BINDING AUTHORITY
Insurance Coverage Decisions: Issued Today - Impact Tomorrow
White and Williams LLP
Randy J. Maniloff
maniloffr@whiteandwilliams.com

December 11, 2009

Texas Two-Step: No Duty to Defend; Yes Duty to Indemnify

Texas Supreme Court Messes With a Sacrosanct Rule

This year's Top 10 Coverage Cases article that I sent out earlier this week (which, by the way, makes a great stocking stuffer) was missing something – a decision from the Supreme Court of Texas. Texas's top court has appeared more than any other in the annual coverage best-of – five out of 30 decisions over the past three years alone. And if not for the fact that the Top 10 is published in mid-December, the Texas Supreme Court would have made an appearance again this year.

The reason: Today's decision in *D.R. Horton-Texas, Ltd. v. Markel International Ins. Co.* -- in which the Texas Supreme Court stated: "***We hold that the duty to indemnify is not dependent on the duty to defend and that an insurer may have a duty to indemnify its insured even if the duty to defend never arises***."

This holding is likely to get policyholders more excited than Tiger Woods playing golf at Vassar.

At issue in *D.R. Horton* was coverage for a routine residential construction defect claim. D.R. Horton built a home and after moving in the homeowners discovered mold. The homeowners sued D.R. Horton for remedial costs, alleging that latent defects in the chimney, roof, vent pipes, windows, window frames, and flashing around the roof and chimney allowed water to enter the house, eventually causing mold damage. *D.R. Horton* at 2.

The complaint only named D.R. Horton as a defendant. However, D.R. Horton claimed that one of its subcontractors, Rosendo Ramirez, performed masonry work on the home and contributed to the alleged defects. However, Ramirez was neither sued in the lawsuit nor implicated by the pleadings. *Id.*

D.R. Horton sought coverage as an additional insured under Ramirez's policy. Ramirez's insurer refused to defend Horton because the complaint did not plead facts indicating that Ramirez's work was defective, and, therefore, did not invoke coverage for Horton under Ramirez's CGL policy. Horton obtained counsel at its own expense and settled with the homeowners during voir dire. *Id.* Horton sued Ramirez's insurer for reimbursement of

defense costs and the settlement payment. *Id.* at 3. [There is no discussion in the opinion of coverage for Horton under its own CGL policy – assuming it had such a policy.]

Under Texas's "eight corners" rule, the duty to defend was to be considered based solely on the allegations in the complaint and the terms of the policy. [The "eight corners" rule is exactly the same as the "four corners" rule that applies in many states. But it is called the "eight corners" rule in Texas because, well, everything is bigger in Texas.]

The court noted that, notwithstanding the "eight corners" rule for purposes of the duty to defend,

> [t]he insurer's duty to indemnify depends on the facts proven and whether the damages caused by the actions or omissions proven are covered by the terms of the policy. Evidence is usually necessary in the coverage litigation to establish or refute an insurer's duty to indemnify. This is especially true when the underlying liability dispute is resolved before a trial on the merits and there was no opportunity to develop the evidence, as in this case. We hold that even if Markel has no duty to defend D.R. Horton, it may still have a duty to indemnify D.R. Horton as an additional insured under Ramirez's CGL insurance policy. That determination hinges on the facts established and the terms and conditions of the CGL policy

Id. at 6-7 (emphasis added).

The court rejected the insurer's argument that "if the terms of the policy, when read in light of the allegations asserted in the petition, do not give rise to a duty to defend, then proof of all of those allegations could not give rise to a duty to indemnify." *Id.* at 7.

Notwithstanding that the complaint only named D.R. Horton as a defendant, and the only one responsible for the defects, Horton presented evidence with its response to the insurer's motion for summary judgment on the duty to indemnify, showing that Ramirez was a subcontractor for D.R. Horton for the home, and performed masonry work and repairs allegedly contributing to the defects. The court held that this evidence raised fact questions that defeated the insurer's motion for summary judgment on the duty to indemnify claim. "The insurer and the putative insured may introduce evidence in coverage litigation to establish or refute the insurer's duty to indemnify." *Id.* at 8-9.

D.R. Horton places insurers with Texas claims in a quandary (and in any "four corners" state that adopts *D.R. Horton*). If an insurer determines, based on the four corners/eight corners of the complaint, that it owes no defense obligation, it is entitled to disclaim coverage for such obligation. That is clear. But then what happens?

The underlying claim is not defended and a default is entered, followed by an assessment of damages hearing. Or the case is defended inadequately by the insured, leading to a larger verdict than should have been. Or the case may be settled – possibly with a consent judgment that passes a "reasonableness" test, but for more than the case is really

worth. Translation – across the board potential for increased exposure for the insurer. In other words, under all of these scenarios, an insurer that unquestionably had no duty to defend may be penalized for exercising a longstanding right.

A copy of the Texas Supreme Court's December 11 decision in *D.R. Horton- Texas, Ltd. v. Markel International Ins. Co.* can be accessed here:

http://www.supreme.courts.state.tx.us/historical/2009/dec/061018.pdf

If you have any questions, please let me know.

Randy

Randy J. Maniloff
White and Williams LLP
1800 One Liberty Place | Philadelphia, PA 19103-7395
Direct Dial: 215.864.6311 | Direct Fax: 215.789.7608
maniloffr@whiteandwilliams.com