



The Weekly Update of Texas Insurance News

# TEXAS INSURANCE LAW NEWSBRIEF



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## **FIFTH CIRCUIT FINDS MOLD NOT COVERED UNDER HOMEOWNERS POLICY BUT ORDERS NEW TRIAL ON MITIGATION OF DAMAGES AND CONDITION PRECEDENT JURY CHARGE ISSUE**

Last Friday, the Fifth Circuit held the Texas Standardized Homeowners Policy-Form B did not cover mold contamination caused by a plumbing leak, but reversed and remanded the case for a new trial based on the jury instruction. Specifically, the court concluded an insured's duty to mitigate may reduce his damage recovery from the carrier, but it was no affirmative defense to the carrier's liability. In *Carrizales v. State Farm Lloyds*, 2008 WL 467097 (5th Cir. February 22, 2008), the insureds filed a claim for mold damages caused by a plumbing leak. State Farm paid more than \$168,000 for the claim, but denied coverage for mold remediation claims totaling more than \$200,000.

The insureds sued State Farm for alleged violations of the Texas Insurance Code, breach of contract and breach of the duty of good faith and fair dealing. The case proceeded to trial, but evidence related to mold was excluded based on an earlier summary judgment ruling. At the close of evidence, the court formulated the jury charge so as to require mitigation of damages on the part of the insureds as a condition precedent to State Farm's liability. The instruction was based on State Farm's claimed affirmative defense of failure to mitigate damages. The jury found for State Farm.

On appeal, the insureds challenged the summary judgment finding and the verdict and the jury instruction requiring mitigation of damages as a condition precedent to recovery. The primary issue related to the mold question dealt with the interaction of two provisions in the HOB policy -- the mold exclusion and the exclusion repeal provision. The court concluded the interaction of the two provisions created no ambiguity in the context of a homeowners mold claim and, thus, mold was not covered. The insured's primary argument on coverage centered on the Texas Supreme Court's 1998 decision in *Balandran v. Safeco*, 972 S.W. 738 (Tex. 1998). In *Balandran*, the Texas Supreme Court found an ambiguity in the policy based on an exclusion repeal provision in the personal property coverage section of the policy. Despite the Texas Supreme Court's decision in 2006 holding mold damage was not covered under the Texas HOB policy (in *Fiess v. State Farm Lloyds*, 202 S.W.3d 744 (Tex. 2006), the insured argued in this case the *Balandran* decision was an exception to *Fiess* and mold was covered if caused by the accidental discharge of water from a plumbing system. The Fifth Circuit disagreed in its decision from last Friday and it found the factors leading to the decision in *Balandran* didn't exist in mold claims -- the precise position argued by State Farm before the trial court and on appeal.

Turning to the jury charge question, the court agreed with the insureds that mitigation of damages was an issue the jury should decide in determining the amount of damage to award, not a condition precedent (or affirmative defense) to liability. The court noted "Where the intent of the parties is doubtful . . . the

agreement will be interpreted as creating a covenant rather than a condition.” The Fifth Circuit acknowledged Texas courts have not yet decided whether the duty to mitigate damages is a condition precedent or an offset to reimbursement under the general homeowner’s policy. Accordingly, the court made an *Erie* guess and concluded mitigation of damages is an offset to damages rather than a condition precedent to recovery under Texas law.

**Editor’s note: Chris Martin of our firm had the privilege of representing State Farm in arguing this case before the Fifth Circuit Court of Appeals.**

## **FEDERAL COURT HOLDS CIVIL AUTHORITY PROVISION DID NOT COVER BUSINESS INTERRUPTION FOR MEDICAL CLINIC CLOSED IN ANTICIPATION OF HURRICANE RITA**

Recently, a Houston federal district court ruled the civil authority provision in an insurance policy covering several medical clinics closed in anticipation of Hurricane Rita was not triggered. In *South Texas Medical Clinics, P.A. v. CNA Financial Corp.*, 2008 WL 450012 (S.D. Tex. February 15, 2008), a civil authority order was issued to evacuate Wharton County, Texas from September 22 to September 24, 2005 because Hurricane Rita was projected to land nearby. The insured owned and operated several medical clinics, including three in Wharton County. The storm, however, took a different path and Wharton County suffered no storm damage. The insured sought business losses from the period covered by the evacuation order but the claim was denied. South Texas Medical sued CNA in Texas state court alleging breach of contract, breach of the duty of good faith and fair dealing, and violations of the Texas Insurance Code. CNA removed the case to federal court.

The policy included coverage for business interruption loss resulting from circumstances when a civil authority enters an order preventing access to an insured’s property, not because of physical damage, but because other property is damaged. The Wharton County Judge issued the evacuation order after observing hurricane damage in Florida and its growing strength in the Gulf of Mexico.

The dispute in this case focused on the policy language stating the civil authority order must be one that “prohibits access to the described premises *due to* direct physical loss of or damage to property, other than at the described premises, caused by or resulting from any Covered Cause of Loss.” In his deposition, the county judge made it clear the damage to property in Florida and offshore was not a causal factor in his decision to order evacuation of Wharton County. Before the district court, the judge analyzed whether the relationship between “damage to property, other than at the described premises” and the mandatory evacuation order was sufficient to find the civil authority evacuation order was issued “due to” Hurricane Rita’s previous damage to property in Florida and offshore.

The court held the causal link between the prior damage and the civil authority order was missing. As such, the court denied the insured’s claim for 542 damages, but determined a fact issue remained as to whether the defendants promptly provided a reasonable explanation for denying the claim.

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