

# Hanna & Plaut Insurance Brief

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## SURETYSHIP v. INSURANCE: Birds of a Different Feather That Sometimes Flock Together

Most commercial liability insurance adjusters will at one time or another confront the issue of suretyship—either in the context of initially allocating risks and damages between coverage under the policy and “coverage” under a performance bond, or in the related context of subrogation. In order to better navigate the waters of these related but disparate vehicles of loss protection, it is important to first understand (1) the similarities and differences between insurance and suretyship, (2) how the rights and obligations of sureties and insurers affect each other, and (3) particular areas of concern, such as subrogation. We begin with the following overview.

### Suretyship: What It Is

Like liability insurance, surety bonds provide protection against loss, but they do so in a fundamentally different way. Rather than protecting against unknown or fortuitous risks, a surety protects a known risk pursuant to specific contractual terms. A surety bond is a tri-partite contractual agreement in which the surety guarantees to the obligee (owner or party receiving benefit of the bond) that the principal (the contractor/subcontractor or party undertaking the obligation) will perform as promised. The most common are contract and commercial/financial surety bonds. Contract bonds are used to guarantee the performance of construction contracts; commercial and financial bonds are used to guarantee other types of transactions, including self-insured workers’ compensation programs and health coverage. Contract bonds are more common and more highly regulated because they are often required in public works contracts. Contract bonds can be further subdivided into three categories: (1) bid bonds, (2) performance bonds, and (3) payment bonds. Bid bonds provide initial financial assurance that the contractor’s bid was made in good faith. Payment bonds guarantee that the contractor will pay certain subcontractors and suppliers. Performance bonds protect the owner from loss if the principal fails to perform in accordance with the contract. Performance bonds are the bonds most likely to be encountered by commercial liability adjusters.

To an even greater extent than insurance, suretyship is controlled by the language of the contract or bond. Texas courts construe surety agreements under the rule of *strictissimi juris* (“of the strictest right or law”) to refrain from extending a surety’s obligation by implication beyond the terms of the agreement. Any material alteration in or deviation from the underlying contract that is the subject of the bond releases the surety from liability. This rule of strict construction favoring the surety has also been ap-

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## Hanna & Plaut Seminars

Hanna & Plaut’s attorneys love to give advice and you can get Continuing Education credit when we do! Hanna & Plaut is licensed by the Texas Department of Insurance to provide continuing education to adjusters. In addition to our standard seminars on claims handling, we are developing a course on depositions for adjusters. Do you need more CE hours? Please contact us at [channa@hannaplaut.com](mailto:channa@hannaplaut.com)

and we can develop a program customized for your needs. Catherine was recently a presenter, along with Michael Sean Quinn, of a telephonic Supreme Court update focusing on the *Guide One Elite v. Fielder Road Baptist Church* decision (see page 2 of this issue) sponsored by the Insurance Law Section of the State Bar of Texas. Please contact us if you would like more information about this presentation.

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## Spotlight Case—GuideOne Elite Ins. Co. v. Fielder Road

In a long-awaited decision, the Texas Supreme Court refused to create an exception to the "eight-corners" or complaint-allegation rule that would permit an insurer to introduce extrinsic evidence in a declaratory judgment action on the duty to defend. *GuideOne Elite Ins. Co. f/k/a Preferred Abstainers Ins. Co. v. Fielder Road Baptist Church*, 2006 WL 1791689 (Tex. June 30, 2006). While the court did not foreclose the possibility of a narrowly crafted exception for extrinsic evidence that goes solely to a fundamental issue of coverage and does not contradict allegations of the underlying petition, the court rejected a broader exception that would permit consideration of extrinsic evidence relevant to both coverage and the merits of the underlying litigation.

The underlying suit involved alleged sexual abuse and molestation committed by an associate youth minister of Fielder Road Baptist Church, Charles Evans, against a minor parishioner, Jane Doe. GuideOne defended Fielder Road pursuant to a reservation of rights, but sought a declaration that it had no duty to defend or indemnify because Evans had ceased working for Fielder Road before GuideOne's policy period began. The trial court granted summary judgment for GuideOne; the court of appeals reversed, holding that Doe's allegations

were sufficient to invoke the duty to defend and that the trial court erred in considering the extrinsic evidence. The supreme court affirmed the court of appeals' judgment.

On appeal, GuideOne argued that the extrinsic evidence of Evans's employment tenure should be considered in determining its duty to defend because: (1) the evidence relates primarily to coverage rather than the merits of the liability case; (2) Doe's allegations alone are insufficient to determine the duty to defend; and (3) an exception should exist for "mixed" extrinsic evidence that affects both coverage and the merits of the liability case. The supreme court acknowledged that other courts have recognized "a very narrow exception" to the eight-corners rule for extrinsic evidence relevant only to "an independent and discrete coverage issue, not touching on the merits of the underlying third-party claim," but held that GuideOne's evidence did not fit this exception because it related to both coverage and the merits. The court declined to broaden the exception to include "mixed" evidence, "because it poses a significant risk of undermining the insured's ability to defend itself in the underlying litigation." Finally, the court noted that cases recognizing a limited "coverage only" extrinsic evi-

dence exception never considered evidence that contradicted any allegation in the third-party claimant's petition "material to the merits of that underlying claim." Because the extrinsic evidence of Evans's employment contradicted Doe's allegation that the church employed him during the relevant coverage period, that evidence was material, "at least in part," to the merits of her claim and sought to contradict in the declaratory action the truth of her allegation in the liability suit.

The court also declined to adopt a "true facts" exception to address collusion or a pervasive problem in Texas with fraudulent allegations designed to invoke the duty to defend, noting that the record was devoid of evidence of fraud and also noting that the policy's explicit defense agreement covered false or fraudulent allegations.

The court also dismissed GuideOne's argument that Doe's allegations of sexual assault and abuse did not constitute "bodily injury" but rather emotional and psychological injury not covered by the policy, holding that "bodily injury is commonly understood to be a consequence of sexual assault and abuse."

## Extrinsic Evidence Not Allowed in Additional Insured or Pollution Exclusion Case

General contractors often require their subcontractors to provide additional insured coverage for them. Consequently, a significant amount of coverage litigation in the construction context revolves around the additional insured language in a given policy. In the construction defect case underlying *D. R. Horton—Texas v. Markel International Ins. Co., Ltd.*, 2006 WL 1766120 (Tex. App. — Houston [14th Dist.] June 29, 2006, n.p.h.), homebuilder D.R. Horton was sued by owners of a home for latent construction and repair defects that allegedly resulted in toxic mold. Although the petition did not name as defendants or even mention any subcontractors in connection with the construction or repairs, Horton asserted that an independent subcontractor, Rosendo Ramirez, was responsible for the defects that

allegedly caused the mold. Horton was an additional insured under Ramirez's general liability policies and tendered defense of the suit to Ramirez's insurers, Markel Insurance and Sphere Drake Insurance. Neither carrier accepted Horton's defense, so Horton hired its own counsel, settled the claims against it, and brought a coverage action against Markel and Sphere Drake.

With regard to Markel, the court of appeals affirmed the trial court's summary judgment on the breach of contract action. Applying the eight-corners rule, the court held that the underlying petition's failure to list Ramirez as a defendant, make any reference to Ramirez, or allege that the plaintiffs were damaged by the

acts or omissions of anyone other than Horton meant that the additional insured endorsement was not triggered since the "plain language" of that endorsement limited Markel's liability to those claims "arising out of work Ramirez performed for Horton." The court held that even "[g]iven their most liberal interpretation in favor of coverage," the factual allegations could not be interpreted as stating a claim arising from Ramirez's work. In reaching this holding, the court rejected Horton's proffer of extrinsic evidence to demonstrate that Ramirez's work was responsible and rejected Horton's argument that an "inference" could be drawn implicating Ramirez. Declining to recognize an extrinsic evidence exception to the eight-corners rule, the court held that neither the facts from extrinsic evi-

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## ***Summit Custom Homes v. Great American Lloyds—Discovery Rule Should Have Determined Manifestation Trigger***

*Summit Custom Homes, Inc. v. Great American Lloyds Ins. Co.*, 2006 WL 1985964 (Tex. App. — Dallas, July 18, 2006, n.p.h.), involved a dispute about which policies were triggered by construction defect litigation. Custom home builder Summit was insured under CGL policies issued by Great American from January 1996 to January 2000 and then by Mid-Continent from January 2000 to January 2005. In 1996 Summit built a home for the Lazaruses; after experiencing problems over the course of several years with the Exterior Insulating and Finishing System (“EIFS”), the Lazaruses sued several contractors and the manufacturer of EIFS in May 2003. One of the defendants, STO Corporation, filed a third-party suit against Summit for indemnity. In their fourth amended petition the Lazaruses added Summit as a defendant. Summit tendered the suit to Great American and Mid-Continent. In the subsequent declaratory action on coverage, the trial court granted the insurers’ motions for summary judgment. The appellate court affirmed in part and reversed in part.

To determine which policies were potentially triggered by the underlying petition, the court first addressed the trigger of coverage. Rejecting the in-

sured’s invitation to adopt an “exposure” or “occurrence” trigger, the court reaffirmed its earlier position that the manifestation trigger applies: “no liability exists on the part of the insurer unless the property damage manifests itself, or becomes apparent, during the policy period.” The only date contained in the underlying petition, however, was 1996, the date the house was built; the court therefore held that Great American “failed to establish as a matter of law that damages did not manifest sometime in 1996, 1997, 1998, 1999 or 2000.”

The court overlooked an important point, however: to avoid limitations problems, the Lazaruses pleaded the discovery rule and alleged that the EIFS problems were “inherently undiscoverable” because they were latent. The Lazaruses further alleged that “[t]he defects cause damage within the wall cavity which is not readily apparent to one examining the exterior of the EIFS surface. As a result the named Plaintiffs would not, in the exercise of reasonable diligence, immediately perceive, or discover the defects complained of herein.” The Lazaruses filed suit in May 2003 and included claims of negligence; thus, even if the discovery rule

toll limitations during the latency of the defects, the defects must have become “apparent” to the Lazaruses no earlier than May 2001 – otherwise the two-year limitations period for negligence would still defeat their claims. The requirement that the damage “become apparent” for purposes of the discovery rule is the same standard that the court applies for the manifestation trigger. Because only these negligence claims (not the contract-based claims) potentially satisfy the “occurrence” requirement of the policy, the court should have held that the facts pled — the discovery rule and the date of filing — allowed the inference that no damage had manifested before May 2001 and that Great American’s policies therefore were not triggered.

Aside from the trigger issue, the court also held that: (1) defective construction can constitute an “occurrence,” as demonstrated by the “your work” exclusion and the subcontractor exception to that exclusion; (2) the Mid-Continent policies were not triggered by virtue of the broad EIFS exclusion contained in each of its policies; and (3) article 21.55 does not apply to an insured’s claim of defense to third-party liability.

## **Suretyship v. Insurance, cont.**

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plied when ambiguity in the bond or contract is pled—in contrast to the *contra proferentem* rule that favors the insured in the insurance context.

### **Suretyship: What It Isn’t**

Despite their similarities, the Texas Supreme Court has identified suretyships and insurance as “different species of economic enterprise.” Thus, suretyships do not constitute the “business of insurance” and are therefore not subject to those portions of the Texas Insurance Code that regulate unfair insurance practices. Suretyship companies are subject to the licensing requirements of the Insurance Code, however.

The surety owes no common-law duty of “good faith and fair dealing” to either its principal or bond obligee, so the extra-contractual remedies of “bad faith” are not available in disputes with sureties. The Texas Supreme Court declined to extend this extra-contractual duty to sureties because (1) bond principals are generally sophisticated; and (2) the indemnity agreement that typically forms an integral part of the surety bond provides considerable protection for the principal by allowing the surety to seek indemnity only for amounts paid in “good faith,” which merely requires the surety not to act maliciously or in willful ignorance of the facts. In other words, “bad faith” in the surety context is a defense to the surety’s indemnity action—but requires a showing tantamount to fraud.

The Texas Supreme Court has not definitively indicated the extent to which the business of suretyship is subject to the Consumer Protection-Deceptive Trade Practices Act.

**In a future edition we’ll explore the interplay of the rights and obligations of sureties and insurance carriers—so stay tuned!**

## Pine Oak Builders v. Great American Lloyds—New Uncertainties About Coverage Triggers?

In *Pine Oak Builders v. Great American Lloyds Ins. Co.*, 2006 WL 1892669 (Tex. App. — Houston [14th Dist.] July 6, 2006, n.p.h.), the Houston Court of Appeals suggested that the “manifestation” trigger may not be as settled as we thought for simple property damage -- the “exposure” or perhaps even a “continuous” trigger might apply in some jurisdictions. In the context of extrinsic evidence, the court also indicated that “absent” facts are not construed in the insured’s favor to trigger coverage.

### Background:

This CGL insurance coverage case arose out of a series of five construction defect suits filed against Pine Oak Builders for damages related to EIFS. Great American insured Pine Oak from 1993 to 2001; Mid-Continent insured Pine Oak from 2001 to 2003. The policies issued after 1999 contained an express “EIFS” exclusion. The insurers denied defense and indemnity, Pine Oak brought suit, and the trial court granted the insurers’ motion for summary judgment. On appeal, the court affirmed in part and reversed and remanded in part.

### CGL Policies and Defective Construction:

In deciding whether the insurers had a duty to defend, the court first considered the extent to which CGL policies cover construction defects, concluding “negligent or inadvertent defective construction that results in damage to the insured’s own work and the result of which is unintended and unexpected” constitutes an accident or occurrence under the policy. The trial court also reaffirmed that the “business risk doc-

trine” is incorporated not through the insuring agreement and definition of “occurrence,” but through exclusions in the policy. Further, the exception to the “your work” exclusion for work performed by subcontractors would be rendered meaningless if defective construction were never an occurrence. Four of the five lawsuits against Pine Oak contained explicit allegations of faulty construction by a sub-contractor and thus fell within the exception.

The fifth lawsuit contained no allegation of work by a subcontractor. Pine Oak argued that extrinsic evidence established the use of subcontractors and the absence of any affirmative or negative statement regarding subcontractors required that the insurers defend. The court held that if the petition is silent on a fact required to create coverage under the policy, the insurer is not obligated to defend. With regard to extrinsic evidence, the court declined to adopt the “permissive” exception, which permits consideration of extrinsic evidence if the facts of the underlying petition, even if true, are insufficient to determine coverage. The court therefore held that the insurers did not have a duty to defend the fifth suit.

### Policy Trigger:

The court next considered whether the remaining four suits alleged an occurrence within the various policy periods. In a surprising move, the court rejected application of the manifestation trigger and instead adopted the “exposure rule” for these simple property damage cases. Citing the policy’s definition of “occurrence,” which includes “continuous or repeated exposure to

conditions,” the court conflated the definition and trigger issues with a claims-reporting requirement and concluded that applying the manifestation trigger was tantamount to rendering the policy a “claims-made” policy. Because each of the four remaining lawsuits alleged that damage began to occur sometime between 1996 and 1997, the court held that each of the post-1995 policies was potentially triggered. (In fact, the court’s discussion on this point seems to indicate adoption of a “continuous” trigger rather than a simple exposure trigger.)

### EIFS Exclusion:

The Mid-Continent policies and the final two years of the Great American policies contained EIFS exclusions that “broadly” precluded coverage for property damage related to EIFS and also coverage for “damage resulting from work performed on any ‘exterior component, fixture, or feature’ of a structure if EIFS is installed on any part of that structure.” After examining the factual allegations of each of the lawsuits, the court concluded that all the damages were either excluded by the broad EIFS exclusion or the “your work” exclusion of the policies. Consequently, only Great American had a duty to defend under its policies issued prior to addition of the EIFS exclusion.

### Article 21.55:

The court joined its sister state courts of appeals in holding that article 21.55 does not apply to an insured’s claim for defense costs in defending a third-party liability action because such costs are not a first-party “claim” under the statute.

## Extrinsic Evidence Disallowed by State and Federal Court

dence nor inferences from those facts could be considered in determining Markel’s duty to defend. As the court further noted, “Our task is not to determine if the underlying facts that prompted the allegations are covered, but whether the petition alleges facts that are covered.” Because the petition failed to invoke the duty to defend, Markel also had no duty to indemnify Horton.

In another recent “eight-corners” case, the Fifth Circuit Court of Appeals refused to allow an insurance carrier to use extrinsic evidence to fill in the gaps of a petition alleging the escape of a pollutant from an oil and gas facility. *Fair Operating, Inc. v. Mid-Continent Casualty Co.*, 2006 WL 2242527 (5th Cir. August 1, 2006) involved a policy that provided limited coverage for “pollution incidents,” requiring that they be “sudden and accidental.” The

Court held that the petition allegations of “escape” of contaminants, without more, did allow for the possibility that it was “sudden and accidental” and thus, the potential of coverage under the policy. The court refused to allow Mid-Continent to introduce extrinsic evidence on this point, because it did not satisfy any potential exception to the “eight-corners” rule..

## Hurricane News—*Tuepker v. State Farm* and *Leonard v. Nationwide* (S.D. Miss.)

Two recent cases decided under Mississippi law are instructive on the methods courts are using to parse causation of losses incurred in last year's hurricanes. In *Tuepker v. State Farm Fire & Cas. Co.*, 2006 WL 1442489 (S.D. Miss. May 24, 2006) and *Leonard v. Nationwide*, 2006 WL 2353961 (S.D. Miss. Aug. 15, 2006), the federal district courts found that an exclusion for "weather conditions" in a homeowner's policy with a "Hurricane Deductible Endorsement" was ambiguous in the context of claims related to Hurricane Katrina. The courts also found that a related concurrent cause provision was ambiguous in this context, where covered losses (those caused by wind and rain) caused the loss in combination with excluded losses (those caused by flooding).

The petitions in both cases alleged that damage to the plaintiffs' homes and contents resulted in part from wind, in

part from rain and in part from storm surge. Both courts first held that wind damage was within the all-risk dwelling coverage. The court also held that the "Windstorm and Hail" peril of Coverage B would cover damage to contents caused by rain that entered through holes in the walls caused by wind.

The courts held that damage caused by a "storm surge" would be excluded under the "water damage" exclusion. The courts held that if the evidence showed part of the loss resulted from covered wind and rain and part from excluded flooding, the question of which proximately caused the damage would be a fact question under Mississippi law.

The *Tuepker* court rejected State Farm's contention that an exclusion for "weather conditions" precluded coverage for hurricane damage regardless of

coverage for hurricane wind and rain damage. Both courts held that the "weather condition" exclusion was ambiguous and therefore "unenforceable" in the context of losses caused by wind and rain that occur during a hurricane. In this connection, the courts found that a concurrent cause preamble to the water damage exclusion was also ambiguous because it purported to exclude coverage for wind and rain damage, both of which are otherwise covered, where an excluded cause of loss such as water damage also occurs.

As a result, both courts held that to the extent the plaintiffs could show their losses resulted from wind, objects driven by wind and rains entering through wind-made openings, those losses would be covered "even if flood damage, which is not covered, subsequently or simultaneously occurred."

## Prejudice Required to Defeat Coverage on Grounds of Late Notice and Settlement Without Consent

In *Coastal Refining & Marketing, Inc. v. United States Fidelity & Guar. Co.*, 2006 WL 145869 (Tex. App.—Houston [14<sup>th</sup> Dist.] May 30, 2006, n.p.h.), the Houston Court of Appeals confirmed that issues of notice and compliance with other policy "conditions" generally present fact issues that cannot be resolved on summary judgment.

Weaver Industrial entered a service contract with Coastal Refining that required Weaver to add Coastal as an additional insured to its CGL and umbrella policies with USF&G. Rolando Lopez, a Weaver employee, sued Coastal after an explosion occurred at one of Coastal's facilities. Without notifying USF&G of the suit, Coastal retained counsel and defended itself. Approximately one month before trial, Coastal tendered defense of the suit to Weaver and USF&G.

USF&G began its investigation and reserved its right to deny coverage based on late notice and Coastal's status as an additional insured. Before USF&G completed its coverage analysis Coastal settled the suit for \$7 million. USF&G sought a declaration that it had no duty to defend or indemnify

Coastal because Coastal breached the policy by (1) failing to give notice of the suit for more than a year after it was filed; (2) settling the suit without USF&G's knowledge or consent; and (3) failing to cooperate. The trial court granted summary judgment for USF&G and the appellate court reversed and remanded.

On the issue of late notice, the policy explicitly provided that coverage was not barred "unless [the insurer is] prejudiced by the insured's failure to comply." USF&G argued that settlement of the suit precluded USF&G's rights to investigate, defend, and participate in negotiations and control settlement. The court rejected USF&G's argument, holding that Texas law "does not presume prejudice merely from the settlement without the insurer's consent." In addition, the court noted that USF&G did not expedite its coverage determination and produced no summary judgment evidence that "the evidence developed by Coastal's defense attorneys was deficient, or that USF&G's investigation was otherwise impaired." Thus, while the court refused to entertain any presumption of prejudice, it did not

entirely foreclose the possibility that in certain cases evidence of prejudice creating a fact issue might be present.

With regard to breach of the voluntary payments clause, the court noted that an insurer is not a volunteer for purposes of the clause when it pays a third-party claim in "good faith" and with a "reasonable belief" that the payment is necessary for the insured's protection. Furthermore, the court held that USF&G again failed to produce any evidence that the payments were prejudicial. Because prejudice was required to demonstrate that the breach was material and the only evidence pertaining to prejudice was that the settlement amount was reasonable, the court held that summary judgment in USF&G's favor was not appropriate.

Finally, the court sang the same refrain in response to USF&G's argument that Coastal failed to cooperate: (1) there was no evidence that Coastal failed to cooperate since it produced all documents requested by USF&G, and (2) USF&G failed to show that it was prejudiced.

## Worker's Compensation News—

### Employer's Delay Barred Its Claim for Reimbursement of Benefits

The Fourteenth Court of Appeals in *Texas Mutual Ins. Co. v. Sonic Systems Int'l., Inc.*, 2006 WL 1547879 (Tex. App. — Houston [14th Dist.] June 8, 2006, n.p.h.), held that an employer's ability to obtain reimbursement as a subclaimant under the Texas Workers' Compensation Act ("TWCA") is co-extensive with the injured employee's

ability to recover benefits. Importantly, because the employer failed to avail itself of the Texas Workers' Compensation process upon Texas Mutual's initial denial of coverage in 1997, it found itself barred from recovery under Texas Labor Code section 409.009 when the injured employee recovered benefits under Alabama's workers' compensa-

tion law in 2001. The employee's recovery of benefits under Alabama law prevented his recovery of such benefits under the TWCA under Texas Labor Code section 406.075(a). However, the employer's common law actions against the insurer survived.

## Employer Liability News—Liability for Conduct of Non-Employees Limited

Plaintiffs often look to the relatively deep pockets of employers to recover for damages caused by the people who work for them. The Texas Supreme Court recently gave employers some protection from such claims, limiting employer liability in two different situations. In *Fifth Club, Inc. v. Ramirez*, 2006 WL 1792214 (Tex. June 30, 2006), a night club patron was assaulted by an off-duty peace officer working as a security guard for the club. The court unanimously held that the nightclub was not liable for the officer's actions because it did not retain control of his actions. The justices refused to recognize a personal character exception to the rule that an owner is not liable for

the acts of independent contractors, disapproving of earlier court of appeals cases that had found vicarious liability for the acts of independent contractors whose duties are personal in character, such as providing security.

*Loram Maintenance of Way, Inc. v. David Ianni*, 2006 WL 1791692 (Tex. June 30, 2006), involved a company where methamphetamine use was rampant. Loram's employee, Tingle, was a heavy methamphetamine user and Loram was aware of their employee's usage of the drug. In fact, Tingle's supervisor had previously given Tingle time off work to purchase more of the drug. In the weeks leading up to the incident Tingle had

become moody and mentally unstable. He was seen using meth at work and threatened one of his wife's friends with a knife. On the day of the incident Tingle spoke of attacking his wife, who was traveling with him on work. Approximately an hour after returning to his hotel Tingle got into an altercation with his wife in a hotel parking lot. An off-duty police officer attempted to intervene and was shot and seriously injured. The Court held that Loram did not owe a duty to protect the public from the wrongful acts of its off-duty employees because Loram did not exercise control over the off-duty activities that cause harm.

## Expert's "Naked Hypothesis Untested and Unconfirmed by the Methods of Science" is Legally Insufficient Evidence of Causation

Recent jurisprudence at the state and federal court level has emphasized the very important role of trial judges as gatekeepers, protecting the jury from unqualified experts and unfounded scientific theories. The Texas Supreme Court recently remedied a trial court's failure to exercise that function in a tire tread separation case, reversing a damages award because Plaintiff's experts were unqualified and their testimony was unreliable. In *Cooper Tire & Rubber Co. v. Mendez*, 2006 WL 1652234 (Tex. June 16, 2006), one of Plaintiff's experts had no college degree but had worked in the examination lab of a tire company for many years and taught courses to policy departments and accident investigators on tire failures.

This expert presented a novel theory for tire failure based on wax contamination. The Court found the theory to be unreliable, based on unfounded assumptions and no more than "subjective belief or unsupported speculation."

Plaintiff's engineering expert testified that by examining the surface of the tire, he had ascertained that belt separation "developed early" and that areas of the tire "never bonded initially when [the tire] was made." In rejecting this testimony as unreliable, the Court found the testimony to be "fundamentally unsupported and therefore of no assistance to the jury" and also found that the only basis for the link between the expert's

observations and conclusions was "his own say-so."

Plaintiff's third expert had an undergraduate degree in chemistry and a master's degree in polymer science and engineering but had no specialized expertise in tire chemistry. In finding that this expert was not qualified to testify on the subject of wax migration and contamination in tires and their effect on tire adhesion, the Court noted that this expert had been found by another appeals court to lack the qualifications to testify in the field of tire failure analysis.

## Questions About Extent of Damage Fair Game for Appraisal

*Johnson v. State Farm Lloyds*, 2006 WL 2053472 (Tex. App.—Dallas July 25, 2006, n.p.h.) involved a disputed hail damage claim. The insured's home was damaged by hail in April 2003. State Farm estimated repairs at approximately \$500, which was within the insured's deductible. Johnson submitted an estimate for repairs of more than \$6,400. State Farm declined Johnson's demand for appraisal, characterizing the dispute about the extent of the hail damage as a coverage issue. Johnson filed suit to compel appraisal and the trial court granted judgment in favor of State Farm. The court of appeals reversed.

State Farm contended that only the ridgeline of Johnson's roof was damaged by hail and that any decision by appraisers on the extent of the damage

would necessarily involve decisions about causation, coverage, and liability because the appraisers would have to segregate hail damage from non-covered causes such as wear and tear. According to State Farm, the parties would first need to agree on "which specific shingles were damaged" and only a dispute over the repair cost for those shingles would be subject to the appraisal clause. Johnson argued that "amount of loss" includes disputes over the extent of the damage as well as the cost of repair. The court rejected State Farm's interpretation of the appraisal clause and held that "if the parties agree there is coverage but disagree on the extent of damage, the dispute concerns the 'amount of loss' and that issue is determined in accordance with the ap-

praisal clause." "The process necessarily requires the appraiser to assess the extent of the damage and exclude payment for causes not covered." The court also noted that nothing in the policy limits "amount of loss" to a dollar valuation that excludes consideration of the extent of damage where it is undisputed that a covered peril caused some loss.

*Johnson* will make it more difficult for carriers to avoid appraisal if a covered peril is at least partly responsible for the insured's loss. However, *Johnson* reaffirms that appraisers are not permitted to make legal determinations regarding the cause of loss and must limit their consideration of extent and valuation to the undisputed, covered loss.

## Claim for Coverage Accrued on Date of Initial Denial

In *Quinn v. State Farm Lloyds*, 2006 WL 1470188 (S.D. Tex. — May 25, 2006), a federal district court held that a homeowners' suit for breach of contract related to a denial of a claim for foundation damage was barred by the statute of limitations. Plaintiff Barbara Quinn filed a claim that her master bathroom shower was cracked and

sinking. State Farm investigated her claim, including conducting plumbing tests and an engineering investigation. After completing its investigation, State Farm concluded that the damage to the foundation was not related to the plumbing leaks and therefore that the claim was excluded from coverage under her homeowner's policy. State Farm informed Quinn of the denial on Septem-

ber 17, 2002. Following the denial, Quinn and State Farm engaged in additional correspondence and State Farm conducted further investigation of material provided by Quinn. In 2004, State Farm made additional payments for water damage related to plumbing leaks, under the same claim number originally assigned to the 2002 plumb-

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## No Stacking of Homeowner Policy Limits with Multiple Claims

In *Coats v. Farmers Ins. Exch.*, 2006 WL 1765925 (Tex. App.—Houston [14<sup>th</sup> Dist.] June 29, 2006, n.p.h.), the Fourteenth Court of Appeals became the first Texas state court to close ranks with the federal Texas district courts and hold that the Texas Homeowner's Policy Form B unambiguously entitles an insured to recover no more than the policy's stated limit of liability, even if the insured suffers multiple losses or claims during the period that, considered in the aggregate, would exceed that limit. After Tropical Storm Allison, Farmers paid the Coatses the limits of their policy for damage to the dwelling and for ALE and a significant amount under personal property coverage. Shortly thereafter, the Coatses filed another claim for dwelling damage

caused by an overflow of their HVAC system, which Farmers denied.

In the subsequent suit, the Coatses contended that they were entitled to receive a sum not to exceed policy limits for each source of damage. The Coatses argued that the "Insurable Interest and Limit of Liability" condition, which limits the carrier's liability to the amount of the insured's interest or the applicable limit of liability for "any one loss," creates at least an ambiguity with regard to the carrier's duty to pay on a per loss basis. The Coatses argued that a per-loss policy limit construction is strengthened because the insurable interest condition expressly provides for reinstatement of the policy limits as repairs are made after a fire loss, but not after any other type of loss. The court

rejected both arguments and held that, reading the policy as a whole, the "Loss Settlement" condition of the policy unambiguously limited the carrier's liability to the smallest of the "limit of liability under this policy applicable to the damage or destroyed building structure(s)" or the cost of repair. The court noted that only this construction would fulfill the objective "that the insured should neither reap economic gain, nor incur loss, if adequately insured." The court further noted that the insurable interest clause describes who is entitled to receive payment if more than one insured has legal or equitable interest in the property and that, considered in context, "any one loss" addresses this disputed allocation, nothing more.

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## Quinn v. State Farm, cont.

(Continued from page 7)

ing leak and foundation claim. State Farm, however, continued to deny Quinn's foundation claim and she filed suit on December 9, 2005. State Farm filed a motion for summary judgment, claiming that the policy's 2-year limitations period, which began running on September 17, 2002, the date of the initial denial, barred Quinn's claims. Quinn argued that State Farm's continued investigation, revisions to repair estimates and

additional payments for water damage after that date, referencing the original plumbing leak and foundation claim number showed that the additional payments related to a single, continuing problem and caused the statute of limitations to begin anew. The court disagreed, holding that the additional investigation and payment in 2004 did not concern Quinn's claim for foundation damage, which was the subject of the lawsuit, but her claim for plumbing leaks. In spite of the fact that they shared a claim number, the

plumbing leak and foundation investigations were always handled separately, as State Farm had determined that they were unrelated. State Farm never modified or withdrew its denial of Quinn's foundation damage claim. Thus, State Farm's additional payment on the plumbing leaks did not extend limitations for the foundation claim, which accrued in 2002.

The district court also echoed prior federal court decisions, stating that there is no cause of action in Texas for negligent claims handling.

## Spotlight on: Eric Peabody

Hanna & Plaut associate Eric Peabody is one of those Texans who was not born here, but got here as fast as he could. Eric received his B.A. *cum laude* in German and Accounting from Eastern Michigan University in 1985 and graduated from the University of Texas School of Law with honors in 1993. After graduation he served as briefing attorney for Justice Bea Ann Smith at the Austin Court of Appeals. Eric wears many hats at Hanna & Plaut. His experience at the Austin Court of Appeals makes him a natural go-to guy for briefing and appellate projects, but Eric also works on a wide variety of first and third party insurance matters. We recently asked Eric to answer some silly (and not so silly) questions:

### 1. What is your favorite aspect of practicing law?

Aside from the people with whom I practice, my favorite aspect of practicing law is the intellectual challenge. While analyzing statutes, cases and contracts might seem tedious to some people, the "public policy" -- and personal and political agendas -- behind the law and documents is often very interesting. Add to that the boundless creativity of some claimants and opposing counsel and you've got only yourself to blame if you're bored.

### 2. What inspired you to become a lawyer?

Before law school I spent several years living in Japan and Germany working in the automobile industry. Originally I planned to pursue a legal career in international

business because my last position involved a lot of interaction with the legal department, which I enjoyed. But coming to UT-Austin for law school changed all that. I knew, like so many others, that staying in Austin was now a top priority. I was fortunate to get a clerkship here after law school and have been here since.

### 3. What do you do in your spare time?

I have always had a strong wanderlust and love to travel. And since I also love to eat well and drink wine, I try to combine those passions. Fortunately, regions noted for delicious food and wine also tend to be geographically beautiful. I'm also a classically trained singer and perform fairly



came from or why it's on my shelf, but the beginning is strange, so I'm encouraged. I just finished Zadie Smith's "On Beauty," which I enjoyed very much.

### 5. What is your dream vacation?

This is a tough question since different types of vacations appeal to me at different times. Sometimes I want to visit friends in familiar places and sometimes I want to explore new cities and countries where I don't know anyone or don't even know the language. Sometimes I want cities and sometimes I want remote countryside. I guess my "dream" vacation is when I'm still in the same frame of mind during the vacation as I was in while planning it. Oh, and good food and wine...

regularly. Languages, cooking, reading, hiking, swimming and just being outdoors are all high on my list.

### 4. What are you reading?

Right now I'm reading two books: the first is Peter Greenberg's "The Travel Detective," which is about how to be a savvy traveler. Getting a few more tips. The other is "Misfortune" by Wesley Stace. I don't know where this book