Tab D).

[8] *See, e.g., Matthews v. State*, ___ S.W.3d ___, No. 2-03-149-CR, 2005 WL 995224 at *3 (Tex. App.—Fort Worth Apr. 28, 2005, no pet. h.).

[9] *Swilley v. McCain*, 374 S.W.2d 871, 876 (Tex. 1964).

[10] *Long v. Knox*, 155 Tex. 581, 291 S.W.2d 292, 295 (1956).

proceedings.[11] The purpose of the doctrine is to "uphold the sanctity of the oath and to prevent abuse of the judicial process."[12]

The Texas Supreme Court case of *Long v. Knox* aptly illustrates the doctrine.[13] In that case, the sole heir of W.C. Knox filed a trespass-to-try-title suit to establish that a piece of property was the community property of Knox and his wife, rather than the separate property of the wife. In a prior suit, however, Knox and his wife filed suit against a creditor of Knox, seeking to enjoin the execution and levy on the same property by pleading that the property belonged solely to Knox's wife's separate estate. In that suit, Knox and his wife subscribed to a jurat that read, "all of said allegations are true and correct."

Applying the doctrine of judicial estoppel, the Texas Supreme Court held that Knox's heir was bound by Knox's averment in the prior suit:

> Although the injunction suit was dismissed and the restraining order expired, the purpose of the affiant was accomplished as thoroughly as if a judgment had been entered in favor of the plaintiffs in that suit. The creditor was convinced and abandoned further efforts. Knox gained the advantage of preventing the property from being sold. ***Having thus sworn under oath in this judicial proceeding that his wife owned the property in***

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[11] *See, e.g., Matthews*, 2005 WL 995224 at *3.

[12] *See, e.g., id.*

[13] 155 Tex. 581, 291 S.W.2d 292 (1956).

> ***her separate right he would not be heard now to maintain a contrary position...***[14]

The same situation exists in this case. In this case, State Farm seeks to avoid coverage by giving the ensuing-loss clause an interpretation that squarely contradicts the interpretation sworn to by its own employees. And like in *Long v. Knox*, State Farm used this prior, contradictory testimony to obtain a strategic advantage in the *Choate* case when it relied on this very testimony to block the Choates' attempts to take the deposition of a corporate representative about State Farm's knowledge that water losses can develop into mold losses if not handled properly:

> [Plaintiffs] have had... the operation guides and [MOOF] manuals. And they specifically discuss in there that those are instructions to the adjusters, Your Honor. They specifically discuss you need to remove water as quickly as possible. You know, mold can grow in "X" amount of time, things of this sort. So they—they know that State Farm is aware of that and instructed their adjusters... ***They've also deposed, of course, three adjusters and the team manager, who handled this loss, and either did or could have asked them, Did you know that water causes mold to grow.*** [15]

Because State Farm insisted that the Choates be limited to State Farm's employees' testimony, State Farm, too, should be bound by this same testimony.

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[14] *Id.* at 295.

[15] *See* Excerpts from Transcript of May 19, 2005 Hearing on State Farm's Mot. to Quash Pls.' Rule 30(b)(6) Not. of Depo. of Corporate Rep. at p. 10 (quoting Melinda Burke, counsel for State Farm) (Appendix at Tab E).

In other words, State Farm cannot simply pick and choose which admissions will and will not be binding on State Farm according to its needs in each case.

C. State Farm's Employees' Interpretation of the Ensuing-Loss Clause Is Extrinsic Evidence that the HO-B Policy Covers Mold that Ensues from a Covered Water Loss.

In any event, State Farm's employees' admissions should be considered as extrinsic evidence of the meaning of the ensuing-loss provision. Under Texas law, once a contract is found to be ambiguous, the court is free to consider extrinsic evidence of the parties' interpretations in determining the contract's true meaning.[16] Accordingly, in determining the true meaning of the ensuing-loss clause, this Court should consider the interpretation taught to, understood by and expressed by State Farm's own employees.

VI.
CONCLUSION

Because State Farm should not be permitted to manipulate the judicial system and to take contrary positions when fighting different policyholders, State Farm should be judicially estopped from arguing in the *Fiess* case that mold ensuing from a covered water loss is not covered under the Texas HO-B policy. Accordingly, Amicus Curiae Ralph and Janice Choate respectfully request that the Court answer "***YES***" to the certified question.

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[16] *National Union Fire Ins. Co. v. CIB Indus., Inc.*, 907 S.W.2d 517, 520 (Tex. 1995)

Respectfully submitted,

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APPENDIX to Post-Submission Brief of J. Ralph Choate and Janice G. Choate as Amicus Curiae in Support of Appellants Fiess