

No. 03-20778

IN THE UNITED STATES COURT OF APPEALS  
FOR THE FIFTH CIRCUIT

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RICHARD FIESS and STEPHANIE FIESS,  
*Plaintiffs-Appellants,*

v.

STATE FARM LLOYDS  
*Defendant-Appellee.*

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**On Appeal from the United States District Court  
for the Southern District of Texas, Houston Division  
Case No. H-02-CV-1912**

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**BRIEF OF THE TEXAS DEPARTMENT OF INSURANCE  
AS *AMICUS CURIAE* IN SUPPORT OF APPELLANTS**

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## SUPPLEMENTAL CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies that in addition to those persons listed in Plaintiffs-Appellants' Certificate, 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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## STATEMENT OF INTEREST

The Texas Department of Insurance (“TDI”) is the author of the standardized homeowner policy Form B (“HO-B”) construed by the district court in this case. Furthermore, TDI is the regulatory agency charged by the Texas Legislature to ensure that insurance companies comply with state law, including insurance policies. The district court’s erroneous construction of HO-B coverage terms will have serious negative implications on homeowners coverage throughout Texas.

In recent years, Texas experienced a significant increase in the number of mold claims filed (and paid by insurers) under the HO-B. TDI began a review of coverage for mold claims and coverage in Texas. Subsequently, the Commissioner of Insurance issued an Order mandating changes to the HO-B. The Order explains that basic coverage remains for reasonable and necessary repair or replacement of property due to mold as an ensuing loss of a covered water loss. Furthermore, several enforcement actions are pending at TDI due to insurers who are seizing a new opportunity to deny valid claims in light of the district court’s decision.

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Order 02-0208, Addendum Tab 2, also available at  
<http://www.tdi.state.tx.us/commish/rules/statefarm.html>.

Bulletin B-0015-02, available at <http://www.tdi.state.tx.us/commish/bulletins/b-0015-2.html>.

## **SUMMARY OF THE ARGUMENT**

The HO-B policy construed by the district court as excluding mold is a standardized policy written and enforced by the Texas Department of Insurance. The Texas Commissioner of Insurance (the “Commissioner”) has issued several bulletins and orders consistently determining that mold becomes a covered loss when it is the result of a covered water loss. In recent years, Texas insurers, including State Farm Lloyds, have paid millions of dollars in claims in accordance with the Department’s bulletins and orders. Moreover, when the Commissioner approved new State Farm policies in Texas, State Farm agreed to maintain basic mold coverage as provided in the HO-B. The plain language of the Fiesses’ HO-B policy covers their claim, and the district court’s decision excluding coverage should be reversed.

## **ARGUMENT**

### **I. THE PLAIN LANGUAGE OF THE HO-B POLICY PROVIDES COVERAGE FOR MOLD AS AN ENSUING LOSS OF A COVERED WATER LOSS.**

Coverage for mold under the Texas HO-B policy “comes from the ‘ensuing loss’ language contained in exclusion 1.f. which provides an exception to the exclusion for mold or other fungi if the mold loss ensues from a covered peril.” *See* Addendum, Tab 1, at 57-8; *see also* Order 01-0115 at <http://www.tdi.state.tx.us/>

commish/multi/co-01-1105.html.<sup>1</sup> The general mold exclusion in the HO-B states that

- (f) We do not cover loss caused by:
  - (1) wear and tear, deterioration or any quality in property that causes it to damage or destroy itself.
  - (2) rust, rot, *mold*, or other fungi.

*We do cover ensuing loss caused by collapse of building or any part of the building, water damage or breakage of glass which is part of the building if the loss would otherwise be covered under this policy. (Emphasis added).*

The unambiguous language states that losses such as mold are covered as an ensuing loss when caused by water damage if the loss would otherwise be covered under the policy. Any other reading of the policy makes the coverage provided by the additional “ensuing loss” provision meaningless. For example, if the provision only means that it covers losses which would otherwise be covered, the whole paragraph would be superfluous. The “ensuing loss” provision can only be read to mean that despite any exclusion language, it includes coverage for certain damage caused by covered water losses.

State Farm then argues that the ensuing loss provision only results in coverage for mold damage if the water damage is caused by mold. However, it is unlikely that mold would itself be the cause of water damage. Rather, water damage is usually the

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<sup>1</sup>On November 28, 2001, the Texas Insurance Commissioner issued Order 01-0115, attached as an addendum to this brief.



cause of mold.

State Farm also argues that if water damage causing mold is covered, there would always be coverage. However, water damage is not always a covered claim. For example, to the extent the damage is shown to be the result of a flood—as it may have been to some extent in this case—the HO-B would not cover repairs due to (flood) water damage or mold resulting from the flood.

## **II. IN RECENT YEARS, TDI HAS REVIEWED MOLD COVERAGE AND CLAIMS MADE UNDER HO-B POLICIES.**

Coverage under the HO-B policy becomes more clear when considered within the context of mold coverage and claim history in Texas. Homeowner claims for water damage to the dwelling have been covered since at least 1978. *See* Addendum, Tab 1, at 58; *see also* Order 01-1105 at <http://www.tdi.state.tx.us/commish/multi/co-01-1105.html>. Unfortunately, the Fiesses are not alone in their problems with mold due to water damage. The growing proliferation of mold claims was brought to the attention of TDI around 2000. Specifically, insurance companies complained of having to pay rising claims for mold as the result of water damage because the standard HO-B provides coverage for mold as an ensuing loss of covered water claims. And until March 2002, the companies were limited to coverage provided by standardized forms with endorsements which were required to be approved by the

Commissioner. *See* TEX. INS. CODE art. 5.35 (Vernon 1997). Therefore, insurance companies sought help from TDI due to its role as the regulatory agency and author of standardized Texas homeowners insurance policies.

The initial inquiry by TDI began as the result of a “relatively sudden, large and unprecedented proliferation of mold claims against Texas homeowners policies over the past two years [1999-2001].” Addendum, Tab 1, at 3; *see* Order 01-1105 at <http://www.tdi.state.tx.us/commish/multi/co-01-1105.html>. The Commissioner noted that the problem was exacerbated by “the fact that the most commonly purchased Texas policy, Texas Homeowners Form-B (HO-B), which is presently a promulgated and standardized form, that provides the most expansive coverage, for all the states, for water damage and any ensuing mold and fungi losses.” *Id.* Insurance companies began seeking approval from TDI for use of various homeowners and dwelling endorsements which would either eliminate or seriously limit coverage for “mold as an ensuing loss” with no option for the policyholder to purchase excluded or limited coverage. *Id.* at 4. Beginning on June 26, 2001, the Commissioner held informational hearings on mold coverage in Austin, Corpus Christi, and Houston. *See id.* Information, data, and comments were solicited from numerous sources. *See id.* at 5.

Additionally, TDI data which was collected from companies representing

approximately 65% of the homeowners insurance market in Texas, confirmed the magnitude of mold losses. *See* TDI's Mold Data Report at <http://www.tdi.state.tx.us/commish/news/molddata3.html>; *see also* <http://www.tdi.state.tx.us/commish/mold.html>. Specifically, data from those insurers showed that in the course of a year and a half, claim frequency (the number of claims per thousand policies insured) had grown more than sixfold, from 1.6 to 10.8. *Id.* The cost of the average mold claim was approximately \$18,000, 5.6 times the cost of an average non-mold related water damage claim. *Id.* As a result, the Commissioner estimated that if policy forms were not modified, policyholders could face premium increases in the double digits over the next several years. *See* Addendum, Tab 1, at 6; *see also* <http://www.tdi.state.tx.us/commish/multi/co-01-1105.html>. The insurance industry calculated rate increases of at least 40% "if the current ensuing mold damage coverage is not changed." *Id.* at 8. During the interim study period, the mold crisis reached the level where insurance companies attempted their own solutions such as refusing to issue the HO-B; refusing to issue new homeowners policies of any type; nonrenewing all HO-B coverage; and refusing to cover homes with a history of a previous water loss. *Id.* at 9.

### **III. ORDER 01-1105 CORRECTLY EXPLAINED MOLD COVERAGE UNDER TEXAS LAW.**

Therefore, on November 28, 2001, the Commissioner issued Order 01-1105 (the "Order"). The Order specified that the changes in standard policies were "designed to modify current coverages for mold and other fungi losses that are ensuing losses resulting from covered water losses in Texas homeowners and dwelling policies." *Id.* at 1. The Commissioner adopted, among other things, new amendatory mandatory endorsements, new mandatory offer endorsements, and amendments to the policy writing rules of the Homeowners and Dwelling sections of the Texas Personal Lines Manual. The changes, while not in effect during the Fiesses' coverage period, are relevant because they show what coverage was required during the relevant time period, and reflects the fact that HO-B policies such as the one purchased by the Fiesses have always covered situations where mold is the result of a covered water loss.

Commissioner's Bulletin B-0015-02, issued some five months later, explains that the Order eliminated mold coverage under certain circumstances, but even after changes were made, it still "provides coverage in the basic policy for removal of mold that results from sudden and accidental discharge, leakage or overflow of water." Bulletin B-0015-02, available at <http://www.tdi.state.tx.us/commish/bulletins/b-0015->

2.html. Although the language in the HO-B policies was not changed prior to the issuance of the Order, and insurers have paid millions of dollars in mold claims, these companies are now beginning to deny coverage for mold claims resulting from covered water losses.

#### **IV. TEXAS INSURERS ARE AWARE OF, AND HAVE PLANNED FOR, MOLD COVERAGE AS THE RESULT OF A COVERED WATER LOSS.**

##### **A. State Farm Admits that Mold is Covered as an Ensuing Loss of a Covered Water Loss.**

Curiously, State Farm Lloyds argues that mold is not covered by HO-B policies.<sup>2</sup> In 2001, however, State Farm began refusing to accept new property insurance business in Texas due in large part to the mold crisis. A September 18, 2001 press release by State Farm discussing the mold crisis is posted on its web site at [www.statefarm.com/media/release/lloyds.htm](http://www.statefarm.com/media/release/lloyds.htm). State Farm Senior Vice President Ron Dodd stated that “much of the financial problem facing State Farm Lloyds is due to mold-related losses.” Specifically, “[o]ur costs for mold-related claims are skyrocketing. . . [o]n average, a claim involving mold costs substantially more than one that doesn’t, and we’re seeing about five times as many claims involving mold this year as we did a year ago.” Furthermore, State Farm was “continuing to evaluate

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<sup>2</sup> Allstate Texas Lloyds Company has also recently changed their legal position on mold coverage as an ensuing loss. The court noted in *Salinas v. Allstate Tex. Lloyds Co.*, 278 F.Supp.2d 820 (S.D. Tex. 2003), that after previously conceding coverage, it is now disputing coverage.

the rate impact of mold claims, and anticipates that additional substantial rate increases will be necessary.” Thus State Farm knows mold was covered, and was increasing premiums in an effort to recoup the cost of paying mold claims.

Additionally, in a March 8, 2002 press release, State Farm acknowledged that “[t]he existing state-mandated homeowners insurance policy [HO-B] contains extensive coverage for water damage, foundations, and mold, with no ability for the policyholder to eliminate any of those coverages.”<sup>3</sup> Therefore, State Farm believed that approval of a new form changing coverage was a “positive development” that would result in base rates which would be lower than the rates for the HO-B policy.

**B. The Order Issued by TDI Approving State Farm’s National Policy is Evidence of Mold Coverage under the HO-B Policy.**

Next, State Farm requested, and received, approval from TDI to issue its national homeowners policy form, the HO-W policy. *See* Addendum, Tab 2; *see also* Order 02-0208 at <http://www.tdi.state.tx.us/commish/rules/statefarm.html>.<sup>4</sup> The order approving use of the State Farm policy also recites State Farm’s agreements relating to coverage for mold as the result of water damage. It states:

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<sup>3</sup> The press release is located at [www.statefarm.com/media/release/homeowntx.htm](http://www.statefarm.com/media/release/homeowntx.htm).

<sup>4</sup>On March 8, 2002, the Texas Insurance Commissioner issued Order 02-0208, attached as an addendum to this brief.

State Farm agrees to extend the coverage for water damage in the same manner as provided in the HO-B that is specified in Commissioner's Order No. 01-1105, concerning Mold, Fungi, or Other Microbes, to its policyholders. Specifically, State Farm extends coverage for reasonable and necessary repair or replacement of property physically damaged by a covered water loss which damage shall include mold, fungi, or other microbes, including a water loss that involves hidden and undetected damage, and where the insured has reported the loss within thirty (30) days of its detection.

*Id.* at ¶ V.F.3. Furthermore, while phasing in the new forms, State Farm agreed “to offer the Fungus (Including Mold) Limited Coverage Endorsement to new policyholders and existing policyholders *currently receiving ensuing mold damage coverage under the HO-B policy form.*” *Id.* at 26 (emphasis added). State Farm's argument that mold was precluded under the HO-B form is inconsistent with its own statements and agreements that mold is covered under the HO-B policy form.

**C. Insurers' Payment of Millions of Dollars in Claims Indicates that Mold Damage as an Ensuing Loss of Water Damage is Covered Under the HO-B Policy.**

Moreover, statistical data collected by TDI from the five largest groups writing homeowners insurance shows that in 2000 and 2001, claims exceeding \$14,999 cost approximately \$768,915,502. *See* TDI's report, available at <http://www.tdi.state.tx.us/commish/news/molddata3.html>. Even small claims, less than \$5,000 each, cost \$101,521,301. *See id.* After paying millions of dollars in

claims, insurers such as State Farm and Allstate are now arguing the original HO-B policy never covered the claims. One court has noted that “[a]fter conceding during several recent court appearances in other mold cases that certain mold damage may be covered under a Texas HO-B policy, Defendant now seizes on the recent decision out of Houston, *Feiss v. State Farm Lloyds*, to support its new argument that mold claims are completely barred under such policies.” *Salinas v. Allstate Tex. Lloyds Co.*, 278 F.Supp.2d 820,822 (S.D. Tex. 2003). The district court in *Salinas* rejected this inconsistent argument by Allstate, and another court in the Southern District of Texas has also correctly applied the language of the HO-B policy to hold that ensuing mold losses are covered.

**V. OTHER COURTS CONFRONTING THE SAME ISSUE HAVE CONCLUDED THAT THE HO-B POLICY COVERS MOLD AS AN ENSUING LOSS.**

Two decisions from the Southern District of Texas correctly interpreted Texas HO-B policies and mold coverage issues. In *Salinas v. Allstate Texas Lloyds Company*, the plaintiffs sued Allstate for denial of their claim for mold and water damage to their home. 278 F.Supp.2d 820 (S.D. Tex. 2003). Rejecting Allstate’s argument that mold claims were completely excluded under the form language, the court found coverage for the plaintiffs. Specifically, the court stated that it “adopts the interpretation of the HO-B Policy discussed in its previous *Flores* opinion and



holds, once again, that the Policy covers mold claims to the extent that the claimed mold damage ensues from an otherwise covered water damage event.” *Id.* at 824.

In the other case, *Flores v. Allstate Texas Lloyd’s Company*, the court also held that Texas HO-B policies cover mold claims under certain circumstances. The Flores family discovered leaks and mold growth in several areas of their home. 278 F.Supp.2d 810 (S.D. Tex. 2003). They filed a claim with their insurance company, Allstate Texas Lloyds Company (“Allstate”), under their HO-B policy. *See id.* at 810. While Allstate did not “generally dispute that the Policy covers ensuing mold damage,” Judge Crane correctly found that “Plaintiffs’ HO-B Policy covers mold damage to the dwelling or to personal property that ensues from an otherwise covered water damage event under the Policy.” *Id.* at 815. The court followed the policy language, recognizing that mold was excluded unless it was an “ensuing loss caused by . . . water damage . . . if the loss would otherwise be covered under this policy.” *Id.* at 814. Therefore, “mold damage to the dwelling is covered as a distinct loss if it ensues from an otherwise covered loss under the Policy.” *Id.*

## CONCLUSION

The plain language of the standard Texas HO-B policy purchased by the Fiesses provides coverage for damage caused by mold which is an ensuing loss of covered water damage. Additionally, the Commissioner has issued several orders and

bulletins explaining that the HO-B policies generally cover mold as the result of a covered water loss. Moreover, insurers have agreed that mold as an ensuing loss is covered, and have charged their policyholders additional premiums to cover the claims. Even State Farm has admitted coverage. Therefore, the trial court's decision granting State Farm's Motion for Summary Judgment should be reversed.

Respectfully submitted,

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I certify that paper and electronic copies of the foregoing Brief of the Texas Department of Insurance as *Amicus Curiae* in Support of Appellants, was served by certified mail and facsimile on November 12, 2003, to the following counsel of record:

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**CERTIFICATE OF COMPLIANCE**

\_\_\_\_ Pursuant to 5th Cir. R. 32 (a), the undersigned certifies this brief complies with the type-volume limitations of Fed. R. App. P. 32(a)(7)(B).

1. EXCLUSIVE OF THE EXEMPTED PORTIONS IN 5th Cir. R. 32.2, THE BRIEF CONTAINS 2,523 words and complies with the type-volume limitations of FRAP 32 (a)(7)(B)(iii).

2. THE BRIEF HAS BEEN PREPARED in proportionally spaced typeface using Corel WordPerfect Suite 9 in Times New Roman Regular 14 point font for text and Times New Roman Regular 12 point font for footnotes.

3. AN ELECTRONIC VERSION OF THE BRIEF AND A COPY OF THE WORD COUNT PRINTOUT ACCOMPANY THE HARD COPIES OF THIS BRIEF.

THE UNDERSIGNED UNDERSTANDS THAT A MATERIAL MISREPRESENTATION IN COMPLETING THIS CERTIFICATE, OR CIRCUMVENTION OF THE TYPE-VOLUME LIMITS IN FRAP 32(a)(7)(B) MAY RESULT IN THE COURT'S STRIKING THE BRIEF AND IMPOSING SANCTIONS AGAINST THE PERSON SIGNING THE BRIEF.

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