

NO. 08-0890

IN THE
SUPREME COURT OF TEXAS

THE HOUSTON EXPLORATION COMPANY, ET AL.

Petitioners

v.

WELLINGTON UNDERWRITING AGENCIES
LIMITED, ET AL.,

Respondents.

*On Petition for Review from the
Fourteenth Court of Appeals at Houston, Texas
No. 14-07-00970-CV*

**PETITIONER THE HOUSTON EXPLORATION COMPANY'S
REPLY TO RESPONDENT'S RESPONSE TO PETITION FOR REVIEW**

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ORAL ARGUMENT REQUESTED

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RECORD REFERENCES

This brief references parties:

The Houston Exploration Company

“THEC”

Offshore Specialty Fabricators, Inc.

“OSFI”

This brief references the record on appeal as:

Sworn Record

“SR”

The Court of Appeals’ Opinion,
issued on July 17, 2008, located at Tab C of the Appendix

“Opinion”

STATEMENT OF JURISDICTION

This Court has jurisdiction over this case under TEX. GOV'T CODE ANN. § 22.001(a)(2) and (6) (Vernon 2004). The court of appeals' decision below conflicts with the jurisprudence of other Texas intermediate courts of appeals and with this Court's jurisprudence on several points of well-settled insurance and contract law. This Court also has jurisdiction over this matter because the court of appeals committed an error of law in mistakenly imposing on the insureds the burden of proving coverage of specific items of repair cost rather than requiring Underwriters to prove exclusion. This mistake is of such importance to the jurisprudence of this state that it requires correction to remove unnecessary uncertainty in the law and unfairness to litigants.

ISSUES PRESENTED

1. Whether the Policy provided coverage for the weather standby charges incurred by THEC in repairing an Occurrence under the Policy?
2. Did the Fourteenth Court err when it shifted the burden to the assured to prove inclusion of specific repair costs (including standby costs) under the Policy's coverage, rather than requiring Underwriters to prove an exclusion to coverage?
3. Did the Fourteenth Court err by relying on stricken language (and inferences from the striking) in interpreting an insurance policy?
4. Did the Fourteenth Court ignore several well-established rules of contract construction?
5. Did the Fourteenth Court err by raising factual issues that were not in dispute below and that were not certified for appeal pursuant to TEX. CIV. PRAC. & REM. CODE § 51.014(d) and then err again by resolving these perceived factual issues? [Unbriefed].
6. If coverage exists for standby repair costs, whether Underwriters' counterclaims for fraud and breach of contract are without merit. [Unbriefed].

ARGUMENT AND AUTHORITIES

I. THIS COURT HAS JURISDICTION TO HEAR THIS CASE BECAUSE THE DECISION OF THE COURT BELOW CREATED CONFLICTS WITH THE JURISPRUDENCE OF THIS COURT AND OTHER TEXAS INTERMEDIATE COURTS OF APPEAL.

TEXAS GOVERNMENT CODE § 22.225(c) confers jurisdiction on this Court in an interlocutory appeal when one court of appeals holds differently from a prior decision of another court of appeals or of the Supreme Court. TEX. GOV. CODE § 22.225(c). Section 22.225(e) clarifies that a court “holds differently from another” when there is an inconsistency in their respective decisions that should be clarified to remove unnecessary uncertainty in the law and unfairness to litigants. *Id.* at § 22.225(e). As is shown below, the court of appeals’ decision conflicts with this Court’s jurisprudence and with the jurisprudence of several intermediate courts. Therefore, this Court has jurisdiction over this interlocutory appeal.

The court below deviated from established Texas law with regard to the burden of proof. It is well established in Texas that, to recover on an insurance policy, an insured must prove that the loss is covered by the policy. *Employers Casualty Co. v. Block*, 744 S.W.2d 940, 944 (Tex. 1998). It is also well established that, after the insured meets the burden of proving that the loss falls within the scope of coverage, the burden shifts to the

insurer to establish that an exclusion applies.¹ Here, the court below also deviated from established Texas law by failing to recognize that losses that flow naturally from a covered loss also fall within the scope of coverage and that language deleted from an insurance policy is not a substitute for an express, written exclusion. *United States Ins. Co. of Waco v. Boyer*, 269 S.W.2d 340, 343 (Tex. 1954); *Self v. King*, 28 Tex. 552, 554 (Tex. 1866); *Imperial Ins. Co. v. Ellington*, 498 S.W.2d 368, 371 (Tex. App.—San Antonio 1973, no writ); *Nat'l Union Fire Ins. Co. v Hudson Energy Co.*, 811 S.W.2d 552, 555 (Tex. 1991); *SMI Realty Mgmt. Corp. v. Underwriters at Lloyds*, 179 S.W.3d 619, 627 n.3 (Tex. App.—Houston [1st Dist.] 2005, pet. denied).

A. The Decision of the Court Below Conflicts with Jurisprudence of this Court and Other Courts of Appeal By Failing to Recognize that Losses that Flow Naturally from a Covered Loss Fall Within the Scope of Coverage

THEC agrees with Underwriters that, even for an all risk policy—which creates a special type of coverage—the insured has the burden of proving that a loss falls within a policy’s general grant of coverage. That issue, however, has never been disputed because Underwriters admitted that there was an “Occurrence” — damage to covered property

¹ See e.g., *Navarro-Martha v. Fulkerson*, 2004 Tex. App. LEXIS 8239, at *7 (Tex. App.—Houston [1st Dist.] Sept. 9, 2004); *Comsys Info. Tech. Servs. v. Twin City Fire Ins. Co.*, 130 S.W.3d 181, 194 (Tex. App.—Houston [14th Dist.] 2003, pet. denied); *Lone Star Heat Treating Co. Ltd. v. Liberty Mut. Fire Ins. Co.*, 233 S.W.3d 524, 526 (Tex. App.—Houston [14th Dist.] 2007, no pet.); *Venture Encoding Serv., Inc. v. Atl. Mut. Ins. Co.*, 107 S.W.3d 729, 733 (Tex. App.—Fort Worth 2003, pet. denied); *Evergreen Nat'l Indem. Co. v. Tan It All, Inc.*, 111 S.W.3d 669, 675 (Tex. App.—Austin 2003, no pet.); *Telepak v. United Servs. Auto. Ass'n*, 887 S.W.2d 506, 507 (Tex. App.—San Antonio 1994, writ denied); *Crocker v. Am. Nat'l Gen. Ins. Co.*, 211 S.W.3d 928, 931 (Tex. App.—Dallas 2007, no pet.); *Sink v. Progressive County Mut. Ins. Co.*, 47 S.W.3d 715, 718 (Tex. App.—Texarkana 2001) rev'd on other grounds, 107 S.W.3d 547 (Tex. 2003); *Cent. Mut. Ins. Co. v. FPE Firstplace Land, LLC*, 271 S.W.3d 454, 456 n.2 (Tex. App.—Tyler 2008, no pet. h.); TEX. INS. CODE ANN. § 554.002.

during the Policy Period. (SR 875-6, 2254). Thus, the court below erred when it held that Underwriters were not required to specifically exclude standby costs that flowed naturally from the Occurrence. In that regard, the decision below conflicts with the jurisprudence of this Court and of the Waco Court. *Boyer*, 269 S.W.2d at 343; *Page v. State Farm Lloyds*, 259 S.W.3d 257, 264 (Tex. App.—Waco 2008, pet. filed).

This Court's position in *Boyer* is derived from a United States Supreme Court case which held that all consequences naturally flowing from an insured peril are properly attributable to that peril. *Lanasa Fruit S.S. & Importing Co. v. Universal Ins. Co.*, 302 U.S. 556, 565 (1938). In *Lanasa*, a shipper purchased an insurance policy covering losses caused by perils of the sea. *Id.* at 568. During transport, the ship became stranded which resulted in the loss of a load of bananas. *Id.* at 557. The Supreme Court found that the stranding was a covered "peril of the sea," and the loss of the bananas naturally flowed from the peril and thus was a covered loss. *Id.* at 565.

Here, THEC proved that a covered fortuitous loss occurred when the piling on an offshore platform fell, causing damage to the platform. (SR 875-6). It also showed that during repairs to the platform, several storms caused THEC to incur standby costs while repair vessels waited for the storms to pass. (SR 922-23). As such, the standby costs flowed naturally from the insured peril because the policy provided that "In the event of an Occurrence covered under Section I of the Policy [Physical Damage] Underwriters agree to indemnify the Assured on the following basis: a. items repaired or replaced— 'New for Old' plus towage, installation *and all other costs necessarily incurred and duly*

justified in repair or replacement....”² In addition, subparagraph 1d³ of the same section of the Policy⁴ incorporates THEC’s contract for the installation of the platform at issue, which included an obligation that THEC pay for standby charges.

Underwriters ignore the fact that this Court adopted the *Lanasa* “all consequences naturally flowing from an insured peril are properly attributable to that peril” analysis, by

² Terms and Conditions (Section I Only), 1. Basis of Recovery Paragraph, at Page 11. (SR 76).

³ As described in THEC’s Petition for Review, the decision below ignores a variety of provisions from the Policy which demonstrate that the Policy covered standby costs. These include sections 1a (SR 76), 1d (SR 77) and the separate standby deductible (SR 96). This failure creates additional conflicts with the decisions of this Court and the intermediate courts. For example, the court below departed from existing law holding that the plain language of a policy should control its interpretation that the entire contract should be harmonized and that portions of a contract will not be read in isolation of one another. *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133-34 (Tex. 1994); *State Farm Life Ins. Co. v. Beaton*, 907 S.W.2d 430, 433 (Tex. 1995); *Royal Indem. Co. v. Marshall*, 388 S.W.2d 176, 180 (Tex. 1965); *Pan Am. Life Ins. Co. v. Andrews*, 340 S.W.2d 787, 790 (Tex. 1960); *Reilly v. Rangers Mgmt., Inc.*, 727 S.W.2d 527, 529 (Tex. 1987); *Coker v. Coker*, 650 S.W.2d 391, 393 (Tex. 1983); *Barnett v. Aetna Life Ins. Co.*, 723 S.W.2d 663, 666 (Tex. 1987); *Gen. Am. Indem. Co. v. Pepper*, 339 S.W.2d 660, 661 (Tex. 1963) (contracts of insurance should be construed in accordance with its plain language); *Lewis v. Foxworth*, 170 S.W.3d 900, 903-04 (Tex. App.—Dallas 2005, no pet.); *Perrotta v. Farmers Ins. Exch.*, 47 S.W.3d 569, 574 (Tex. App.—Houston [1st Dist.] 2001, no pet.); *Clemons v. State Farm Fire & Cas. Co.*, 879 S.W.2d 385, 391 (Tex. App.—Houston [14th Dist.] 1994, no writ). The decision below also ignores the separate deductible by dismissing it as a “mere sentence fragment” and treats it as surplusage. See, e.g., *Aetna Life Ins. Co.*, 876 S.W.2d at 133 (stating that each part of an insurance contract should be given effect); *Seagull Energy E&P, Inc. v. Eland En.*, 207 S.W.3d 342, 345 (Tex. 2006); *Melton v. Ranger Ins. Co.*, 515 S.W.2d 371, 374 (Tex. Civ. App.—Fort Worth 1974, writ ref’d n.r.e.); *Republic Ins. Co. v. Silvertown Elevators, Inc.*, 493 S.W.2d 748, 753 (Tex. 1973) (finding that inapplicable and meaningless surplusage in an insurance policy should be disregarded); *Pilot Life Ins. Co. v. Koch*, 617 S.W.2d 786, 788 (Tex. Civ. App.—Eastland 1981, ref. n.r.e.); *Lyons v. State Farm Lloyds & Nat’l Cas. Co.*, 41 S.W.3d 201, 206 (Tex. App.—Houston [14th Dist.] 2001, pet. denied); *Am. Int’l Specialty Lines Ins. Co. v. Triton Energy Ltd.*, 52 S.W.3d 337, 341 (Tex. App.—Dallas 2001, no pet.); *U.S. Fire Ins. Co. v. Gnade*, 2005 Tex. App. LEXIS 1825, at *6 (Tex. App.—Waco Mar. 9, 2005, pet. denied); *Commercial Union Assurance Co. PLC v. Silva*, 75 S.W.3d 1, 4 (Tex. App.—San Antonio 2001, pet. denied); *Tan It All, Inc.*, 111 S.W.3d at 678.

⁴ The Policy specifically states:

use of prehire vessels/equipment – [I]f, in the event of physical . . . damage to the property insured which is covered by Section I, repairs . . . are carried out by vessels . . . and/or labour which the Assured have on charter, hire or contracted to them, the cost or the proportion thereof shall be based on the pre-agreed hire or contract rates for such employment when used in or about the repair . . . replacement . . . of losses covered by Section I and shall be so recoverable as a claim hereon. In the event that the Assured utilizes its own vessels . . . or labour for an repair . . . replacement or other work in respect of . . . physical damage covered by Section I, then, subject otherwise to the terms and conditions of the Policy, a reasonable charge in respect of such work shall be recoverable as a claim hereon. Provided always that the recoverable costs referred to in this paragraph shall not exceed the costs of employing approved vessels . . . and/or labour from other available sources.

holding that “where...an insured peril sets other causes in motion which in unbroken sequence and connection produce the final result for which the insured seeks to recover under his policy, the peril insured against will be regarded as the direct and proximate cause of the entire loss, so as to render the insurer liable for the entire loss within the limits fixed by the policy.” *Boyer*, 269 S.W.2d at 343. Thus, the Fourteenth Court’s holding is in direct conflict with this Court’s jurisprudence.

Likewise, the Fourteenth Court’s decision conflicts with the Waco court of appeals. Following the *Lanasa/Boyer* logic, the Waco Court held in *Page v. State Farm Lloyds*, that an insurance policy covered any “physical loss caused by a peril listed below,” including a loss caused by an accidental discharge, leakage or overflow of water. 259 S.W.3d at 264. *Page* argued, despite the fact that mold was expressly excluded from the insurance policy, the cost of repairing mold damage to her home caused by an occurrence, a plumbing leak, rendered those costs covered. *Id.* The Waco court agreed. *Id.* Furthermore, the decision below also disregards the Fourteenth Court’s own jurisprudence in *de Laurentis v. United Services Automobile Association*, as pointed out in THEC’s Petition for Review on page 5. 162 S.W.3d 714, 722 (Tex. App.—Houston [14th Dist.] 2005, pet. denied).

Thus, a conflict exists between the Fourteenth Court’s decision and the jurisprudence of this Court, the Waco Court of Appeals, and the United State Supreme Court, which is sufficient to confer jurisdiction on this Court. *Id.*; *Boyer*, 269 S.W.2d at 343; *Lanasa*, 259 S.W.3d at 264.

Underwriters attempt to support the court of appeals' decision that THEC failed to prove that standby expenses were covered by citing *Hardware Dealers Mut. Ins. Co. v. Berglund*, 393 S.W.2d 309, 310-311 (Tex. 1965). But *Berglund* does not address the *Lanasa/Boyer/Page* line of cases, and is easily distinguishable because the Code has changed the allocation of the burden of proof since the case was written in 1965. *Berglund* was decided prior to the 1991 enactment of TEXAS INSURANCE CODE § 554.002,⁵ at a time when an insured was required to prove *both* that a policy provided coverage *and* that any exclusions pled by an insurer did not apply. See *Telepak v. United Servs. Auto. Ass'n*, 887 S.W.2d 506, 507 (Tex. App.—San Antonio 1994, writ denied). This is no longer the law in Texas. See *id.*; TEX. INS. CODE § 554.002. Thus, *Berglund* will not support Underwriters' claim that it is an insured's burden to show "that each alleged charge fell within the Policy's grant of coverage."⁶

B. The Court Below Departed From Texas Law When It Allowed Stricken Language To Serve As An Exclusion To Coverage.

The court below compounded the errors described above by allowing language stricken from the Policy to serve as a written exclusion to coverage.

While the Fourteenth Court expressly denied that it was treating the stricken

⁵ The Code specifically assigns the burden of proof as "[i]n a suit to recover under an insurance...contract, the insurer...has the burden of proof as to any avoidance or affirmative defense...Language of exclusion in the contract or an exception to coverage claimed by the insurer...constitutes an avoidance or an affirmative defense." TEX. INS. CODE § 554.002.

⁶ If this Court's analysis and its allocation of the burden of proof were correct, then every time there is a loss under a physical loss or damage policy, the insured would bear the burden of proving that each and every item for which recovery is sought was expressly included under the policy. For example, under this Court's analysis, an insured in an automobile property damage policy would bear the burden of proving that the policy expressly provided for reimbursement of the costs of a new hood, a new windshield, a new fender, *etc.*

language of Paragraph 13 as an exclusion to coverage, such treatment is the only way that the court below could reach the result it did. Belying the Court's denial that it treated stricken language as an exclusion is the fact that the Court stated that the impact of the stricken language on the Court's interpretation of the policy was "decisive." (Opinion at 15). Underwriters erroneously argue that THEC failed to show that a conflict exists sufficient to confer jurisdiction on this Court because THEC discussed the "effect" of the Fourteenth Court's opinion. A conflict, however, may arise when a court correctly states the law, but misapplies it. *Henry Schein, Inc. v. Stromboe*, 102 S.W.3d 675, 689 (Tex. 2003). That is precisely what happened here. The Court below misapplied the law by stating that it did not consider the deletion of paragraph 13 an exclusion to the policy, when that is the only way that the Court could reach its conclusion.

While it is sometimes appropriate to review what has been deleted from a contract, language that is no longer a part of a policy can never rise to the level of a clear and unequivocal exclusion. *Ellington*, 498 S.W. at 371; *Hudson Energy Co.*, 811 S.W.2d at 555; *SMI Realty Mgmt. Corp.*, 179 S.W.3d at 627 n.3. Thus, the decision below conflicts with this Court's rulings which hold that matters outside the four corners of a contract may not be considered in interpreting an unambiguous policy. Instead, a court must give effect to the written expression of the parties' intent, as stated in the policy. *Baladrán v. Safeco Ins. Co. of Am.*, 972 S.W.2d 738, 741 (Tex. 1998); *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 433 (Tex. 1995). If Underwriters wanted to override coverage of standby losses, then it was their burden expressly to say so, *in the policy. Id.*

The Court's creation of an exclusion for Underwriters is especially offensive because Underwriters are sophisticated parties who clearly knew how to include an exclusion in a policy. In fact, they inserted two pages of other very specific exclusions in this policy.⁷ Thus, the court below deviated from Texas law holding that courts must assume items omitted from a specific list were intentionally omitted. *Meadows & Walker Drilling Co. Pac. Employers Indem. Co.*, 324 F. Supp. 282 (S.D. Tex. 1971) (applying Texas insurance law). Further, the court below erred in creating a standby exclusion for Underwriters because Texas courts cannot draft a policy for the parties.⁸

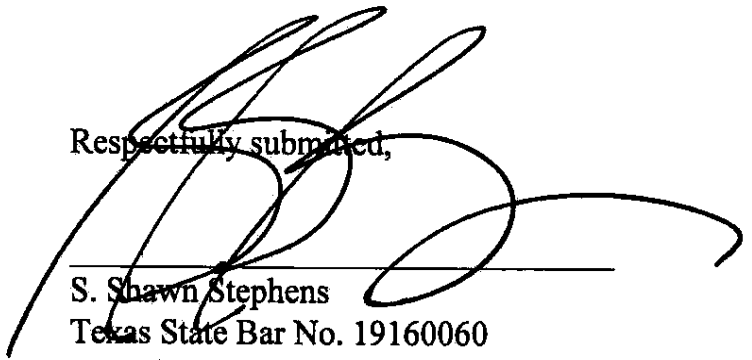
CONCLUSION AND REQUEST FOR RELIEF

For all the foregoing reasons, this Court should grant the Petition for Review, and grant The Houston Exploration Company all other relief to which it is entitled.

⁷ The express exclusions were for aircraft and helicopter; the wrong location of the platform; infidelity of the principal; repairing and replacing faulty welds; radioactive contamination; rust and oxidation repairs; dumping rocks in the wrong location; war, revolution, insurrection and hostilities; and terrorist acts. (SR 1055-56).

⁸ See e.g., *Ulico Cas. Co. v. Allied Pilots Ass'n*, 262 S.W.3d 773 (Tex. 2008) (noting that the court will not "change, re-write or enlarge the risks covered by the policy"); *Nat'l Union Fire Ins. Co. v. Crocker*, 246 S.W.3d 603, 606 (Tex. 2008); *Puckett v. U.S. Fire Ins. Co.*, 678 S.W.3d 936, 938 (Tex. 1984); *Fortis Benefits v. Cantu*, 234 S.W.3d 642, 649 (Tex. 2007) (stating that an insurance policy must be enforced as written); *Barnett*, 723 S.W.2d at 665.

Respectfully submitted,

A large, stylized handwritten signature in black ink, appearing to read 'S. Shawn Stephens', is written over a horizontal line. The signature is highly cursive and loops around the line.

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CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of Petitioner The Houston Exploration Company's Reply to Underwriters' Response to the Petition for Review and Appendix has been served in accordance with the Texas Rules of Appellate Procedure on the counsel of record listed below via certified mail/return receipt requested on this the 5th day of March, 2009.

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