

Thornton Law Chronicles

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Internet Updates

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TEXAS SUPREME COURT: NO MOLD COVERAGE UNDER HO-B “ENSUING LOSS” CLAUSE

Fiess v. State Farm Lloyds, ___ S.W.3d ___, 2006 WL2505995 (Tex.2006).

In this long-awaited coverage opinion, the Texas Supreme Court answered a question certified to it by the United States Fifth Circuit Court of Appeals: whether the “ensuing loss” provision contained in exclusion 1(f) of the former version of the Homeowner’s Form B insurance policy, when read in conjunction with the remainder of the policy, provides coverage for mold contamination caused by water damage that is otherwise covered by the policy. The Court, in a 7-2 opinion authored by Justice Brister, answered the question “no.”

The majority opinion pointed out that the question “is not whether insurers should provide mold coverage in Texas, a public policy question beyond our jurisdiction as a court” – and of course insurers now routinely provide mold coverage, but as part of a separate endorsement that is priced accordingly. Rather, the Court viewed its job in this case as one of policy construction according to rules which, as Justice Brister wrote, “have been around for a long time, long before this dispute arose.” *Fiess*, at *1. The pertinent provision, as set forth in the exclusions to coverage, is as follows: “We do not cover loss caused by: ... (2) rust, rot, mold, or other fungi ... We do cover ensuing loss caused by... water damage... if the loss would otherwise be covered under this policy.”

The result necessarily flows from the majority’s rejection of the argument that the provision is ambiguous:


In this case, it is hard to find any ambiguity in the ordinary meaning of “we do not cover loss caused by mold”... Evidence of prior policies is extrinsic evidence, and thus inadmissible unless this policy is ambiguous. Ambiguity must be evident from the policy itself; it cannot be created by introducing parol evidence of intent. And while we have looked at a prior policy in deciding between reasonable constructions of a current one, we have never done so in lieu of construing the current one at all...

Id., at *2. The term “water damage,” as used in the ensuing loss clause, cannot operate to restore the mold coverage expressly excluded in the immediately preceding clause: “Mold does not grow without water; if every leak and drip is “water damage,” then it is hard to imagine any mold, rust, or rot excluded by this policy, and the mold exclusion would be practically meaningless.” *Id.*, at *4.

The dissenting opinion, authored by Justice Medina and joined by Justice O’Neill, suggested that the provision at issue “is susceptible to more than one reasonable interpretation and is therefore ambiguous,” and that under familiar rules of construction such ambiguity must be construed in favor of the insured. *Id.*, at *6 (Medina, J., dissenting). The dissent relied in part on the Texas Department of Insurance, which filed an amicus brief in the case in

which it argued that, even though mold itself is initially listed as an exclusion, it is nevertheless brought back into coverage by the ensuing loss language of paragraph 1(f), “which provides an exception to the exclusion for mold or other fungi if the mold loss ensues from a covered peril.” *Id.*, at *9. Justice Medina wrote that “[a]lthough I do not view this language to be as clear and unambiguous as the agency responsible for its inclusion in the policy, I do accept the Department’s interpretation as an alternative reasonable construction.” *Id.*

Both the majority and dissenting opinions observed in footnotes that the Court had before it for consideration only the ensuing loss clause of paragraph 1(f); the once equally controversial “accidental discharge” clause found in a separate section of the policy dealing with personal property – which provides in part that exclusions 1(a) through 1(h) “do not apply to loss caused by this peril” (i.e., accidental discharge, leakage, or overflow of water or steam from within a plumbing, heating or air conditioning system or household appliance) – was not under review because the Fiesses had failed to preserve error before the Fifth Circuit on this issue. *Id.*, at *11, fn. 3. The accidental discharge clause was last construed by the Texas Supreme Court in the case of *Balandran v. Safeco Insurance Company of America*, 972 S.W.2d 738 (Tex.1998), cited by both the majority and the dissent. In that case the Court concluded that exclusion 1(h), which excludes coverage for damage caused by foundation movement, does not apply either

to dwelling or to personal property coverage when the foundation movement is itself caused by the referenced “accidental discharge, leakage or overflow of water or steam...” 

- Vaughan E. Waters


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INSURER DEFENDING UNDER LIMITED RESERVATION OF RIGHTS HAS RIGHT TO POST-JUDGMENT INTERVENTION

Ross v. Marshall (Allstate Texas Lloyds Insurance Co., Intervenor), 426 F.3d 745 (5th Cir. (Tex.) 2005), pet. denied on rehearing, – F.3d – , 2006 WL 1892654 (5th Cir. (Tex.) July 11, 2006)

An African-American family brought tort and civil rights claims against a father whose 20-year-old son burned a cross in their yard in Katy, Texas. On the night in question, and at the father’s house, the son and his friends imbibed alcohol and constructed a large wooden cross. The plaintiffs sought to recover from the father on the basis that he had negligently delegated authority over his property to his son, and that he was vicariously liable for his son’s intentional torts. The father’s homeowner’s insurer, Allstate, provided an attorney to defend him, subject to a reservation of rights. Following a judgment holding the father vicariously liable for \$10 million in damages, the father fired his Allstate-assigned counsel and entered into an agreement with the plaintiffs that involved his abandoning an appeal and assigning his rights against Allstate. Allstate

sought to intervene as of right for the purpose of appealing the judgment. The trial court denied the intervention, and struck the insurer's answer and notice of appeal. The insured subsequently abandoned his appeal and assigned all rights and claims against his insurer to the plaintiffs. Allstate appealed.

On appeal, the plaintiffs asserted Allstate had no right to intervene in the suit after judgment because it had reserved its right to deny coverage, and therefore, it did not have a sufficient interest in the litigation. The United States Court of Appeals, Fifth Circuit, reversed and remanded. The Fifth Circuit recognized, had it defended its insured under a full reservation of rights, that alone would have been insufficient for Allstate to intervene because Allstate's interest in the litigation was entirely contingent on the outcome of the coverage dispute. But since, in this case, Allstate had defended the father under a limited reservation of rights, accepting coverage for any negligent conduct while denying coverage for any intentional conduct, the Fifth Circuit held Allstate had a direct interest in the litigation sufficient to support its right of intervention. 

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DUTY TO DEFEND AND THE "EIGHT CORNERS RULE" WITHSTANDS APPEAL TO TEXAS SUPREME COURT

Guideone Elite Insurance Company v. Fielder Road Baptist Church, – S.W.3d – , 2006 WL 1791689,


49 Tex. Sup. Ct. J. 877 (Tex. June 30, 2006) (not yet released for publication)

Effective March 31, 1993, Guideone Elite Insurance Company issued a commercial general liability policy to Fielder Road Baptist Church. "Jane Doe" filed a sexual misconduct lawsuit against the church in June 2001, alleging she was sexually abused and exploited by Evans, an associate youth minister of the church. In September 2001, Guideone filed this declaratory judgment action seeking construction of the CGL policy and a declaration that it had no duty to defend or indemnify the church in the underlying sexual misconduct lawsuit. In the declaratory judgment action, Guideone and the church filed a stipulation that Evans ceased working for the church before the Guideone policy went into effect.

Having considered the stipulation of the parties, the trial court granted summary judgment to Guideone, rendering a declaratory judgment declaring that Guideone had no duty to defend the church in the underlying sexual misconduct case. But the Fort Worth Court of Appeals reversed because the trial court violated the "eight corners" or "complaint allegation rule" when it considered the parties' stipulation on the duty to defend issue. Under that 40-year-old rule, the duty to defend is considered based only on the four corners of the insurance policy, plus the four corners of the plaintiff's petition, without regard to the truth or falsity of the plaintiff's allegations. In short, according to the appeals

court, the parties' stipulation that Evans was not employed within the church's policy period went beyond the eight corners, and constituted extrinsic evidence that should not have been considered by the trial court in determining the duty to defend.

Guideone petitioned the Texas Supreme Court for review, urging the court to adopt an exception to the eight-corners rule to permit the use of extrinsic evidence that is relevant to coverage and the merits of the underlying case. The supreme court declined Guideone's invitation.

The Texas Supreme Court affirmed, holding that "[t]he policy here obligated Guideone to indemnify the Church in the event of a meritorious claim for sexual misconduct, but with respect to the duty to defend, the contract provided that Guideone should 'defend any suit brought against [the insured] seeking damages, even if the allegations of the suit are groundless, false or fraudulent . . .'" Further, the court stated, "if Guideone knows these allegations to be untrue, its duty is to establish such facts in defense of its insured, rather than as an adversary in a declaratory judgment action." 

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PREJUDICE REQUIREMENT STILL STANDS AGAINST AN INSURER'S DENIAL BASED ON INSURED'S FAILURE TO GIVE PROMPT NOTICE OF CLAIM

Coastal Refining & Marketing, Inc. v. U.S. Fidelity and Guaranty

Company, – S.W.3d – , 2006 WL 1459869 (Tex. App. – Houston [14th Dist.] May 30, 2006)

The late notice defense has been a source of controversy for more than 30 years. As long ago as 1973, the Texas State Board of Insurance issued Order 23080 – requiring a showing by the insurer of prejudice in late notice defense cases involving bodily injury and/or property damage. In *Travelers Indemnity Company of Connecticut v. Presbyterian Healthcare Resources* (N.D. Tex. 2004), a hospital made a claim under its CGL policy with Travelers after it got sued by a physician claiming the hospital's peer review committee defamed him. There, the federal district court in Dallas held that the insurer must show it has been prejudiced by the insured's failure to provide timely notice of the claim before denying a defense and indemnity. In *New Era of Networks, Inc. v. Great Northern Insurance Company* (S.D. Tex. 2003), the federal district court in Houston held similarly.

Recently, in *Coastal Refining & Marketing, Inc. v. U.S. Fidelity and Guaranty Company* (Tex. App. – Houston [14th Dist.] May 30, 2006), the Houston Court of Appeals (14th District), has also imposed the prejudice requirement on an insurer.

In *Coastal*, USF&G brought a declaratory judgment action against its additional insured, Coastal Refining and Marketing, Inc. Coastal was an additional insured on one of its contractors' CGL policies with USF&G. The

contractor's employee was seriously injured in a May 1999 explosion at Coastal's refinery in Corpus Christi, Texas, and he and his family sued Coastal there for negligence and gross negligence. Without notifying USF&G, Coastal retained defense counsel and, just a few weeks before the trial setting, attended a mediation where the underlying personal injury suit did not settle. Coastal's excess carrier, Lexington, assumed the defense of Coastal following the mediation, through the same defense counsel, and continued negotiations with the underlying plaintiffs. Days after the mediation, and less than a month before trial, Coastal's defense attorneys notified the agent and producer of the USF&G policy of the lawsuit, and made a demand for coverage. Three days later, USF&G began its investigation, got up to speed on the settlement negotiations, and informed Coastal's attorneys that it had insufficient information to respond to Coastal's demand. The next day Coastal's attorneys and its excess insurer settled the personal injury suit for \$7 million.

USF&G then filed this declaratory judgment action, asserting it had no duty to indemnify Coastal for the settlement funds. USF&G moved for summary judgment on the grounds that Coastal breached explicit policy conditions by (a) failing to give USF&G notice of the claim/suit for over a year after it was filed, (b) settling the lawsuit without USF&G's knowledge or consent, and (c) breaching its duty to cooperate with USF&G. The trial court granted USF&G's motion

without stating the reasons for its decision, and Coastal appealed.

The Houston Court of Appeals reversed and remanded because USF&G presented no evidence that it was prejudiced by Coastal's delay in notifying USF&G of the claim, and because there was no evidence USF&G was prejudiced by Coastal's settlement of the claim without USF&G's knowledge or consent. Significant to the appeals court's decision was explicit language in the USF&G policy stating that failure to comply with the prompt notice provision would not bar coverage "unless [USF&G] is prejudiced thereby." And citing the Texas Supreme Court's decision in *Hernandez v. Gulf Group Lloyds* (Tex. 1994), the appeals court explained that an insurer is required to show prejudice before denying coverage on the basis that the insured settled a claim without the insurer's consent. 📖

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**ISSUE OF FIRST IMPRESSION:
HOMEOWNERS' POLICY DOES
NOT ENTITLE INSURED TO A
LIMIT OF LIABILITY FOR EACH
SOURCE OF DAMAGE**


Coats v. Farmers Insurance Exchange, – S.W.3d – , 2006 WL 1765925 (Tex. App. – Houston [14th Dist.] June 29, 2006)

The plaintiffs in this lawsuit bought their Homeowners Form B policy from Farmers. The policy was effective from July 30, 2000 to July 30, 2001, and the policy

limits were \$138,000 for damage to the dwelling, \$82,800 for loss to contents within the dwelling, and \$27,600 for loss of use including alternative living expenses (“ALE”). On April 18, 2001, the plaintiffs filed an insurance claim for hail and water damage to their roof. Farmers informed the insureds that the costs to repair the roof damage did not exceed the \$1,000 policy deductible. On June 14, 2001, the plaintiffs filed a second claim for water and roof damage that occurred as a result of Tropical Storm Allison. After first issuing a denial, Farmers re-opened the second claim after discovering that several water sources had caused damage to the home. Among those sources were a leak in the HVAC system, several leaks in the roof, and a hot tub leak. During March 2002, Farmers determined the plaintiffs’ home was a total loss and paid the policy limits for the dwelling and ALE. During July 2002, the insureds filed a third claim, in which they alleged an HVAC overflow caused water and mold damage to the dwelling. Farmers investigated the third claim and determined the damage allegedly caused by the HVAC overflow was considered, and paid for, when appellants received the policy limits in connection with the second claim.

The plaintiffs sued Farmers for not paying anything on the third claim. Farmers moved for summary judgment, contending it owed nothing because it had paid the policy limits. The plaintiffs responded that they were entitled to receive a sum not to exceed policy

limits for each source of damage. because the homeowner’s policy states its limits of liability apply “in any one loss.” Rejecting the plaintiffs’ interpretation of the policy, the trial court granted Farmers’ motion for summary judgment, and the plaintiffs appealed.

The Houston Court of Appeals, 14th District, affirmed the trial court’s ruling. In this case of first impression, and construing the policy as a whole and focusing on the “Loss Settlement” provisions, the appeals court held that the policy unambiguously entitled the plaintiffs only to the lesser of the limit of liability or what it would cost to repair or replace the home – and not a separate policy limit for each source of the damage. 

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APPRAISAL CLAUSE IN HOMEOWNER’S POLICY CAN BE INVOKED FOR A DETERMINATION OF EXTENT OF LOSS FROM COVERED PERIL, AS WELL AS AMOUNT OF LOSS

Johnson v. State Farm Lloyds, – S.W.3d –, 2006 WL 2053472 (Tex. App. – Dallas July 25, 2006)

This case involves the question of whether the meaning of the term “amount of loss” in an appraisal clause of a homeowner’s insurance policy includes the extent of loss, and whether the insured can compel the insurer to appraisal when there is a dispute about the extent of loss.

This dispute arose after the insured’s roof was damaged by hail in April 2003. State Farm inspected the property and concluded that only the ridgeline of the roof was damaged by hail. State Farm estimated the repair cost at \$499.50, which was less than the deductible, and declined any payment on the claim. At the insured’s request, State Farm made another inspection, but the result was the same. The insured argued the entire roof needed replacement – and she submitted an estimate of over \$6,400. She also hired an attorney who wrote State Farm, demanding it submit to the appraisal process pursuant to the policy’s appraisal clause. State Farm declined, stating that the parties’ disagreement about the extent of the hail damage was a coverage issue that could not be decided by appraisal.

The insured filed this declaratory judgment action, and State Farm and the insured moved for summary judgment. The trial court granted State Farm’s motion, and denied the insured’s. The insured’s appeal followed.

The Dallas Court of Appeals reversed and rendered judgment for the insured, holding that “the appraisal process determines the amount that should be paid because of loss from a covered peril . . . [which] . . . necessarily requires the appraiser to assess the extent of the damage and exclude payment for causes not covered.” 

- Richard C. Harrist

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Firm Community News

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Project Takes Place in Palo Alto Neighborhood

Given the success of last year's volunteer project, Thornton Biechlin Segrato Reynolds & Guerra participated in another Habitat for Humanity home build on June 17, 2006. The firm fielded a team of over 20 employees, spouses and adult children who helped with roofing, drywall, and building of a tool shed at a new home in the Palo Alto neighborhood on the southern side of San Antonio.

Legal Assistant Rose Ann Cavazos, who came with her daughter, had this to say about the experience. "It was the first time that either my daughter or I had participated in something like this. We really enjoyed being involved and doing our part to help out."



Legal Assistant Rose Ann Cavazos, along with her co-workers, enjoyed the hard work at the Summer Habitat for Humanity Build Project.

To learn more about Habitat for Humanity projects in the San Antonio area, go to www.habitatsa.org or call Habitat for Humanity of San Antonio, Inc. at 210.223.5203. 

Attorney Kudos

During Summer 2006 various attorneys with the firm were recognized for their hard work and dedication.


Thornton Real Estate Attorney Scott Cline spoke at seven different Town Hall Meetings hosted by the San Antonio Board of Realtors. His presentations focused on legal education as it relates to real estate issues and ethics. More than 800 real estate agents heard his presentation. Here are some comments from a few participants:

"Mr. Cline, I just wanted to say thank you for your presentation this morning. I really appreciate the calm and measured manner in which you presented the issues that have such damaging potential to our profession. It was a timely topic, well presented and I thank you for that."

*Dennis Shumaker
Vice President, Residential Sales
Coldwell Banker D'Ann Harper,
Realtors®*

"Scott, thank you so much for being our speaker at the Second Quarter Town Hall meeting. As always, you did an outstanding job. Thanks for sharing your talent and expertise."

*Travis Kessler
President
San Antonio Board of Realtors*

Also this Summer, Thornton attorneys Michael Holland, Richard Reynolds and Rusty Biechlin were selected by their peers as "Best Lawyers in San Antonio" and were featured in the August issue of *Scene in SA* magazine. In addition, Mr. Reynolds and Mr. Biechlin were selected as top attorneys in the community in *San Antonio* magazine. 



l to r - Mike Holland, Richard Reynolds, Rusty Biechlin

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It's A Win!

Breach of Contract

New Thornton attorney **Jose Trevino**, who received his license to practice law less than a year ago, recently won his first case involving a breach of contract suit brought against a local architect. The plaintiff claimed she engaged the architect to draw a set of plans to remodel her attic that were faulty as she contended that she could not find a contractor to implement the design. Plaintiff

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sought the return of the fees she paid the architect and consequential damages relating to delay of construction. Defense argued that plans were drawn according to plaintiff's requests. Further, the defense contended that nothing was wrong with the plans, other than plaintiff wanted to change the design. The verdict ruled in favor of Mr. Trevino's client, the architect and defendant.

Personal Injury Case

Attorney **Rafael Garcia, Jr.** of Thornton's McAllen office recently tried a motor vehicle personal injury jury case in

Hidalgo County on behalf of his client, the defendant motorist. The DPS trooper who investigated the accident concluded that Mr. Garcia's client's failure to yield the right of way from a stop sign was the sole factor contributing to the accident and issued a citation to Mr. Garcia's client.

The plaintiff alleged soft-tissue injuries to her neck, back and ankle, missed over one month from work, and claimed she continued with pain at the present time. However, due to many inconsistencies developed during the plaintiff's trial cross examination by Mr. Garcia, the jury returned a defense verdict

placing 75% comparative negligence on the Plaintiff.

Insurance Errors and Omissions

Richard Reynolds recently secured a victory for his client, an insurance broker and his agent. Mr. Reynolds' client was sued by a business owner who claimed they failed to properly advise him and to provide the business with adequate types and amounts of coverage. The jury found unanimously in favor of Mr. Reynolds' client, citing that there was insufficient evidence to support the plaintiff's claim. 📖

**The Counselor Is In:
Scott F. Cline**



Scott Cline was born in Houston, Texas and grew up in Wharton, Texas. After graduating from the University of Texas, Austin with a Bachelor of Business Administration in Finance, he went on to law school at South Texas College of Law, graduating in 1981. For the past

two decades, Scott's practice of law has covered much of the field of personal injury litigation. Today, Scott focuses his practice in the defense of real estate brokers and agents. In fact, Scott is a regular speaker at San Antonio Board of Realtors and various brokerage firms throughout South and Central Texas, educating brokers and agents on the legal complexities of real estate agent transactions.

Outside of work, Scott has a busy family and social life that keeps him active in the community. He and his wife Hilary are often found on the sidelines of the soccer field watching their daughter Hayley score goals. He participates actively with their son Drew in Boy Scouts of America and enjoys attending University of

Texas football games with his eldest son, Will. Additionally, Scott is an avid reader and history buff, who travels to ancient cities and far off places found in the stories he loves to read. His love of reading goes hand-in-hand with his enjoyment of coffee, and he can often times be found at the local coffee house poring over documents and briefs for his clients. Scott has true dedication and commitment to his work and his family, whatever the time of day, and brings this same effort and spirit to his clients needs. 📖

- Jose "J.J." Trevino, Jr.

Thornton Law Chronicles continues to offer this feature, "The Counselor is In." Each quarterly printing will spotlight a different attorney, offering our readership insight into the real people who are the building blocks of our firm.