

September 7, 2007

Triple Threat – Texas Supreme Court Rejects the Economic Loss Doctrine and Favors Policyholders on Faulty Work Claims and Statutory Penalties for Failure to Defend

On August 31, 2007 the Texas Supreme Court issued an eagerly awaited opinion *Lamar Homes, Inc. v. Mid-Continent Casualty Company*, No. 05-0832 (Tex. Aug. 31, 2007) in which it resolved a long-standing controversy between policyholders and insurance carriers as to whether commercial general liability (“CGL”) policies cover property damage resulting from defective workmanship. This case arises out of a dispute between homeowners Vincent and Janice DiMare and their homebuilder, Lamar Homes, Inc. Several years after purchasing their home, the DiMare’s encountered problems that they attributed to defects in their foundation. The DiMare’s sued Lamar and its subcontractor complaining about these defects. Lamar forwarded the lawsuit to its insurer, Mid-Continent Casualty Company, seeking a defense and indemnification under its CGL policy. Mid-Continent refused to defend, prompting Lamar to seek a declaration of its rights. Lamar also sought recovery under Article 21.55 of the Texas Insurance Code (recodified as § 541.051-061 of the Texas Insurance Code) for failing to promptly provide a defense.

On cross motions, the federal district court granted summary judgment in favor of Mid-Continent, concluding it had no duty to defend Lamar for construction defects that harmed only Lamar’s own product. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 335 F. Supp. 2d 754 (W.D. Tex. 2004). The court reasoned that the purpose of a CGL policy is to “protect the insured from liability resulting from property damage (or bodily injury) caused by the insured’s product, but not for the replacement or repair of that product.” *Id.* at 759. The court was concerned that if an insurance policy were to be interpreted as providing coverage for construction defects, it would allow a contractor to receive initial payment for the work from the homeowner, then receive subsequent payment from the carrier to repair and correct defects to the contractor’s own work.

Lamar appealed the federal district court’s decision to the U.S. Court of Appeals for the Fifth Circuit. Noting disagreement among Texas courts about the application of a CGL policy under these circumstances, the Fifth Circuit certified the following three questions to the Texas Supreme Court as the final authority on questions of Texas civil law:

- 1) When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege an “accident” or “occurrence” sufficient to trigger the duty to defend or indemnify under a CGL policy?
- 2) When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege “property damage” sufficient to trigger the duty to defend or indemnify under a CGL policy?
- 3) If the answers to certified questions 1 and 2 are answered in the affirmative, does Article 21.55 of the Texas Insurance Code apply to a CGL insurer’s breach of the duty to defend?

Lamar Homes, Inc. v. Mid-Continent Cas. Co., 428 F.3d 193, 200-01 (5th Cir. 2005).

Fortunately for policyholders, the Texas Supreme Court concluded that allegations of unintended construction defects may constitute an “accident” or “occurrence” under a CGL policy and that allegations of damage to or loss of use of the home itself may also constitute “property damage” sufficient to trigger the duty to defend under a CGL policy. In coming to this conclusion, the Supreme Court rejected the insurer’s false assumption that construction defects resulting from a contractor’s failure to perform under contract are always intended or expected and thus, not an “accident” or “occurrence.” In addition, the Supreme Court rejected the notion that damage to the contractor’s own work is not “property damage” but rather a contractual, economic loss. In doing so, the Supreme Court sternly noted that the economic loss rule is a liability defense or remedies doctrine, not a test for insurance coverage. Quite simply, whether a third-party’s claim lies in contract or tort is irrelevant to the existence of coverage. The Supreme Court did not address the duty to indemnify, because as the Court noted, that duty is not triggered by mere allegations, but rather proof at trial.

With respect to the third and final question, the Supreme Court concluded that the prompt-payment statute, formerly Article 21.55, and now codified in Chapter 542 of the Texas Insurance Code, may be applied when an insurer wrongfully refuses to promptly pay a defense benefit owed to an insured. The prompt-payment statute provides that an insurer, who is “liable for a claim under an insurance policy” and who does not promptly respond to, or pay, the claim as the statute requires, is liable to the policyholder not only for the amount of the claim, but also for “interest on the amount of the claim at that rate of eighteen percent a year as damages, together with reasonable attorney’s fees.” TEX. INS. CODE § 542.060(a). Not merely limited to the construction industry, this holding provides all general liability policyholders the hammer necessary to compel their insurers to provide a defense.

The question has been raised, however, under what circumstances, if any, must a policyholder submit its legal bills to its insurer in order to “mature” its rights under the prompt-payment statute when the insurer has denied coverage?

If you would like assistance or more information regarding the recent *Lamar Homes* decision or any other insurance related matter, please contact one of the Haynes and Boone Insurance Coverage Practice Group partners listed below.

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