The Weekly Update of Texas Insurance News
TEXAS INSURANCE LAW NEWSBRIEF
www.mdjwlaw.com
A Service of Martin, Disiere, Jefferson & Wisdom L.L.P.
Principal Office 808 Travis, Suite 1800 Houston, Texas 77002 713.632.1700 FAX 713.222.0101
111 Congress Avenue, Suite 1070 Austin, Texas 78701 512.610.4400 FAX 512.610.4401
900 Jackson Street, Suite 710 Dallas, Texas 75202 214.420.5500 FAX 214.420.5501

January 15, 2007

"CORROSION" VERSUS "DECAY" PROPERTY COVERAGE INTERPRETED

Recently, the Corpus Christi Court of Appeals addressed the insurance coverage interpretation and construction of the first party coverage exclusion for "rust, corrosion, fungus, decay, . . ." In *Certain Underwriters at Lloyd's Subscribing to Policy No. WDO- v. KKM, Inc.*, 2006 WL 3803462 (Dec. 28, 2006), a building collapsed in June, 2002. The building was insured for first party property coverage with Lloyds. Lloyds denied coverage for the collapse and sought declaratory relief that it had no obligation to pay the building owner's claim. The trial court found that the terms of the Lloyds' policy were ambiguous and the issue of policy coverage was submitted to the jury. The jury found that the building owner was entitled to coverage and awarded money damages.

On appeal, Lloyds argued that the trial court erred in determining that the terms "corrosion" and "decay" were synonymous or ambiguous. According to Lloyds, the application of the unambiguous exclusions for corrosion bars recovery. The Court expressly noted that all parties agreed that the claim asserted by the building owner involved a collapse caused by corrosion – the collapse was caused by advanced corrosion of the steel reinforcement of the concrete beams and columns. The "central" issued addressed by the Corpus Christi Court was whether a collapse caused by corrosion is a covered loss under the policy.

Lloyds argued that the policy's use of the terms "rust, corrosion, fungus, decay, decomposition, hidden or latent defect" demonstrates that the terms are each different and carry unique meanings. The Court noted that if each word were in fact different, then decay and corrosion would not be the same and the policy's language allowing coverage for collapses caused by hidden decay would not extend to collapses caused by corrosion. In contrast, the building owner argued that the policy was ambiguous because corrosion could mean decay, something similar to decay, or something entirely different than decay. If decay can be read to include corrosion or to be synonymous with corrosion, then the building owner's claim would arguably be covered by the provision for collapse caused by hidden decay.

The Court began its analysis by setting forth the black letter law governing rules of insurance policy construction and ambiguities. The Court then noted that, in this case, the policy did not provide any special definitions of "corrosion" or "decay." Accordingly, the Court gave the terms their plain, ordinary and generally accepted meanings. Noting that Webster's Dictionary lists "decompose," "rot," putrefy," and "spoil" as synonyms of "decay," the Court found relevant that Webster's did not include "corrode" as such synonym. However, "in distinguishing the subtle differences between the terms, Webster's Dictionary states that 'decay' implies a slow change from a state of soundness or perfection . . ." In order to conclude that the trial court erred, the Corpus Christi Court noted that it would have to hold that the policy has a single definite or certain legal meaning: "We would have to conclude that, as a matter of law, decay is not corrosion and vice versa. In our view, doing so would be ill-advised."

In further support of its determination, the Corpus Christi Court relied upon *McConnell Construction Company v. Insurance Company of St. Louis*, 428 S.W.2d 659 (Tex. 1968) which construed the terms "corrosion" and

"contamination." Noting that the *McConnell* Court found that "corrosion . . . connotes disintegration, oxidation, decay of metal and the like," the Court found that the meaning of the terms "corrosion" and "decay" in the policy were uncertain and that the issue was properly submitted to the jury.

WHETHER WATER COLLECTING ON MAN-MADE PATIO CONSTITUTES "SURFACE WATER"

In *Crocker v. American National General Insurance Company*, 2007 WL 29708 (Jan. 5, 2007), the Dallas Court of Appeals considered whether water which collected on a man-made patio and then drained into the insureds' home constituted water on the surface of the ground for purposes of the insureds' homeowners' policy's Surface Water Exclusion. The insureds argued that the water was on the surface of the patio, not the surface of the ground. The insureds further argued that the surface of the patio was elevated at least one foot above the surface of the ground, and, therefore, no water on the patio's elevated surface could ever constitute surface water as that term has been defined by Texas courts. American National countered that it would be a strained interpretation of "surface water" to hold that it does not include rainwater that falls upon concrete and asphalt structures such as patios, roads, driveways, playground blacktops and parking lots – structures which are by their nature placed upon the surface of the ground.

The Court relied upon *Valley Forge Insurance Co. v. Hicks Thomas & Lilienstern*, 174 S.W.3d 254 (Tex. App. – Houston [1st Dist.] 2004, pet. den'd), *Transamerica Insurance Company v. Raffkind*, 521 S.W.2d 935 (Tex. Civ. –App. – Amarillo 1975, no writ), and *Sun Underwriters Insurance Company of New York v. Bunkley*, 233 S.W.2d 153 (Tex. Civ. App. – Fort Worth 1950, writ ref'd) to determine that the insureds' proposed definition of "surface water" does not reflect the popular and ordinary meaning of the term. The average reasonable person would not limit surface water to water whose flow has not been altered in any way by paved surfaces, buildings, or other structures. Although the insureds argued that because the rain hit the patio instead of the dirt and that because the top of the patio was a foot from the soil, it was not water on the surface of the ground, the Court noted that the insureds' argument, taken to its logical extension, would provide that only water which landed directly on the ground and dirt may constitute "surface water." In rejecting the insureds' argument, the Dallas Court found that "surface water" can include rainwater that has collected on the surface of a man-made patio.

USE OF EXTRINSIC EVIDENCE IMPROPERLY USED TO AVOID DUTY TO DEFEND

Recently, the Fifth Circuit Court of Appeals, in *Liberty Mutual Insurance Company v. Graham*, 2006 WL 3743108 (Dec. 21, 2006), had the opportunity to address the use of extrinsic evidence in the determination of the duty to defend. Graham was driving a company vehicle belonging to his employer, Eagle Contracting, L.P., when he collided with a motorcycle carrying Mikel Johnson and Christy Wright. At the time of the collision, Graham was on his way home from a local restaurant where he had been celebrating his 40th birthday with a friend. Graham had consumed alcoholic beverages at the restaurant, fell asleep while driving his company truck, and ran into the back of Johnson's and Wright's motorcycle.

Johnson and Wright sued Graham and Eagle in state court. Liberty Mutual brought a declaratory judgment action against Graham seeking a declaration that Liberty was not obligated to defend or indemnify Graham in the Johnson/Wright litigation. Liberty sought to establish the unauthorized nature of Graham's use of the Eagle vehicle by introducing Eagle's written vehicle usage policy as well as evidence of Graham's intoxication.

The trial court, while acknowledging the general prohibition against extrinsic evidence in duty to defend disputes, concluded that the extrinsic evidence *was proper* in this case. Continuing, the trial court found that the extrinsic evidence affirmatively established a lack of permissive use by Graham at the time of collision, thus vitiating Graham's "insured" status under the policy and coverage thereunder.

On appeal, the Fifth Circuit first examined the Johnson/Wright allegations as pled in their lawsuit against Graham and Eagle. The Court expressly noted the significance of the Johnson/Wright allegations in their lawsuit:

- Graham had a long history of permissive use of the vehicle notwithstanding any written or unwritten policies to the contrary;
- Eagle knew and condoned the use of a company vehicle by Graham and other employees in violation of purported policies;
- Eagle had no effective or even attempted policy or practice to regulate personal use of company vehicles;
- Eagle had receipts clearly indicative of the use of Graham's company vehicle for personal use; and
- The night of the collision was Graham's 40th birthday and Eagle allowed some of its employees, including Graham, to drive business vehicles in pursuit of personal activities.

The Court noted that "the central issue in this case is whether the district court erred in concluding that Graham was not entitled to a defense from Liberty in the state court suit brought by the state court plaintiffs. The resolution of this question depends on whether the state court plaintiffs' allegations are sufficient to demonstrate that Graham was a permissive user of the Eagle vehicle and an 'insured.'"

The Court then examined and reiterated black letter law surrounding the eight corners rule. The Court also addressed the Texas Supreme Court's recent decision in *GuideOne Insurance Company v. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006) regarding the introduction of and reliance upon extrinsic evidence to determine the duty to defend. Finally, the Fifth Circuit reconciled the Johnson/Wright factual allegations and pleadings with *GuideOne* relative to the underlying trial court's introduction of and reliance upon Eagle's written vehicle usage policy. Noting that Texas law required the Court to consider the allegations in the complaint along with any reasonable inferences that flow from the facts alleged, the Court determined that it was reasonable to infer that Johnson/Wright claimed Graham was driving the vehicle with Eagle's permission at the time of the collision. Further, the Court argued its conclusion that the underlying complaint alleged a covered claim was supported by the Texas Supreme Court's command to liberally construe a plaintiff's allegations in favor of coverage and to resolve all doubts regarding the duty to defend in favor of the insured.

Finally, as to the duty to defend, the Court rejected Liberty Mutual's argument that the extrinsic evidence related solely to Graham's status as an insured and, while it may have contradicted the factual basis of the state court claims against Eagle, the evidence did not challenge the merits of the state court plaintiffs' case against Graham. The Fifth Circuit then examined *International Service Insurance Company v. Boll*, 392 S.W.2d 158 (Tex. Civ. App. – Houston 1965, writ ref'd n.r.e.) and other Texas intermediate court decisions to determine that the underlying trial court had erred in admitting extrinsic evidence which directly contradicted the unambiguous factual allegations which were sufficient to infer that Graham was driving with Eagle's express or implied permission. Because the Liberty Mutual policy unambiguous covered permissive drivers, the duty to defend was invoked.

COURT PERSONNEL'S INADVERTENT DISCLOSURE OF DOCUMENTS SUBJECT TO PROTECTIVE ORDER DOES NOT DESTROY CONFIDENTIALITY

In *In Re Ford Motor Company*, 2006 WL 3751574 (Dec. 22, 2006), the Texas Supreme Court recently determined that a court's inadvertent disclosure of documents which were subject to a protective order does not destroy the confidentially of such documents. The Court examined the express terms of the Protective Order to determine that the owner of the privilege, the parties with the paramount interest in protecting the confidential information, must be the ones whose voluntary submission would forfeit the privilege, not the inadvertent production by a third party. Further, the Texas Supreme Court noted that the clear and unambiguous terms of

the Protective Order shall govern the documents which are subject to its protection, including trade secret documents and "other confidential research, development and commercial information." Thus, the order protected not only trade secrets, but also documents that, while not rising to the level of a trade secret, still contained confidential information. Finally, the Court addressed whether the public disclosure of the disputed documents defeated their confidentiality. The Court noted that the qualitative view on how the documents were disclosed in the first place was the proper consideration, as opposed to the quantitative view of how many people or how much publicity the disclosure and attendant publication of documentation generated: "The privilege to maintain a document's confidentiality belongs to the document owner, not to the trial court." Mistaken document production by a court employee in violation of a court-signed protective order cannot constitute a party's voluntary waive of confidentiality. No matter how many people eventually saw the materials, disclosures by a third party, whether mistaken or malevolent, do not waive the privileged nature of the information.