AN UPDATE ON RECENT INSURANCE COVERAGE DECISIONS AND THEIR IMPACT ON THE CONSTRUCTION INDUSTRY:

THE POLICYHOLDERS' PERSPECTIVE

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I. *GEICO General Insurance Co. v. Austin Power, Inc.*, 357 S.W.3d 821 (Tex. App.—Houston [14th Dist.] 2012, pet. denied)

The 2012 New Year began where 2011 left off, as the Fourteenth District Houston Court of Appeals addressed an insurer's duty to defend its insured where an exact date of injury was not alleged in the pleading against the insured. *See GEICO General Ins. Co. v. Austin Power, Inc.*, 357 S.W.3d 821 (Tex. App.—Houston [14th Dist.] Jan. 5, 2012, pet. denied).

A. Background Facts

In *GEICO*, an underlying lawsuit existed in which Weldon Bradley and his wife claimed that Austin Power, Inc., among others, was responsible for injuries he suffered in connection with exposure to asbestos-containing products and machinery. *Id.* at 823. The Bradleys did not identify the specific date on which his injuries occurred. *Id.* Ultimately, Austin Power was dismissed from the case, but sought recovery from its insurer for the defense costs it incurred in defending the *Bradley* lawsuit. *Id.*

GEICO's predecessor insured Austin Power from December 31, 1969 to December 31, 1970, and had a duty to defend Austin Power "against any claims arising out of an occurrence that results in bodily injury during the coverage period, even if the allegations are groundless, false or fraudulent." *Id.* The trial court granted summary judgment in favor of Austin Power, and GEICO appealed, contending that the pleadings lacked a "specific temporal factual allegation" and therefore was not a potentially covered claim that could trigger a duty to defend.

B. The Duty to Defend

In analyzing the duty to defend, the court agreed that a specific date of injury was not alleged. *Id.* at 824. Nevertheless, the court found "other indications of time of injury." *Id.* In particular, the court stated:

> Plaintiffs alleged that Austin Power "created hazardous and deadly conditions to which Mr. Bradley was exposed and which caused him to be exposed to a large amount of asbestos fibers." By re-incorporation, the plaintiffs alleged that Mr. Bradley was exposed to asbestos "on numerous occasions," and that "each exposure" caused or contributed to his injuries. In the conspiracy count against all defendants, we find the allegation that "for many decades, Defendants [acted] . . . individually, jointly and in conspiracy with each other and other entities . . . ." Finally, the plaintiffs alleged damages resulting from "asbestos-related lung disease."

Id.

In arguing that the foregoing is insufficient to trigger a defense obligation, GEICO sought to distinguish the holding in *Gehan Homes Ltd. v. Employers Mutual Casualty Co.*, 146 S.W.3d 833 (Tex. App.—Dallas 2004, pet. denied), in which the insured was sued for "past" bodily injuries and property damage. The Dallas Court of Appeals construed the pleadings liberally as required under Texas law, finding that the insurer did not establish that no potential for coverage existed within the policy period. *Id.* at 846.

GEICO contended that *Gehan Homes* was distinguishable because the *Bradley* petition did not include the signifier, "past". *GEICO*, 357 S.W.3d at 825. But just like in *Gehan Homes*, the underlying plaintiffs in the instant dispute used the past tense in alleging that Weldon Bradley "*has suffered* injuries" from asbestos exposure. *Id.* (emphasis in original). Further, the Bradleys alleged numerous exposures and a decades-long conspiracy. Moreover, it can take years of exposure to produce asbestos-related diseases. *Id.* (citations omitted). The court stated:

> In effect, the Bradleys alleged that Weldon was injured sometime before the petition was filed. Nothing in the pleadings negates the possibility that the injury occurred between December 31, 1969 and December 31, 1970. Construing the pleadings liberally and resolving any doubts in the insured's favor, we agree with the trial court that this is an allegation of a potential occurrence within the policy's coverage period.

Id. See also id. (rejecting GEICO's claim that *Gehan Homes* also was distinguishable because the court of appeals placed the burden of proof on the insurer to establish a lack of coverage, as the court noted that as a movant for summary judgment, the insurer does have that burden).

GEICO also claimed that under *Pine Oak Builders, Inc. v. Great American Lloyds Insurance Co.*, 279 S.W.3d 650 (Tex. 2009), the court could not infer a claim that might have been, but was not, alleged. *GEICO*, 357 S.W.3d at 825. In *Pine Oak*, however, the insured sought to introduce extrinsic evidence that would have brought the claim against within coverage. The extrinsic evidence, though, contradicted the pleadings and, therefore, the Supreme Court refused to read facts into the pleadings that were not actually alleged. *Id.* at 826. In the instant case, the Houston Court of Appeals noted that Austin Power's coverage claim was not dependent on extrinsic evidence, but on the allegations themselves when liberally construed under well-established Texas law. In particular, "[t]he allegations in the *Bradley* petition, when construed liberally in favor of Austin Power, support the inference that Weldon's injury potentially occurred during the policy period, and therefore the claim is potentially covered. This is sufficient to trigger GEICO's duty to defend the suit." *Id.*

C. Commentary

The decision in *GEICO* is another example of the liberal standards applied to the duty to defend. In particular, the opinion correctly follows in the footsteps of *Gehan Homes* and even the recent *Vines-Herrin* decision (although it was not cited by the court in *GEICO*).[1] Put simply, even a date-deprived pleading can be sufficient to trigger a duty to defend, so long as *some* indication of timing of damages is alleged.

[1] *See Vines-Herrin Custom Homes, LLC v. Great Am. Ins. Co.*, 357 S.W.3d 166 (Tex. App.—Dallas, 2011, pet. denied) (holding that, at a minimum, the petitions adequately plead that actual physical damage to the property potentially occurred during appellees' policy periods).

II. *Mid-Continent Casualty Co. v. Academy Development, Inc.*, 476 F. App'x 316 (5th Cir. 2012)

On April 20, 2012, the U.S. Fifth Circuit Court of Appeals affirmed the Southern District of Texas's decision in *Mid-Continent Casualty Co. v. Academy Development, Inc.*, 476 F. App'x 316 (5th Cir. 2012). In doing so, the court found that a claimant need not own the damaged property at issue in order to establish an insurer's duty to defend its insured against claims for damages *because of* such property damage. In addition, where the duty to defend under more than one insurance policy is triggered across consecutive policies, the insured may select the policy under which it wants its defense provided.

A. Background Facts

Academy Development Inc., along with Chelsea Harbour, Ltd., Legend Classic Homes, Ltd. and Legend Home Corp. (collectively "Academy"), developed the lake-front Chelsea Harbour subdivision in Fort Bend County, Texas. On or about May 23, 2005, a group of subdivision homeowners (the "Budiman plaintiffs") alleged Academy knew at the time they sold the homes the lake walls were falling and water was leaking from the lakes onto the home sites. The Budiman plaintiffs brought claims of statutory fraud, negligence, negligent representation and DTPA violations. The jury ultimately returned a verdict for Academy. *Id.* at 317.

Legend Classic Homes, Ltd. was a named insured under five CGL policies issued by Mid-Continent. The other defendants were all listed as additional named insureds on the policies. The policies themselves were identical except for variations in the deductible amount per policy[2] and some provided the deductible applied to defense costs. *Id.* at 317–18. Initially, Mid-Continent agreed to defend Academy, but after the Budiman plaintiffs filed their ninth amended petition, Mid-Continent argued it no longer had a duty to defend Academy because that petition did not allege claims of "property damage." *Id.* at 318. Mid-Continent filed a declaratory judgment action, seeking a ruling that it did not owe a defense or indemnity to Academy. Mid-Continent and Academy agreed to file cross-motions for summary judgment as to whether Mid-Continent had a duty to defend and, based on the policies triggered, how the defense costs should be allocated across the policies. *Id.* The district court found in favor of Academy, and Mid-Continent appealed. *Id.*

B. "Damages Because of . . . 'Property Damage'"

After acknowledging Texas law regarding determining the duty to defend, the court turned to the allegations in the Ninth Amended Petition to analyze whether a duty to defend existed. *Id.* at 319. According to the court, the Budiman plaintiffs alleged diminution in value of their homes attributable to damage to their property, as distinct from damage to their homes. While the court emphasized that the plaintiffs' allegations that the leaking lakes *may* have caused structural damage to their homes was insufficient to allege "property damage," the plaintiffs' reference to damage to their "homes *and properties*" had to be liberally construed to mean that the damage was distinct and sufficient to be considered "property damage."

[2] The deductibles were as follows: 2000–2001: $1,000 per claim; 2001–2002: $5,000 per claim; 2002–2003: $5,000 per claim; 2003–2004: $50,000 per occurrence; and 2004–2005: $100,000 per occurrence.

Moreover, even if the foregoing was insufficient, the diminution in value of the homes was directly attributable to defective lakes that were themselves damaged—i.e., cracked. Under Texas law, the court explained, "allegations of unintended construction defects or faulty-workmanship constitute allegations of "property damage" under a CGL policy sufficient to trigger an insurer's duty to defend. *Lamar Homes, Inc. v. Mid–Continent Cas. Co.*, 242 S.W.3d 1, 4 (Tex. 2007). Accordingly, the petition alleges property damage to the lakes that resulted in diminution in the value of underlying-action plaintiffs' homes." *Academy*, 476 F. App'x at 320. In reaching its conclusions, the court specifically rejected Mid-Continent's claim that the damaged property had to be owned by the claimant, noting that nothing in the CGL policy includes an ownership requirement. *Id.* at 320–21. Regarding the duty to defend, the court said, "the only relevant inquiry here is whether, under the eight-corners rule, there is a duty to defend, not whether the underlying-action plaintiffs had standing to sue for damage to the lakes." *Id.* at 321.

C. Allocation of Defense Costs

Having found that the duty to defend existed, Mid-Continent argued to the court that it could apportion Academy's defense costs on a *pro rata* basis across all five insurance policies at issue. *Id.* The court, however, disagreed, noting that Texas courts already had rejected the *pro rata* method for calculating an insurer's defense obligation when more than one policy is triggered by a claim. *Id.* (citing *Tex. Prop. & Cas. Ins. Guar. Ass'n v. Sw. Aggregates, Inc.*, 982 S.W.2d 600, 604–07 (Tex. App.–Austin 1998, no pet.); *CNA Lloyds of Texas v. St. Paul Ins. Co.*, 902 S.W.2d 657, 661 (Tex. App.–Austin 1995, writ dism'd)). Simply put, an insurer's obligation under its policy is to provide a *complete* defense, not a *pro rata* defense. *Id.* As such, the district court correctly concluded that Academy could select the policy under which it would be provided a defense.

D. Commentary

The Fifth Circuit's decision in *Academy* is important for its recognition that CGL policies cover "damages *because of* property damage" with no limitation that the property damaged be owned by the claimant. Additionally, and more importantly, the court's decision to adhere to established Texas law and allow Academy to select the policy providing its defense is significant and reinforces the principle that an insurer owes a complete defense under any triggered policy year.

III. *D.R. Horton, Inc. v. American Guarantee & Liability & Insurance Co.*, 864 F. Supp. 2d 541 (N.D. Tex. 2012)

In May 2012, Judge John McBryde issued a lengthy opinion addressing an insured's lawsuit against a second-level excess liability insured. *See D.R. Horton, Inc. v. American Guarantee & Liability & Insurance Co.*, 864 F. Supp. 2d 541 (N.D. Tex. 2012). Although a lengthy opinion, a couple key issues were addressed, and a brief summary of each follows.

A. Establishing Property Damage During the Policy Period

The first insurance coverage issue addressed by the court was whether probative evidence existed that there was covered property damage during the 1999-2000 policy period. *Id.* at 553.

The court began by noting that coverage can exist under Texas law for defective work that, in turn, caused physical damage to a home's structure. *Id.* (citing *Grimes Constr., Inc. v. Great Am. Lloyds Ins. Co.*, 248 S.W.3d 171, 171–72 (Tex. 2008) (summarizing *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007)). It then explained that Texas follows the "actual injury" or "injury-in-fact" approach in determining when insurance coverage is triggered. *Id.* at 554 (citing *Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20, 25 (Tex. 2009)). Following that case law, and a decision in *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651 (Tex. App.—Houston [14th Dist.] 2006, pet. denied), the court found that "[i]n order to prevail on an insured property damage claim, the insured must distinguish, and apportion, the insured property damage costs from the non-insured costs." *Id.* at 555. In other words, the insured carries the burden to establish what is covered. *Id.* And, in this regard, Judge McBryde correctly noted that "[t]he defective work does not itself constitute property damage. Nor does the cost of preventive work, i.e., the cost of repairs or replacement to prevent future property damage, constitute insured property damage."

Turning to the evidence presented, the court found that D.R. Horton's pleadings would not even have survived a motion to dismiss for failure to state a claim on which relief could be granted because no factual allegations existed as to the makeup of the allegedly covered claims. *Id.* Simply put, no allegations existed that property damage resulted from any alleged defective construction, let alone any allegations that the damages occurred during the pertinent policy period. *Id.* at 556. Similarly, the court found that the summary judgment evidence presented by D.R. Horton also was insufficient. For example, the underlying pleadings attached to D.R. Horton's vice president and legal counsel's affidavit only alleged claims for defective construction and not for any resulting property damage. *Id.* In addition, the professional engineer's affidavit relied on by D.R. Horton appeared to show that the engineer was retained to convert the uncovered defective construction claims into claims for property damage repair caused by the defects. *Id.* at 557. The court found that the engineer's breakdown was strikingly similar to, although conveniently transformed, the cost-of-repair breakdown supplied in one of the underlying lawsuit settlement documents. *Id.* at 558. Moreover, his affidavit did not even purport to qualify him as an expert under Rule 702 of the Federal Rules of Evidence, *id.* at 562, and the court was not persuaded that he had the requisite expertise to help the trier of fact establish the point in time when property damage occurred. *Id.* Accordingly, the court found the affidavit fell short of establishing that the alleged damages occurred, let alone that they occurred during the 1999-2000 policy period. *Id.* at 563.

In addition, the court rejected D.R. Horton's reliance on a claims adjuster's affidavit in which the adjuster argued that a "close of escrow date" should govern the timing of the damages for purposes of insurance coverage. *Id.* The court noted that the affidavit sought to get around the holding of *Don's Building*, but doing so would require the court to revise the insurance policy and not review it, adopting an approach as a matter of policy, instead of law. *Id.* And, in any event, the "close of escrow date" method only would apply to continuous or progressive damage losses, and no evidence existed that such damage occurred in the underlying claims. *Id.* Accordingly, and in connection with its findings above, the court found that D.R. Horton failed to carry its burden to establish that damage occurred during the pertinent policy period. *Id.* at 564.

B. Establishing Exhaustion of the Underlying Policies by Payment of Claims

In addition to the foregoing, the court also addressed D.R. Horton's failure to establish exhaustion of insurance underlying American Guarantee's excess coverage. *Id.* at 565 *et seq.* Looking at the pleadings themselves, the court noted that D.R. Horton again would not have survived a motion to dismiss because the subject of "exhaustion" was mentioned only twice in its pleadings. *Id.* at 566. D.R. Horton simply alleged that defense costs, judgments and settlements over the years resulted in exhaustion of the underlying policies, but it did not provide any supporting factual allegations. *Id.* Further, the court had previously struck the only affidavit that contained any "evidence" of exhaustion, leaving D.R. Horton without any probative evidence of exhaustion. *Id.* And, even if allowed, the statements therein were conclusory in nature and not supported by any facts. *Id.* Thus, the court found that D.R. Horton did not establish exhaustion of the underlying policies.

C. Commentary

Although Judge McBryde has had a penchant for summarily disclaiming construction defect insurance coverage in the past, this opinion provides a more in-depth analysis of coverage for construction defects. While one could perhaps question some of the factual determinations made by the Court, the opinion emphasizes the burden on the insured to provide evidentiary support to support coverage and highlights the fact that conclusory allegations are not sufficient. Moreover, as the Supreme Court noted in *Don's Building* when it adopted the "actual injury" trigger, establishing *when* property damage occurred is not necessarily the easiest trigger method to apply, but it gives proper credence to the terms of the insurance policy. Accordingly, insureds must present probative evidence of when damage actually occurred in order to establish coverage under a particular policy. Similarly, it is important to specifically identify any claims and associated payments that may have been made by underlying insurers in order to establish exhaustion.

IV. *Downhole Navigator, L.L.C. v. Nautilus Insurance Co.*, 686 F.3d 325 (5th Cir. 2012)

On June 29, 2012, the U.S. Fifth Circuit Court of Appeals affirmed the Southern District of Texas's 2011 decision, finding that a potential conflict of interest created by liability insurer's reservation of rights letter did not disqualify counsel offered by the insurer to represent the insured or entitle the insured to reimbursement for the cost of hiring independent counsel. *See Downhole Navigator, L.L.C. v. Nautilus Ins. Co.*, 686 F.3d 325 (5th Cir. 2012).

A. Background Facts

An oil well operator hired Downhole Navigator to help redirect an oil well, and Downhole developed the plan to conduct the deviation while also participating in the deviation process. *Id.* at 327. Downhole's negligence, however, caused damage to the well, and the oil operator brought suit. *Id.* Downhole tendered the claim to Nautilus for a defense and indemnity under its CGL policy, and Nautilus agreed to defend subject to a reservation of rights. *Id.* Among other things, Nautilus reserved the right to deny coverage based on a "testing or consulting" exclusion. *Id.* In response, Downhole rejected the proffered defense, arguing that a conflict of interest existed by way of the reservation of rights letter. Accordingly, Downhole contended it

was entitled to independent counsel at Nautilus's expense. *Id.* In reply, Nautilus disagreed, insisting that Downhole was not entitled separate counsel until a coverage issue developed. *Id.* Ultimately, Downhole filed suit against Nautilus, seeking recovery of the cost of its independent counsel and indemnity in the oil well operator's lawsuit. *Id.* at 327–28. On cross-motions for summary judgment, Nautilus prevailed in that it was not obligated to reimburse Downhole for its cost of retaining independent counsel, but the court denied the motion as to the duty to indemnify because it was premature. *Id.* at 328.

B. The Appeal

Looking to Texas law, the Fifth Circuit noted that an insurer's "right to conduct [its insured's] defense includes the authority to select the attorney who will defend the claim and to make other decisions that would normally be vested in the insured as the named party in the case." *Id.* (quoting *Northern County Mut. Ins. Co. v. Davalos*, 140 S.W.3d 685, 688 (Tex. 2004)). However, in some situations, an insurer may not insist on that contractual right. *Id.* For example:

> In the typical coverage dispute, an insurer will issue a reservation of rights letter, which creates a potential conflict of interest. And when the facts to be adjudicated in the liability lawsuit are the same facts upon which coverage depends, the conflict of interest will prevent the insurer from conducting the defense.

Id. (quoting *Davalos*, 140 S.W.3d at 689).

Applying that principle to the facts before it, the court agreed that Nautilus did not have to fund Downhole's use of independent counsel. *Id.* at 329. In particular, the court agreed that "the facts to be adjudicated" in the underlying lawsuit were not the same "facts upon which coverage depends." *Id.* The court's analysis on this point is worth quoting at length:

> If the insurance policy between Downhole and Nautilus excluded coverage for Downhole's negligent conduct, and Nautilus accordingly reserved its right to disclaim coverage based on whether Downhole had negligently performed its work, then the "facts to be adjudicated" in the Sedona litigation would be equivalent to the "facts upon which coverage depends." But no such equivalency exists, as Downhole's negligence is not a coverage issue between Downhole and Nautilus. Indeed, although the policy excludes coverage for "testing" or "consulting" services, the facts about whether Downhole breached a duty to Sedona by failing to act as a reasonably prudent provider of deviation-correction services are not equivalent to the facts that could determine whether Downhole was "testing" or "consulting" for Sedona. Unlike the former category of facts, the latter category of facts will not be adjudicated in the Sedona litigation; the underlying fact-finder will not decide whether Downhole's work constituted "testing" or "consulting." Likewise, while several other issues—whether Downhole provided "professional" or "data processing" services to Sedona, whether Downhole should have expected the damage to the well resulting from its work, or whether Downhole was occupying the property while providing its

> deviation-correction services—could be critical coverage issues, they are irrelevant to whether Downhole acted negligently.

Id.

Moreover, the court disagreed that the Supreme Court of Texas's decision in *Unauthorized Practice of Law Committee v. American Home Assurance Co.*, 261 S.W.3d 24 (Tex. 2008), changed the calculus. Downhole focused on the Supreme Court's opinion in *UPLC* where the Court noted that "[o]ther coverage issues may also depend on facts *developed* in the litigation." *Downhole*, 686 F.3d at 329 (quoting *UPLC*, 261 S.W.3d at 40 (emphasis added)). According to Downhole, the use of the word "developed" relaxed the *Davalos* standard such that a conflict of interest arises whenever the facts that could be developed in the underlying lawsuit are the same on which coverage depends. *Id.* The Fifth Circuit, however, disagreed: "One inconsequential line of dicta—'[o]ther coverage issues may also depend on the facts developed in the litigation,'—surely did not usher in a doctrinal change." *Id.* at 330 (internal citation omitted). Simply put, the "mere observation that coverage issues may turn on facts developed in the litigation does not necessarily entail that a conflict of interest will arise if the facts that could be developed in the underlying litigation are the same facts upon which coverage depends. Proceeding from the former observation to the latter conclusion requires an illogical leap." *Id.*

The court also rejected Downhole's contention that the only time the *Davalos* standard is met is where there is an intentional conduct exclusion and the claimant alleges intentional wrongdoing. *Id.* The court noted that a number of other scenarios also exist where the facts to be adjudicated are the same facts on which coverage depends. *Id.* at 330–31 (noting examples pertaining to breach of contract exclusions and breach of contract claims, as well as a reservation for damages outside the policy period where the timing of damages will be adjudicated in the underlying case). Accordingly, the court agreed with the district court and found that Nautilus was not obligated to reimburse Downhole for its independent counsel. *Id.* at 331. *See also Coats, Rose, Yale, Ryman & Lee, P.C. v. Navigators Specialty Ins. Co.*, 2012 WL 4858194 (5th Cir. 2012) (unpublished opinion) (finding the insured was not entitled to independent counsel); *see also Partain v. Mid-Continent Specialty Ins. Servs., Inc*., 838 F. Supp. 2d 547 (S.D. Tex 2012) (same)

C. Commentary

The holding in *Downhole Navigators* continues the current trend of narrowing the scenarios in which an insured has a right to independent counsel. Gone are the days—if they ever truly existed—where an insured is entitled to independent counsel merely because a reservation of rights is issued. Rather, under the Fifth Circuit's opinion, a thorough analysis of the actual facts to be adjudicated will be necessary in order to determine whether they truly are the same as the facts on which coverage depends. Only when they completely align will an insured be entitled to independent counsel.

V. *Great American Lloyds Insurance Co. v. Audubon Insurance Co.*, 377 S.W.3d 802 (Tex. App.—Dallas 2012), *opinion withdrawn by settlement,* 2013 WL 85240 (Tex. App.—Dallas Jan. 8, 2013)

In August 2012, the Dallas Court of Appeals addressed an insurer-vs.-insurer dispute involving consecutive liability insurance policies and the insurers' respective obligations to their mutual insureds. *See Great American Lloyds Insurance Co. v. Audubon Insurance Co.*, 377 S.W.3d 802 (Tex. App.—Dallas 2012), *opinion withdrawn by settlement*, 2013 WL 85240 (Tex. App.—Dallas Jan. 8, 2013). While the opinion ultimately was withdrawn in early 2013 because of a settlement reached while the petition for review with the Supreme Court of Texas was pending, the decision still provides insight into this important issue.

A. Background Facts

Holigan Family Investment, Inc. was a homebuilder with CGL insurance coverage from Great American from July 1995 to July 1997, and from Audubon and other insurers from July 1997 until 2002. A homeowner filed suit against the insured for construction defects and resulting damage, and the various carriers agreed to jointly defend Holigan against the claims. Great American's participation was for one-third of the defense costs, but, approximately a year after agreeing to defend, Great American withdrew from the agreement, contending that the earliest date of damage—based on discovery to that date—was on or about March 30, 1998. Accordingly, Great American contended that the damage fell outside its policy period and, therefore, no duty to defend or indemnify existed. *Id.* at 805. Ultimately, the other insurers settled the claims and Audubon sued Great American for contribution and reimbursement of defense and settlement costs. The trial court granted Audubon's motion for summary judgment and Great American appealed.

B. The Appeal

At the outset, the Dallas Court of Appeals disagreed that Great American did not have a duty to defend the homebuilder in the underlying lawsuit. *Id.* at 806. The basis for Great American's argument was that the underlying pleading was completely date-deprived—"The petition did not allege when the home was built, when the homebuilder attempted to make repairs, or when the damage occurred." *Id.* at 807. The court relied on its earlier decision in *Gehan Homes, Ltd. v. Employers Mutual Casualty Co.*, 146 S.W.3d 833, 838 (Tex. App.—Dallas 2004, pet. denied), finding that it must construe the pleadings liberally in favor of coverage. *Great Am.*, 377 S.W.3d at 807. Because the homeowners filed the underlying lawsuit in 2001 and alleged bodily injury and property damage in the "past," the court found Great American owed a duty to defend.

Turning to the "your work" exclusion, Great American contended that the "subcontractor exception" did not apply because the word "subcontractor" was not mentioned in the pleadings. *Id.* at 808 (citing *Pine Oak Bldrs., Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650, 654–55 (Tex. 2009)). Unlike in *Pine Oak*, however, the petition before the court included allegations that "the homebuilder and its 'contractors,' 'agents,' and 'representatives' were negligent in constructing the balcony and installing the HVAC system." *Id.* Moreover, when the underlying lawsuit was refiled in Dallas County, the plaintiffs included the HVAC subcontractor as a

defendant. *Id.* Thus, the allegations were sufficient to trigger the exception to the "your work" exclusion and did not preclude Great American's duty to defend. *Id.*

After addressing a statute of limitations argument premised on Audubon's technical omission of the earliest Great American policy in its pleading, the court then addressed Great American's claim that *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, 236 S.W.3d 765 (Tex. 2007), barred Audubon's claims for reimbursement and contribution. *See Great Am.*, 377 S.W.3d at 810. Rejecting Great American's contention, the court noted that, while *Mid-Continent* involved two insurers covering injury and damage during the same policy period, Great American and Audubon issued consecutive policies. *Id.* at 811. Because the policies applied to different policy periods, they could not cover the same injury or damage and, therefore, the "other insurance" provisions were not applicable. The parties did not cite, and the court did not find, any case applying *Mid-Continent* to bar an insurer's claim for contribution and reimbursement where the insurers were not co-primary insurers because their policies covered different periods. *Id.* at 811–12.

Finally, after determining that the actual facts established property damage occurred during Great American's policy period—and, thus, its no-evidence motion for summary judgment on Audubon's breach of contract claim failed—the court addressed Great American's argument that Audubon failed to allocate the loss at issue between their policies. *Id.* at 814. The court, however, construed Great American's argument as a collateral attack on the reasonableness of the settlement of the underlying case. *Id.* "When an insurer breaches its duties to defend and indemnify its insured, however, the insurer may not collaterally attack the settlement by litigating the reasonableness of the agreement." *Id.* (citing *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 670–74 (Tex. 2008)). Accordingly, Great American was barred from litigating whether Audubon properly allocated the loss among the policies. *Id.*

C. Commentary

Although the *Great American* opinion ultimately was withdrawn by the Dallas Court of Appeals, the decision remains persuasive. As other courts did in 2012, the Dallas appellate court reiterated that a duty to defend can exist absent date-specific pleadings. Moreover, the applicability of the "subcontractor exception" need not be limited to *only* "subcontractors," but applies to "contractors" working on the named insured's behalf. In addition, the Dallas Court of Appeals also joined the litany of cases that have limited the application of the *Mid-Continent* doctrine, finding that it does not apply to consecutive, rather than concurrent, insurers.

VI. *Indian Harbor Insurance Co. v. KB Lone Star, Inc.*, 2012 WL 3866858 (S.D. Tex. Sept. 5, 2012)

On September 5, 2012, Judge Melinda Harmon of the Southern District of Texas issued a lengthy opinion resolving cross-motions for summary judgment pertaining to the duty to defend and reserving for later adjudication the duty to indemnify. *See Indian Harbor Ins. Co. v. KB Lone Star, Inc.*, 2012 WL 3866858 (S.D. Tex. Sept. 5, 2012). Judge Harmon initially relied on the "contractual liability" exclusion to negate coverage for damage to the scope of the named insured's own work, but then addressed whether additional insured coverage still existed for

claims regarding damage to and the loss of use of the homes at issue because of the named insured's work, which was beyond the scope of the parties' contract.

A. Background Facts

Pursuant to its contract with Innovative, KB Lone Star contended it was an additional insured under a Blanket Additional Insured endorsement on Innovative's CGL policy. KB and Innovative had been sued for construction defects and property damage at a subsidized housing development, called "Mirasol," in San Antonio. After the underlying litigation was settled, Indian Harbor filed the instant action, seeking a declaration that it had no obligation to defend or indemnify KB for the claims asserted against it. *Id.* at *2.

B. Analyzing Coverage

After a lengthy discussion of relevant Texas case law pertaining to the interpretation of insurance contracts and coverage thereunder, the court turned to the merits of the case before it. The court rejected Indian Harbor's contention that an insurer's obligation to defend an underlying lawsuit is not triggered if the pleading is entirely date deprived. *Id.* at *14. Relying on *Gehan Homes, Ltd. v. Employers Mutual Casualty Co.*, 146 S.W.3d 833, 845–46 (Tex. App.—Dallas 2004, pet. denied), and *GEICO*, 357 S.W.3d at 824–25 (discussed *supra*), the court noted that carriers can be obligated to defend when the pleadings at issue are silent about the time of the damage. *Indian Harbor*, 2012 WL 3866858 at *14. Because the possibility existed that property damage occurred during the policy period, the court found that a duty to defend could be triggered. *Id.* (rejecting Indian Harbor's reliance on *Amerisure Mut. Ins. Co. v. Travelers Lloyds Ins. Co.*, 2010 WL 1068087 (S.D. Tex. Mar. 22, 2010), which found to the contrary).

The court, however, agreed with Indian Harbor that a duty to defend did not exist because the "additional insured" endorsement at issue had not been triggered. *Id.* at 26. In reaching its conclusion, the court agreed that the most recent petitions at issue in the underlying lawsuits did not implicate Innovative's concrete work in that it was not alleged to have been defective or have caused any property damage. *Id.* The court refused to allow KB's conclusory allegation that the concrete work caused damage to the homes in order to support its claim for additional insured coverage. *Id.* (citing *D.R. Horton-Texas, Ltd. v. Markel Int'l Ins. Co., Ltd.*, 300 S.W.3d 773, 778–81 (holding that the insurer had no duty to defend the additional insured because the underlying petition did not allege that the work of the named insured caused the damage)).

Moreover, the court agreed with Indian Harbor that two exclusions precluded the duty to defend. First, because the allegations by the underlying plaintiffs were that KB intended the deficiencies in quality of materials and construction and deliberately ignored all relevant construction standards, the court found the "expected or intended injury" exclusion applied. *Id.* Second, after examining at length the district court's decision in *Ewing Construction Co. v. Amerisure Insurance Co.*, 814 F. Supp. 2d 739 (S.D. Tex. 2011), and the Fifth Circuit's affirmation, 684 F.3d 512 (5th Cir. 2012), the court agreed that the contractual liability exclusion negated coverage for KB, as "[a]ll the alleged construction deficiencies are deliberate failures by KB to satisfy its contractual obligations, and, contrary to KB's charges, the only damages alleged in the most recent underlying pleadings are to the subject of the contract, the Mirasol project houses." *Id.* (failing to note that the Fifth Circuit had previously withdrawn its opinion and

certified questions to the Supreme Court of Texas in *Ewing*). Notably, the court seemed to reject KB's claim that, as an additional insured, so long as the damage at issue exceeded the scope of the named insured's contract, the exclusion would not apply. Of course, as noted above, the court also rejected KB's assertion that *any* of the damage at issue was the result of Innovative's work.

Notwithstanding the foregoing conclusions as to the duty to defend, which had not been triggered, the court refused to rule on the duty to indemnify. In doing so, the court noted that, although the underlying lawsuits had been settled, "this Court cannot rule out the possibility that KB could prove that its actions toward the *Arias* and *Saha* plaintiffs below were not intentional but negligent or that some damage beyond that to the Mirasol project houses was effected." *Id.* Accordingly, the court denied Indian Harbor's summary judgment on the duty to indemnify.

C. Commentary

Aside from the court's reliance on the holding in *Ewing* that had been withdrawn, Judge Harmon's opinion is nevertheless important in reaffirming basic principles of the duty to defend. Namely, date-deprived pleadings do not foreclose the potential for coverage under a liability insurance policy. Moreover, absent allegations specifically pertaining to the work of a subcontractor, a general contractor cannot obtain additional insured coverage under the subcontractor's insurance policy. In other words, the duty to defend remains governed by the "eight corners" rule.

VII. *PPI Technology Services, L.P. v. Liberty Mutual Insurance Co.*, 701 F.3d 1070 (5th Cir. 2012)

Just after Thanksgiving, the Fifth Circuit Court of Appeals affirmed a lower court decision by Judge Janis Graham Jack of the Southern District of Texas, finding that allegations of property damage in an underlying liability lawsuit were not sufficient to allege "property damage" for insurance coverage purposes. *See PPI Tech. Servs., Inc. v. Liberty Mut. Ins. Co.*, 701 F.3d 1070 (5th Cir. 2012).

A. Background Facts

The underlying facts of the liability lawsuit were fairly straightforward. The insured, PPI, was involved in well-planning and overseeing the drilling of wells on three leases in Louisiana. In particular, a well was to be drilled on one lease, but it resulted in a dry hole. Ultimately, it was determined that the well actually was drilled on a different lease (Lease 18892 instead of Lease 18891). Thus, the lessor and operator of the leases sued PPI, alleging that the company's negligence caused the drilling rig to be towed to the wrong lease, resulting in the dry hole and "property damage." The non-operator working interests owners also filed suit. *Id.* at 1073.

After Liberty Mutual denied coverage to PPI for the underlying lawsuits, PPI filed the instant action, seeking a declaration that Liberty Mutual owed a defense and indemnity. On cross-motions for summary judgment, Judge Jack ruled that allegations of "property damage" were legal, rather than factual, in nature and refused to consider them in determining coverage. *Id.* The district court concluded that those allegations were legal in nature because they "concern the definition and categorization of certain conduct and objects, rather than the '*facts* giving rise to the alleged actionable conduct.'" *id.* at 1073–74 (quoting the district court decision).

Accordingly, the mere legal assertions did not constitute allegations for purposes of Texas's "eight corners" rule. *Id.* at 1074.

B. The Appeal

On appeal, the court did not address PPI's arguments regarding the existence of an "occurrence," noting that its determination on the "property damage" issue was dispositive of coverage. *Id.* After reviewing Texas law regarding the duty to defend, the court turned to the allegations in the underlying lawsuit, noting the following relevant allegations:

> Royal contends that "PPI caused the drilling rig to be towed to [ ] and placed upon [ ] the wrong location." Subsequently, towing the rig to the wrong lease resulted in "the well being drilled in the wrong location" and a "dry hole." Drilling in the wrong location caused Royal and the nonoperating working interest owners to "expend[ ] in excess of $4,200,000.00 for the drilling of the Well in the wrong location." The Blue Moon Plaintiffs seek $737,752.40 in delay rentals to maintain the lease where the well was ultimately drilled. Additionally, Royal alleges that PPI caused "property damage to Royal as an owner in the property where the well was being drilled" including "physical injury to tangible property, including all resulting loss of use of the property." Finally, Royal alleges that PPI's "acts and omissions constitut[e] negligence and negligence per se."

Id. at 1075. The court also set out the definition of "property damage" in the standard CGL policy, which includes "physical injury to tangible property." *Id.*

The court then discussed a similar case in which coverage was not found because of the lack of "property damage" where all that was sought were economic damages resulting from a misplaced well. *Id.* at 1076 (discussing *Lay v. Aetna Ins. Co.*, 599 S.W.2d 684 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.)). Attempting to distinguish *Lay*, PPI argued that the use of the phrase "property damage" was sufficient to trigger coverage, but the court disagreed. *Id.* at 1076–77. The court said that the mere use of the phrase "property damage" and parroted policy language was not sufficient because none of those assertions were accompanied by facts illustrating specific harm or damage to tangible property. *Id.* at 1077 ("For example, there is no claim that the land was damaged, presumably because the well was drilled in the lake.").

Although the district court found that one assertion potentially alleged "property damage," i.e., that the lessor suffered "property damage throughout the lease where the well was drilled," the appellate court said that the better reading was that the lessor only asserted that it owned the property on which the drilling occurred, "making this allegation as hollow as the other cursory references to 'property damage.'" *Id.* Accordingly, that too was insufficient to establish "property damage."

Despite PPI's attempts to convince the court otherwise, the Fifth Circuit ultimately ruled that more specific factual assertions are necessary to establish "property damage" for purposes of CGL coverage. *Id.* at 1078. To hold otherwise would enable an plaintiffs to trigger coverage in every case by merely reciting the definitions in the insurance policy. *Id.* The court also rejected

PPI's claim that the pleading should be construed in its favor, noting that because they were not *factual* allegations, there was nothing to be construed. *Id.* at 1078–79.

C. Commentary

Although a somewhat brief opinion, the Fifth Circuit's decision in *PPI* is important in defining what is necessary to trigger coverage for "property damage" under CGL policies. Simply put, it is insufficient merely to incorporate the phrase "property damage." Rather, it is necessary to include specific factual allegations (e.g., cracking sheetrock, peeling paint, etc.) in order to assert a potentially covered claim.

VIII. *AIX Specialty Insurance Co. v. Universal Casualty Co.*, 2012 WL 6862489 (S.D. Tex. Dec. 27, 2012)

At the end of 2012, Magistrate Judge Nancy Johnson issued a comprehensive decision in *AIX Specialty Insurance Co. v. Universal Casualty Co.*, 2012 WL 6862489 (S.D. Tex. Dec. 27, 2012), regarding an insurer's obligation to defend a named insured and an additional insured with respect to two underlying lawsuits.

A. Background Facts

EGH filed suit in the first underlying lawsuit against G.T. Leach in connection with a condominium project in Galveston, Texas. *Id.* at *2. Ultimately, EGH added several of G.T. Leach's subcontractors, including Ashford Glass & Mirror, to the lawsuit. *Id.* After executing the contract, G.T. Leach and Emerald Towers changed the skin for the building without obtaining approval of the lender or the engineer of record. Allegedly, the changes were negligently implemented, resulting in damage to portions of the project and jeopardizing windstorm certification. *Id.*

In addition, the project suffered from water and moisture infiltration that damaged otherwise nondefective property. *Id.* at *3. While the first leaks occurred in the summer of 2007 (and before substantial completion), neither EGH or the lender learned about them until later. After substantial completion, the leaks persisted and additional leaks occurred. *Id.* Repair attempts in 2008, 2009 and 2010 only made the condition worse. *Id.* The costs of remediation and repair were expected to exceed $2 million. *Id.*

Each of G.T. Leach's subcontractors agreed to provide CGL coverage through additional insured coverage, as well as to defend and indemnify G.T. Leach in any lawsuit arising from their work. G.T. Leach asserted claims for breach of contract and contribution against the subcontractors. *Id.*

In the meantime, the Emerald by the Sea Condo Association filed a separate lawsuit against G.T. Leach, contending that G.T. Leach's acts and omissions constituted negligent construction and a breach of the implied warranty of workmanlike construction, resulting in damages. *Id.* In response, G.T. Leach filed a third-party petition against each of the subcontractors, including Ashford. *Id.* at *4. Ultimately, the two lawsuits were consolidated.

B. Coverage Analysis

One of Ashford's carriers, AIX, brought the instant action against another Ashford carrier, Universal Casualty ("UCC"), seeking a declaration that UCC had a duty to defend Ashford and G.T. Leach in the underlying lawsuit. UCC raised a number of coverage defenses, which the court addressed as follows:

1. Coverage not Triggered by the Underlying Lawsuits

At the outset, the court rejected UCC's contention that, because the Condo Association did not assert any claims against Ashford, it did not owe a duty to defend. *Id.* at *6–*7. Rather, according to the court, G.T. Leach's third-party complaint against Ashford was sufficient to give rise to a claim for property damage triggering CGL coverage. *Id.* at *7. Turning to EGH's lawsuit, the parties did not dispute that UCC's 2006-2007 policy was triggered, but disputed that the 2005-2006 and 2007-2008 policies were not. *Id.* The court agreed that the allegations were insufficient to trigger the earlier policy, but they were sufficient to trigger the later policy, as allegations existed that "[a]dditional leaks have occurred since then [2007]" and prior to repairs that began in 2008. *Id.* Notably, the court rejected the insurer's reliance on the "fortuity doctrine," finding it necessarily does not apply where allegations exist of damage that occurs *during the policy period*. *Id.* at *8.

2. G.T. Leach as an Additional Insured

With respect to the Condo Association claims, the court found that G.T. Leach was not afforded additional insured coverage because the plaintiff sued only G.T. Leach and in no way implicated the work of Ashford or any other subcontractor. *Id.* Importantly, G.T. Leach's third-party petition against its subcontractors does not alter the analysis because the "eight corners" rule incorporates only the underlying plaintiff's complaint and the relevant policy. *Id.*

Turning to the EGH claims, UCC argued that coverage did not exist for G.T. Leach because the additional insured endorsement extended only to vicarious liability for Ashford's active negligence. *Id.* The court disagreed, however, noting that, following G.T. Leach's filing of a third-party complaint, EGH asserted claims that "at least some, if not all, of the damages were caused by Leach's subcontractors," and a provision of the prime contract stated that "[G.T.] Leach is fully responsible and liable for costs of correcting defective work." *Id.* at *9. Thus, under a liberal interpretation of the pleadings, the allegations were sufficient to show that G.T. Leach was liable for EGH's damages, regardless whether G.T. Leach or the subcontractors caused the alleged property damage. *Id.* Therefore, additional insured coverage under the 2006-2007 policy was triggered. *Id.*

With respect to the 2007-2008 policy, the court relied on the same analysis to find that the phrase "caused by" in the additional insured endorsement was satisfied. *Id.* Moreover, the court also rejected the insurer's contention that Ashford's operations were not still ongoing during the 2007-2008 time frame as required by the endorsement's provision that status as an additional insured would expire when Ashford's operations for the additional insured are completed. *Id.* Because repairs were sporadically performed from 2008 to 2010, there was

nothing in the complaint to suggest that Ashford was not engaged in ongoing operations during the 2007-2008 policy period. *Id.*

3. Contractual Liability Provisions

Relying on an amended definition of "insured contract," which excludes any part of a contract or agreement "[t]hat provides for indemnity and defense of any person or organization for the party's sole negligence and/or provides for indemnity and defense of any person or organization regardless of fault," UCC also argued that coverage was eliminated for G.T. Leach because the subcontract obligated Ashford to defend and indemnify G.T. Leach for damages arising out of Ashford's work, regardless of cause or G.T. Leach's fault or negligence. *Id.* at *10. Again, the court disagreed, noting that regardless of whether the contractual indemnity provision was enforceable, the insurer still was obligated under the additional insured endorsements to provide a defense. *Id.*

4. Applicability of Policy Exclusions

UCC also relied on three contractual liability endorsements that precluded coverage for "Construction Professional Liability," "Construction Management Errors and Omissions," and "Exterior Insulation and Finish System." *Id.* While acknowledging that the exclusions may be implicated, the court noted that allegations separate and apart from "thin stucco" and the change in exterior application existed, which contributed to the cause of water infiltration and resulting damage. *Id.* at *11. Thus, the endorsement exclusions did not preclude the possibility of a potentially covered claim, which is all that is required to trigger a defense. *Id.*

Turning to exclusions j(5) and j(6), the court noted that, under Texas law, those exclusions only apply to ongoing operations damages. *Id.* Because some of the allegations refer to leaks and damage occurred *after* completion, exclusion j(5) did not preclude the insurer's duty to defend G.T. Leach or Ashford. *Id.* And, with respect to j(6), because some of the damage was to otherwise nondefective property, regardless of who worked on that property, the exclusion did not negate the duty to defend. *Id.* at *12.

Looking at exclusion k and l, which preclude coverage for damage to "your product" and "your work," respectively, the court noted that such exclusions do not preclude coverage for damage *beyond* the insured's product or work. *Id.* In addition, the "your product" exclusion typically does not apply to the construction of a building because they are not manufactured. *Id.* Thus, neither of the exclusions was applicable to preclude a defense obligation. *Id.* at *12–*13.

Finally, the court addressed the "impaired property" exclusion, exclusion m, finding that it did not apply because allegations existed that there was physical injury to tangible property. *Id.* at *13. According to the court, the exclusion only implies to impaired property and property that is not physically injured. Thus, even if the exclusion applied to *some* of the alleged damages, the exclusion did not apply to *all* the alleged damages and, therefore, a duty to defend existed. *Id.*

C. Commentary

Magistrate Judge Johnson's opinion in *AIX* provides an excellent summary of the prototypical coverage defenses raised in a "run-of-the-mill" construction dispute involving

coverage for a named insured and additional insured. The opinion serves as one of the most updated explanations regarding triggering the duty to defend and applying allegations in an underlying complaint to the intricacies of the business risk exclusions. Accordingly, it serves as a perfect reminder as to how coverage can be obtained in construction defect claims.

IX. *Pride Transportation v. Continental Casualty Co.*, ___ F. App'x ___ (5th Cir. Feb. 6, 2013)

On February 6, 2013, the U.S. Fifth Circuit Court of Appeals affirmed a Northern District of Texas decision involving a *Stowers* demand. *See Pride Transp. v. Cont'l Cas. Co.*, ___ F. App'x ___ (5th Cir. Feb. 6, 2013). In doing so, the court upheld the lower court's finding that an insurer's settlement for policy limits on behalf of a single insured—even where such settlement leaves another insured uncovered by insurance—is not a violation of the *Stowers* doctrine.

A. Background Facts

The facts of *Pride Transportation* are fairly straight-forward. Krystal Harbin, while driving for Pride, struck Wayne Hatley's pickup truck from behind, causing Hatley to collide with a crane truck and leaving Hatley a paraplegic with limited use of his upper extremities. Slip Op. at 2. Pride had a primary insurance policy with a $1 million limit of insurance that was issued by Continental Casualty, and a $4 million excess policy with Lexington Insurance. Harbin was insured under both policies. Both Harbin's and Pride's counsel agreed the value of the case exceeded the limits of insurance. *Id.* at 3.

In June 2007, Harbin was offered a settlement of the claims against her in exchange for the full $5 million of insurance, but it expressly excluded Pride from the settlement. *Id.* Continental tendered its limits to Lexington, so that Lexington could respond to the demand. *Id.* at 3–4. Lexington asked the Hatleys to consider including Pride in the settlement, but they refused. In addition, Harbin refused to allow Lexington to make a formal counter-offer of $5 million in exchange for a full release of all parties, instead requesting that Lexington offer the original settlement, which Lexington did. *Id.* at 4. As a result of the exhaustion of both insurance policies, the insurers withdrew their defense of Pride. *Id.* Ultimately, Pride, Lexington and Continental ended up in litigation wherein the federal district court granted summary judgment on the insurers' behalf. *Id.* at 5.

B. The *Stowers* Doctrine

In reviewing Pride's appeal, the Fifth Circuit noted that, in Texas, "[t]here is no duty of good faith and fair dealing owed to the insured in this context [i.e., an insurer's handling of third-party insurance claims]—common law duties are limited to contractual obligations and the *Stowers* duty to accept a reasonable settlement demand." *Id.* at 6. An insurer is liable under *Stowers* if a demand is rejected where

> (1) the claim against the insured is within the scope of coverage, (2) the demand is within the policy limits, and (3) the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment.

Id. (quoting *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994)). Further, the court noted that "when faced with a settlement demand arising out of multiple claims and inadequate proceeds, an insurer may enter into a reasonable settlement with one of the several claimants even though such settlement exhausts or diminishes the proceeds available to satisfy other claims." *Id.* at 7 (quoting *Farmers Ins. Co. v. Soriano*, 881 S.W.2d 312, 315 (Tex. 1994)). And, the Fifth Circuit had extended *Soriano* to cases with multiple insured defendants. *Id.* (citing *Travelers Indem. Co. v. Citgo Petrol. Corp.*, 166 F.3d 761 (5th Cir. 1999). At bottom, the court explained:

> The insurer cannot be liable for failing to settle remaining claims "unless there is evidence that either (1) [the insurer] negligently rejected a demand from the [claimant] within policy limits; or (2) the [initial settlement demand] was itself unreasonable." *Soriano*, 881 S.W.2d at 315. The test for whether the settlement was unreasonable invokes the same standard as did *Stowers*: "that a reasonably prudent insurer would not have settled the [initial] claim when considering solely the merits of [that] claim and the potential liability of its insured on the claim." *Id.* at 316.

Id.

In the instant case, the insurers did not reject any demands for Pride *or* Harbin. Rather, Pride's arguments were based solely on a claim for liability for *accepting* a demand. *Id.* "Although the *Stowers* duty imposes liability on insurers who reject reasonable demands covered under their policies, we decline to use this case, as Pride wishes, to extend the *Stowers* duty to impose liability on insurers for accepting demands." *Id.* Accordingly, the only liability against the insurers had to be contractual in nature—i.e., Pride claimed that the settlement on behalf of Harbin was unreasonable and, therefore, did not allow the insurers to escape their contractual duty to defend Pride. *Id.* at 8.

The basis of Pride's argument was that the settlement offer was not, in fact, a valid *Stowers* demand in that it left Harbin and Pride open to further liability because Pride had an indemnity claim against Harbin and the Hatleys maintained their claims against Pride. *Id.* at 8–9. The court found it unnecessary to determine whether the *Stowers* requirements had been met, finding instead that Pride only could prevail if a reasonable insurer would have rejected the settlement on behalf of Harbin considering solely the merits of that claim and the potential liability of Harbin on that claim. *Id.* at 9. Pride's claim that Harbin had residual liability to Pride was not sufficient to render the settlement unreasonable because Lexington's policy excluded coverage for claims by one insured against another, and an insurer does not have a duty to settle excluded claims. *Id.* (citing *St. Paul Fire & Marine Ins. Co. v. Convalescent Servs., Inc.*, 193 F.3d 340, 345 (5th Cir. 1999). In light of the foregoing, and because of the likelihood and degree of potential exposure to excess judgment for Harbin, "the Settlement was reasonable as a matter of law and did not result in a breach of the insurance contracts." *Id.* at 9–10.[3]

[3] Notably, the court also rejected Pride's claim that the decision in *American Western Home Insurance Co. v. Tristar Convenience Stores, Inc.*, 200 WL 2412678 (S.D. Tex. June 2, 2011), should have been addressed in the reasonableness inquiry. *See Pride*, slip op. at 11 (distinguishing *Tristar* because that case involved the rejection of a settlement demand that would have released all the insureds).

C. Commentary

The Fifth Circuit's affirmation of the Northern District of Texas's holding in *Pride Transportation* helps solidify the usually murky landscape of the *Stowers* doctrine. Aside from reaffirming that an insurer's only liability to its insured in the context of third-party insurance claims is under the *Stowers* doctrine or under the parties' contract, the court also reaffirmed that an insurer can, in fact, exhaust the limits of insurance on behalf of a single insured even if other insureds are left uncovered. In doing so, the insurer need only act reasonably.

X. Other Cases of Note

A. Vicarious Liability Additional Insured Coverage: *Continental Casualty Co. v. American Safety Casualty Insurance Co.*, 365 S.W.3d (Tex. App.—Houston [14th Dist.] 2012, pet. filed)

This case involved an insurer versus insurer dispute involving additional insured coverage arising out of an injured subcontractor's employee's claim against a general contractor. The general contractor's insurer covered its defense and then sought reimbursement from the subcontractor's carrier. In the court of appeals, the court ruled that the additional insured endorsement was limited to claims for vicarious liability and, because the underlying lawsuit involved separate claims of negligence against both the general contractor and the subcontractor, the endorsement was not triggered. Further, the jury ultimately did not find that the injuries at issue arose solely from the subcontractor's negligence, and that the responsibility was shared by the general contractor, the subcontractor's employee and the underlying plaintiff. Accordingly, no duty to indemnify existed either.

B. "Contractual Liability": *Colony National Insurance Co. v. Manitex*, 461 F. App'x 401 (5th Cir. 2012) (per curiam)

The *Manitex* case involved the interpretation of the definition of "insured contract" under an exception to the CGL policy's "contractual liability" exclusion. In the case, JLG manufactured cranes and sold them to Powerscreen, and the latter assumed JLG's liabilities. In turn, Powerscreen sold the cranes to Manitex, under an agreement in which Manitex assumed Powerscreen's liabilities. One of the cranes ultimately malfunctioned and Manitex was sued. Manitex sought coverage from Colony, but Colony denied coverage under the "contractual liability" exclusion. Looking to the definition of "insured contract," which meant "that part of any other contract or agreement pertaining to your business . . . under which you assume the tort liability of another party to pay for 'bodily injury.'" The court found the exception did not apply because Manitex contractually agreed to assume Powerscreen's liabilities and those liabilities only were contractual in nature and not tort. Thus, there was no duty to defend or indemnify. This case reinforces the fact that the "insured contract" exception to the contractual liability exclusion requires an assumption of "tort" liabilities.

C. "Contractual Liability": *Blanton v. Continental Insurance Co.*, Civil Action No. H-10-2169 (S.D. Tex. Apr. 11, 2012)

The *Blanton* decision involved a determination of an insurer's duty to defend certain insureds for claims arising from their installation of engines in a vessel owned by J.A.M., as well

as arising from subsequent repairs that J.A.M. alleged were faulty. The policy had a Ship Repairer's Liability component and CGL coverage. Under both policy coverage parts, there were "contractual liability" exclusions. Noting the Supreme Court of Texas's earlier decision in *Gilbert Texas Construction* and the Southern District of Texas's decision in *Ewing Construction*, the court determined that it had to decide whether the underlying lawsuit included allegations that the insureds assumed liability for their work through a contract. Analyzing the facts alleged, and noting that they established the existence of a contract with respect to the attempted repairs to the engines, the court found the exclusion applied because of a breach of a contractual duty to perform that work competently. The court also rejected the argument that the existence of negligence claims were sufficient to trigger an exception to the exclusion, noting that the *facts* established only a contractual claim. Accordingly, there was no duty to defend.

Notably, even if its application of *Ewing* was correct to a certain extent, the court appears to have gone a step further, applying the "contractual liability" exclusion to negate coverage where the insured's work caused damage *beyond* its own work. In particular, the court noted that the damages at issue were to the engines themselves, but *also to the vessel*. Because the insureds did not contract to build the vessel and because the court did not indicate that the insureds assumed any liability in their contract for damage to the vessel (as was the case in *Gilbert*), the applicability of the exclusion should not have extended to those damages. Rather, those damages appear to be run-of-the-mill damages to third-party property that the CGL policy was undoubtedly meant to cover. Accordingly, there should have been a duty to defend.

Ignoring the damages to the vessel, in the event *Ewing* is overturned, the duty to defend still may not have been triggered by the facts alleged with respect to damage to the engines. That is, the "your work" exclusion would apply to negate coverage for those damages.[4] Again, though, because there was damage *beyond* the engines, and all that is needed for a duty to defend is a single potentially covered claim, the duty to defend should have been triggered.

D. "Contractual Liability": *Gemini Insurance Co. v. Tristream East Texas LLC,* Civil Action No. H-11-2709 (S.D. Tex. Nov. 16, 2012)

The *Tristream* court also addressed the "contractual liability" exclusion, but the decision appears to apply the exclusion correctly like in *Manitex*. In that case, the insured, Tristream, contractually agreed to purchase 100% of Eagle Rock's natural gas liquids produced from wells covered by the contract. A leak at the insured's facilities began a chain-reaction whereby the plant ultimately was shut down and Tristream was unable to accept Eagle Rock's natural gas for production. Eagle Rock disputed Tristream's claim that its obligations were suspended under the contract because of a force-majeure event. Ultimately, the parties settled their disputes, but Eagle Rock's insurers, who paid some $5 million in insurance proceeds to Eagle Rock, filed a subrogation action against Tristream. Tristream's carriers, however, refused to participate in the defense.

[4] According to the court's opinion, the policy did not have a "subcontractor exception" to the "your work" exclusion. Regardless, though, no mention was made of the use of subcontractors to perform the installation or repair work.

In analyzing the allegations asserted by the carriers, which were no different than Eagle Rock's allegations, the court disagreed with the insurers regarding the existence of an "occurrence," finding that the plant shutdown was an unexpected "accident" and, therefore, an occurrence. Regarding the requirement of "property damage," the court correctly noted that allegations of future damage and activities performed to *avoid* future damage do not constitute "property damage." However, allegations existed of the loss of use of Eagle Rock's wells because of the inoperability of the plant, and that was sufficient to trigger the definition of "property damage" in the policies at issue.

Having established satisfaction of the insuring agreement, the court turned to the "contractual liability" exclusion, finding that it applied to negate coverage. No dispute existed that the exclusion applied, so the court focused on whether the exception for liability for damages "that the insured would have in the absence of the contract or agreement" applied. Because Tristream contractually agreed to purchase 100% of Eagle Rock's natural gas, the court found that Tristream could not have been liable in tort. The court explained that Tristream did not have an independent common law duty to purchase the natural gas, and, without the existence of the contractual relationship, the shutdown of the plant would have had no effect on Eagle Rock and Tristream would not have been liable to that company. Importantly, the court noted that Tristream's negligence at its own plant only would have harmed Tristream in the absence of the contractual agreement to buy 100% of Eagle Rock's natural gas. Accordingly, there was no duty to defend, and for the same reasons, no duty to indemnify.