Legal Beat

By MICHAEL SEAN QUINN

Leaky Pipes: Highest Court Takes On Slabs

Insurers providing coverage to homeowners systematically exclude gradual damage to foundations. To the insurance mind, imperceptibly slow property damage is not event-like and is, therefore, not insurable. Insurance is for fortuities, and only events or event-like omissions can be fortuitous. Besides, gradual property damage is too difficult to distinguish from wear and tear, a paradigm of uninsurability.

Texas insurers have struggled with foundation claims for many years. Many such claims have arisen in the Corpus Christi area, and the geography around Dallas-Fort Worth augurs a future flow of claims. Homeowner (HO) insurers fear a future deluge of these claims everywhere.

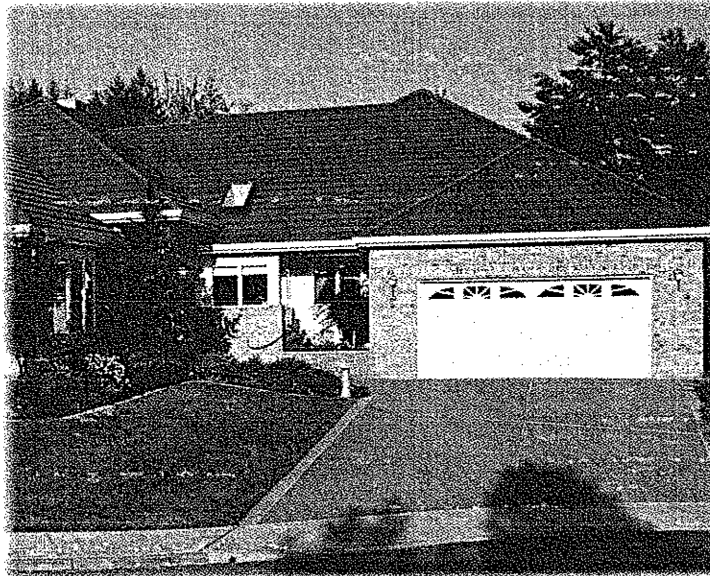
Throughout the 1990s, insurers thought they were finally rid of them. Last year in *Sharp v. State Farm* the federal Fifth Circuit agreed. It held that the 1991 Texas Standard Homeowner's Policy—Form B did not provide coverage for foundation damage resulting from plumbing leaks. On August 22, 1997, however, the Texas Department of Insurance issued an encyclical, BULL-B0032-97, condemning the *Sharp* case and admonishing insurers not to rely on it.

Because of the Commissioner's vigorous reaction, the Fifth Circuit certified a very similar case to the Texas Supreme Court to get the matter resolved. On July 3, 1998, the high court decided that case, *Balandran v. Safeco*, by a vote of 7-2. It held that there was coverage for foundation damage resulting from plumbing leaks under the 1991 form. In effect, thereby, the Supreme Court overruled Sharp and vindicated TDI. The legal arguments are fascinating.

The Problem

The Balandran's home had serious plumbing leaks; those leaks caused the soil to expand; and that expansion damaged the foundation. The jury awarded the Balandrans $66,500, but the trial judge found in favor of the insurer anyway. The Balandrans appealed, and the case ended up in the Texas Supreme Court.

Most of the legal argument focuses upon the organization of the insurance contract. There are two coverage parts in the property section of the policy: Coverage A, which insures the dwelling against all risks



of physical loss, and Coverage B, which insures personal property against various listed perils. An exclusion applicable to both of these parts unquestionably excludes foundation damage from any cause, except for a loss ensuing, for example, from other water damage.

One of the named perils Coverage B insures against is the "accident discharge, leakage or over flow of water...from within a plumbing...system[.]" The policy quickly goes on to say that when "loss [is] caused by this peril," the exclusion of gradual foundation damage does not apply. The homeowners argued that this language rescinds the gradual-foundation-damage exclusion for plumbing leaks which injure insured dwellings. The insurer rejected this move.

It pointed out that the pivotal language is found in Coverage B, which pertains to personal property. The insurer contended that the gradual-foundation-damage exclusion as to the dwelling coverage could not be affected by anything which was said in Coverage B.

The Majority

The majority found itself of two minds. On the one hand, Safeco's argument was reasonable. On the other, so was the homeowner's. What legal principle might end such a quandary?

Insurer's Argument. Safeco contended that all language in Coverage B must be only about personal property coverage. None of any of that language, therefore, pertains to dwellings. Anyone who knows anything about insurance policies knows that different coverages are kept rigidly distinct, Safeco implied. Indeed, sometimes, comprehensive insurance policies are conceived as multiple contracts banded together. (Given the historical evolution of named peril policies, this conception has considerable merit. They started as individual, separate policies which later got stuck together.)

Insured's Argument. The insured contended that there is no reason why separate coverages must be kept rigidly separate when one of them contains language importing the other. No express provision of the policy mandates this type of inflexible segregation. Indeed, there are some explicit connections. First, the insuring agreements of both coverage parts may be defeated by a roster of exclusions common to both coverages. Second, the very language at issue in this case says that exclusions applicable to both Coverage A and Coverage B "do not apply to loss caused by" the peril of plumbing leaks.

The insured argued that the unqualified use of the word "loss" in the key disputed language includes both personalty losses and dwelling losses. After all, the term "loss"—when used without any qualification—refers to any loss at all. Since there is no rule in insurance law that different coverage parts cannot refer to each other, there is no reason why the unqualified use of the term "loss"—which might very well mean "all losses"—should be restricted when the two coverages are serviced by a common group of exclusions.

Letting historically distinct coverage sections interpenetrate may be innovative, and might seem inelegant, when viewed through traditionalistic lenses. But clear contract language should triumph over wispy custom. Isn't that what rigorous draftsmanship is really all about? Besides, how many consumers know about the evo-

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lution of property insurance forms?

The Court. Chief Justice Phillips wrote for the majority. He started from the proposition that these opposing arguments are about how to interpret the policy and that both of them are reasonable. Fortunately, he said, the law prescribes a rule of resolution.

When a court is confronted with two reasonable interpretations of an insurance policy, it must adopt the interpretation favoring the insured, even if the interpretation urged by the insurer is the more reasonable. This rule derives from the general maxim of contract law that uncertain contract language is to be construed against the party selecting it.

The substantial power of this general principle within insurance law is also justified by the much discussed special relationship between insurers and insureds which arises from their unequal bargaining positions. (This special relationship is the cornerstone of the common law tort of insurer bad faith in Texas.)

The majority bolstered its argument by reference to the circumstances under which the form was created. Sometime ago, the State Board of Insurance, TDI's predecessor, mandated the creation of a new HO form. In 1989, it created an advisory committee. It was to be an easy-to-read form, not substantively differing from the existing policy. The advisory committee wrote a policy and certified compliance.

But the form policy used from 1978 to 1991 provided coverage for foundation damage resulting from plumbing leaks. Hence, the insured's argument that coverage existed in the 1991 form was reasonable because of the circumstances of its conception, gestation and birth.

The Minority

Justice Owen dissented for herself and Justice Hecht. She found no ambiguity, although she observed that the entire court agreed that the 1991 policy was "very poorly drafted." She believed that Coverage A and Coverage B were distinct and should not be construed so as to interpenetrate. It was quite obvious to her that the use of the word "loss" in the crucial sentence in Coverage B referred only to losses afflicting personalty.

Justice Owen also thought it entirely inappropriate to review the drafting history of the policy. She conceded that SBI mandated that there be no substantive change in the policy. She remarked, however, that this mandate was simply not carried out. The drafters may have intended that there be coverage for plumbing leaks, but they unambiguously failed to write that intention into the form.

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Critique

Coverage A is all risk coverage. Coverage B is named peril coverage. All the Coverage B perils are within the ambit of the risks insured against in Coverage A. The key sentence in Coverage B says that individual exclusions which apply to both Coverage A and Coverage B "do not apply to loss caused by" the named peril of plumbing leaks. This sentence does not say "loss to personalty." It does not say "losses except to realty."

Given the generality of the sentence, no meaning is sacrificed if it is paraphrased to say "Exclusions common to both Coverage A and Coverage B do not apply to any loss caused by leaky water pipes. Once this paraphrase is acknowledged, the majority's holding is unquestionably correct.

Nobody on the court adopted this paraphrase. Justice Owen thought it obvious that the term "loss" referred only to Coverage B. Her view hinges, however, on the idea that Coverages A and B must be kept rigidly distinct for some reason. Neither the language of the contract nor any explicit legal principle supports her assumption. On the other hand, if the above paraphrase is correct, then Justice Phillips did not need the contra-insurer ambiguity rule to generate his holding. The majority's bottom-line position is unequivocally supported by the clear language of the policy, if my paraphrase is right.

The majority's use of drafting history must also be carefully scrutinized. In the leading Texas case, *CBI Industries* (1995), the court said drafting history could not be used to establish an ambiguity. In *Balandran*, the court said, "[w]hile parole evidence of the parties' intent is not admissible to create an ambiguity, the contract may be read in the light of the surrounding circumstances to determine whether an ambiguity exists." It also implied that once an ambiguity is established, courts may use drafting history to bolster an application of the contra-insurer ambiguity rule. Unfortunately, the majority stumbled here twice.

First, the difference between looking outside a contract to create an ambiguity and looking outside a contract to determine whether there is an ambiguity is a distinction of ethereal subtlety. Second, if drafting history disambiguates a policy, then the contra-insurer ambiguity rule should never come up. That rule is always and only a rule of last resort.

Insurance controversies surrounding plumbing leaks and foundation damage will not go away. Such injuries are physical losses and they can constitute an economic catastrophe for a homeowner. On the other hand, these claims can be conjured, and there are people doing a brisk business helping homeowners "document" very questionable claims. TV programs like *Dateline* and *60 Minutes* will eventually do some stories on all this. The public will be entertained, if not enlightened. Too bad engineering investigations of these claims are quite expensive. More than a few of them affect the price of HO insurance for everybody.

The *Balandran* case is of signal importance to all sorts of insurance intermediaries. The 1991 policy has been issued upon hundreds of thousands of Texas dwellings. Many agents sell lots of them. For years there has been confusion about its provisions. Many newspapers recently described the *Balandran* decision. Unfortunately, many of those summaries are defective. Negligent misrepresentations by insurance agents are actionable, and the damages can be large. In the immortal words of Phil Esterhaus the "duty sergeant" on Hill Street Blues, "Be careful out there!" ■

Quinn is an Austin-based attorney with the law firm of Sheinfeld, Maley & Kay. He was recently selected to receive the 1998 Outstanding Law Journal Article Award by the Texas Bar Foundation.

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