The Weekly Update of Texas Insurance News
TEXAS INSURANCE LAW NEWSBRIEF
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TEXAS SUPREME COURT WITHDRAWS PRIOR OPINION AND LIBERALLY CONSTRUES ADDITIONAL INSURED PROVISION

Last Friday, the Texas Supreme Court withdrew its earlier opinion (for a second time—*see MDJW Newsbrief* dated February 18, 2008) in *Evanston Ins. Co. v. Atofina Petrochemicals, Inc.,* 2008 WL 400394 (Tex. Feb. 15, 2008). In its new opinion from last week, the Texas Supreme Court reversed itself and closely examined the interplay between a contractual indemnity agreement and the scope of coverage afforded to additional insureds.

In the most recent decision in *Evanston Ins. Co. v. Atofina Petrochemicals, Inc.*, No. 03-0647 (Tex. June 13, 2008), the court addressed three specific issues: 1) "whether a commercial umbrella insurance policy purchased to secure the insured's indemnity obligation in a service contract with a third party also provides direct liability coverage for the third party;" 2) "whether the insurer is bound to pay the amount of an underlying settlement between the additional insured;" and 3) "whether article 21.55 (now Chapter 542) of the Texas Insurance Code, the "Prompt Payment of Claims" statute, authorized the imposition of penalties and attorney's fees for the insurer's failure to pay the claim timely."

Addressing the first issue involving the breadth of additional insured coverage, the court focused on the policy language defining who is an insured, the provision discussing the named insured's duty to indemnify the additional insured, and a separate provision defining an insured to include "A person or organization for whom you have agreed to provide insurance as is afforded by this policy; but that person or organization is an insured only with respect to operations performed by you or on your behalf, or facilities owned or used by you." The court reasoned that each "who-is-an-insured" clause served to grant coverage independently and, therefore, it held the policy provided the broader scope of coverage and did not exclude liabilities arising out of the additional insured's sole negligence.

Addressing the second issue of "whether the insurer was bound to pay the amount of an underlying settlement between the additional insured," the court revisited related decisions and held the insurer's "denial of coverage barred it from challenging the reasonableness" of the settlement and the insurer was thus bound to pay the $5.75 million settlement. Addressing the third issue of whether article 21.55 of the Texas Insurance Code applied in this context, however, the court observed the claim in this case was a third-party claim involving the insured's liability to another and not a first-party claim falling within the statute. Accordingly, the court held that the additional insured was not entitled to attorney fees or damages under article 21.55.

Editor's note: The high court's treatment of the 21.55 penalty provision is interesting in light of the court's ruling in *Lamar Homes* where it addressed the same statute in a liability claim involving the duty

to defend. Last Friday's decision in *Atofina Petrochemicals* properly ruled the penalty provision does not apply to indemnity benefits under a liability policy. It still leaves claims for previously tendered defense benefits subject to the 18% statutory penalty pursuant to its decision in *Lamar Homes*, despite the obvious inconsistency between the two decisions. A majority of the Texas Supreme Court apparently doesn't have any problems with applying the 18% statutory penalty to *defense benefits* under a liability policy when coverage is later determined to exist, but it does have problems applying the same penalty provision to the same claim under the same policy as it relates to *indemnity benefits*. Friday's decision in *Atofina Petrochemicals* is simply a good illustration of why the 21.55 holding in *Lamar Homes* was terribly wrong. In the prior decision from the high court, they reversed and rendered. The new opinion reversed and *remanded* back to the trial court to decide the question of attorney fees and interest.

TEXAS SUPREME COURT HOLDS SUBCONTRACTOR HAS STANDING TO SUE MANUFACTURER UNDER DOCTRINE OF EQUITABLE SUBROGATION

Also last Friday, the Texas Supreme Court ruled a subcontractor had standing to recoup contractual payments from alleged third-party tortfeasors. In *Frymire Engineering Co., Inc. v. Jomar Int'l, Ltd*. (No. 06-0755)(June 13, 2008), the owner of a Dallas hotel hired a general contractor to remodel a meeting room. The GC subcontracted work to Frymire and required Frymire to pay for any damages caused to the GC or hotel owner "by reason of [Frymire's] performance of the work." Frymire was also required to obtain liability insurance to cover this indemnity obligation.

During installation, a water line ruptured resulting in extensive damage to the hotel. Frymire's liability carrier paid the hotel owner $458,496 and a release was signed in favor of Frymire and its insurer from "all actions, claims, and demands" stemming from the accident. Nearly two years after signing the release, Frymire sued the manufacture of a valve alleging negligence, product liability, and breach of warranty. The manufacturer filed both traditional and no-evidence motions for summary judgment which the trial court granted. The court of appeals affirmed holding Frymire lacked standing to sue because it failed to establish the right to equitable subrogation.

After reviewing the requirements for equitable subrogation, and in route to reversing the lower appellate court, the Supreme Court held: 1.) Frymire's indemnity payment extinguished the tort liability debt primarily owed by the manufacturer (evidence was presented the water valve was defective); 2.) the indemnity payment was an involuntary payment made pursuant to a binding contractual obligation; and 3.) the manufacturer would be unjustly enriched if it escaped liability for its defective product because of Frymire's contractual payment. The net result was Frymire had standing to pursue equitable subrogation against the water valve manufacturer.

WACO COURT OF APPEALS FINDS HO-B POLICY PROVIDES COVERAGE FOR MOLD DAMAGE RESULTING FROM PLUMBING LEAKAGE OR OTHER SIMILAR DISCHARGE

In what can only be described as a terrible interpretation of Texas law, last week the Waco Court of Appeals concluded the Texas Homeowners Form B policy provides coverage for mold damage resulting from a plumbing leak or similar accidental discharge of water. In *Page v. State Farm Lloyds*, 2008 WL 2374760 (Tex. App.—Waco June 11, 2008), the insured discovered water and mold damage in her home and reported it to State Farm. After a plumbing system test, several sanitary sewer line leaks were detected. State Farm issued payments for remediation and repair of the structure, a separate remediation payment for contents, and ALE. Page requested additional funds and State Farm refused. Page then sued State Farm for breach of contract, breach of the duty of good faith and fair dealing, fraudulent

misrepresentation, DTPA violations, and Insurance Code violations. State Farm's summary judgment was granted by the trial court and this appeal followed.

Page argued the Texas Supreme Court's decision in *Fiess v. State Farm Lloyds* (202 S.W.3d 744 (Tex. 2006)) did not universally exclude coverage for mold damage to a dwelling or its contents. In *Fiess*, the Supreme Court answered a question certified to it by the Fifth Circuit asking whether the ensuing loss provision in Exclusion "when read in conjunction with the remainder of the policy, provide[s] coverage for mold contamination caused by water damage that is otherwise covered by the policy." *Fiess*, 202 S.W.3d at 745-46 (quoting *Fiess v. State Farm Lloyds*, 392 F.3d 802, 811-12 (5th Cir.2004)). The mold damage at issue in *Fiess* was caused by plumbing leaks and water leaks in the roof and around some windows. In *Fiess*, the Supreme Court concluded that the mold exclusion applied and the mold damage at issue was not covered. *Fiess*, 202 S.W.3d at 745. Among other things, the Court held: (1) the mold exclusion is unambiguous; and (2) mold damage is not "water damage." *See id.* at 746-48, 50-51.

In this appeal, State Farm argued *Fiess* resolved the question. Page argued because the loss resulted from plumbing leaks the Supreme Court's decision in *Balandran v. Safeco Ins. Co. of Am*erica., 972 S.W.2d 738 (Tex. 1998), actually controlled and required coverage. The question in *Balandran* was whether the HO-B policy provided coverage for damage from foundation movement caused by an underground plumbing leak. *Id*. The Court held in *Balandran* that the exclusion repeal provision was ambiguous because it was susceptible to two reasonable interpretations. Applying the *Balandran* rationale here, the appellate court reversed State Farm's summary judgment; instead holding the HO-B policy covers any loss (including mold) to the dwelling or its contents resulting from a plumbing leak subject to the limits of liability.

The remaining issues handled by the court included objections to summary judgment evidence, causation, amount of damages, and extra-contractual claims. Because the court concluded Page's contractual claim was valid, it determined State Farm was not entitled to summary judgment on Page's extra-contractual claims.

Editorial note: The *Page* decision is legally incorrect for multiple reasons and the court will have an opportunity to modify its decision before it is appealed to the Texas Supreme Court. First, in *Fiess*, the "*Balandran* argument" was briefed extensively by both parties. It is no accident that in *Fiess* the Texas Supreme Court referred to and cited *Balandran* SIX times in support of several different propositions of law. There can be no question the high court wanted everyone to know that its expansive holding on the mold coverage issue in *Fiess* considered and rejected the *Balandran* argument. Second, every federal district court and every appellate court to consider this exact same argument since *Fiess* has rejected the argument that mold coverage exists under the HO-B policy if the loss was caused by a plumbing leak. The more significant recent decisions rejecting this argument based on the expansive and unqualified language in *Fiess* include *Carrizales v. State Farm Lloyds*, 518 F.3d 343 (5th Cir. 2008); *Salinas v. State Farm Lloyds*, 2008 WL 552498 (5th Cir. 2008); *Sailer v. State Farm Lloyds*, 2008 WL 638183 (5th Cir. 2008); and *Mungia v. State Farm Lloyds*, 2008 WL 1874561 (5th Cir 2008).