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

THE POLICYHOLDERS' PERSPECTIVE

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I. *Great American Insurance Co. v. Hamel*, 444 S.W.3d 780 (Tex. App.—El Paso 2014, pet. granted)

On September 19, 2014, the El Paso Court of Appeals issued an important decision addressing an insured's post-judgment assignment of claims against its insurer to its judgment creditor in *Great American Insurance Co v. Hamel*, 444 S.W.3d 780 (Tex. App.—El Paso 2014, pet. granted). The court found that the judgment against the homebuilder was enforceable against the insurer, the assignment was valid and no exterior insulation and finish system ("EIFS") exclusion applied to negate coverage. A petition for review filed by Great American sat at the Supreme Court of Texas for some time as the Court had other cases where it could address these issues. Ultimately, however, the Court issued holdings in those cases without addressing these issues. Accordingly, the Supreme Court granted petition and oral argument took place on February 28, 2017.

A. Background

Terry Mitchell Builders ("TMB") was a homebuilder insured by Great American Insurance Co. under five consecutively issued CGL polices. *Id.* at 784. TMB was retained by the Hamels to inspect and complete construction of a home that a prior contractor had abandoned. TMB completed the home in October 1995—seven months before Great American's first policy incepted. By August 2000, the Hamels observed damage to their home, which inspectors determined was the result of water intrusion related to roofing and fascia board areas. *Id.* at 785. As a result, in 2005, the Hamels filed suit against TMB in relation to its failure to construct and inspect the home in a good and workmanlike manner. When TMB tendered the lawsuit to Great American for a defense and indemnity, Great American denied coverage. *Id.*

Just before trial, the Hamels executed a letter in which they agreed to pursue only TMB and its insurer. The Hamels agreed that they would not attempt to enforce any judgment obtained against Terry Mitchell individually or against any of his other entities. They also agreed not to seek a levy on the tools of his trade or to assign any judgment against TMB or use the judgment to effect Mitchell's personal credit. In exchange, Mitchell executed the agreement as evidence of his commitment to appear at trial and not seek a continuance. *Id.* The parties also stipulated to certain facts in advance of the trial. *Id.*

At trial, the case was tried to the bench. During that trial, TMB's counsel examined witnesses and elicited evidence favorable to TMB's defense. In particular, counsel secured evidence that: "(1) the defects, other than the defective shower, were constructed by GSM rather than TMB; (2) the project was 60–70 percent complete when TMB became involved in the construction; (3) the roof was not constructed under TMB's watch; (4) the roof deck, roof valleys, and flat roof were already constructed when TMB took over the construction; (5) an inspector for the City of Flower Mound and another building inspector inspected the construction upon completion and determined that the newly-constructed home 'passed' inspection; and (6) the Hamels' expert, Donald Yeandle, had been asked on the day of trial if he would make an offer on the house and had replied that he had in fact already done so." *Id.* at 803. As part of the foregoing, Mitchell, as president of TMB, testified about the problems at the home and acknowledged his work may not have been completely performed in a good and workmanlike manner. Nevertheless, he also noted that the house had been 60-70% complete when he took

over and errors made by the prior contractor were easy to miss. *Id.* at 785–86. Moreover, most of the problems about which he had been asked questions were portions of the project constructed by the prior contractor. *Id.* at 786. Ultimately, the court entered findings of fact and conclusions of law, finding that TMB breached its obligations to the Hamels and entered judgment against the company, including an award of $50,000 for mental anguish and distress. *Id.*

Thereafter, in September 2005, TMB assigned to the Hamels most of its claims against Great American. *Id.* at 787. Great American refused to pay the judgment. As such, the Hamels filed the instant declaratory judgment action. *Id.* Just as the construction case was tried to the bench, so was the coverage lawsuit, and the court again ruled in favor of the Hamels. *Id.* During the trial in the coverage case, the Hamels' expert from the liability lawsuit testified again in the coverage lawsuit, presenting ample evidence of the type and timing of the damages at issue. *Id.* at 787–93. Great American cross-examined the expert on the stand, and also challenged his qualifications to even serve as an expert. *Id.* at 789, 792–93. A second expert also testified about the damages on their behalf. *Id.* at 793–97. Great American objected to his qualifications and cross-examined him as well. *Id.* at 796–97. With regard to the experts' qualifications, the trial court had a separate hearing to address the issues and simply denied Great American's motions because Great American had failed to show that they lacked the necessary knowledge. *Id.* at 805. In addition to the expert testimony, the Mr. Hamel also took the stand and provided live testimony to the court regarding the damages that the Hamels suffered. *Id.* at 809 (discussing Mr. Hamel's testimony). In effect, Great American had the opportunity to retry the liability and damages that already had been tried in the construction case.

B. Liability for Underlying Judgment

In its first issue on appeal, Great American claimed that it was not liable for the underlying judgment entered against TMB. *Id.* at 798. The company's complaint was that the judgment was not the result of an "actual trial" as required under *State Farm Fire & Casualty Co. v. Gandy*, 925 S.W.2d 696, 714–15 (Tex. 1996). Essentially, Great American complained about the stipulations, the covenant not to execute on the personal assets of Mitchell, and also argued that the "trial" was less than robust. The appellate court disagreed with Great American, finding that sufficient evidence existed to support the trial court's finding that the company was bound by the judgment. In doing so, the court noted that TMB defended itself in good faith at trial and the judgment entered was neither an agreed judgment nor a consent judgment. *Hamel*, 444 S.W.3d at 799. Thus, the coverage court's conclusion that Great American breached its duties to defend and indemnify TMB were upheld on review. *Id.*

The court also explained that insurers that breach their defense obligation are not entitled to rely on the "actual trial" requirement of their insurance policy. *Id.* (citations omitted). Under the "eight corners" rule used to determine an insurer's duty to defend its insured, the court explained that the Hamels' pleading against TMB included allegations that, if taken as true as required under Texas law, adequately stated a potential cause of action within the terms of coverage set out in one or more of the Great American policies. *Id.* at 800–01. In doing so, the court rejected Great American's claim that the "manifestation" trigger should apply because, as in *Don's Building Supply, Inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20, 28–29 (Tex. 2008), the terms of the policies did not support the use of a "manifestation" trigger and, instead, the "actual injury" trigger applied. *Hamel*, 444 S.W.3d at 801. Because Great American was found

to have violated its duty to defend TMB, Great American could not contest compliance with the "actual trial" requirement in the insurance policy. *Id.* (citations omitted).

Additionally, the court addressed Great American's *Gandy* argument. *Id.* In that case, the Supreme Court of Texas held that "in no event is a judgment, rendered in favor of a plaintiff against an insured without a fully-adversarial trial, binding on the insured's insurer or admissible as evidence of damages in an action against the insurer by plaintiff as the insured's assignee. *Id.* (citing *Gandy*, 925 S.W.2d at 714–15). Because *Gandy* only applies to a specific set of assignments with special attributes and is inapplicable to cases that do not present the five unique elements addressed in *Gandy*, the court compared the two cases. *Id.* at 802 (citing *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 673 (Tex. 2008)). Finding the facts readily distinguishable from *Gandy*, the court noted that TMB's assignment was *post-judgment* and occurred after a trial to the bench resulted in a judgment, whereas Gandy's assignment was a pre-trial assignment of rights. *Id.* And, unlike in *Gandy*, Great American never tendered a defense to its insured or made a good-faith effort to adjudicate the coverage issues prior to adjudication of the underlying lawsuit. *Id.* Further, the court, in detail, analyzed the trial court's findings in the coverage case in determining that a "fully adversarial trial" took place between TMB and the Hamels. *Id.* The court rejected the insurer's reliance on several cases in which the insured did nothing at trial or counsel appeared but did not ask any questions. *Id.* at 802–03. The court emphasized that TMB's testimony was not influenced by his prior agreement with the Hamels and was "candid and forthright." *Id.* at 803. As such, *Gandy* did not apply and the assignment was not invalid. *Id.* at 803–04.

C. Covered Damages during a Great American Policy Period

After analyzing and determining that the expert testimony presented by the Hamels was reliable and properly admitted, the court turned to issue four of Great American's appeal pertaining to its argument that the Hamels did not prove covered damage occurred during a Great American policy or, alternatively, failed to allocate damages among the policies and segregate between covered and uncovered damages. *Id.* at 808. According to the court, the expert testimony established that wood rot, resulting in a greater than 50 percent decrease in strength, occurred during Great American's first policy period and required replacement of the wood at that time. Further, while additional rot would have occurred, it would not have increased the Hamels' damages. *Id.* At worst, the damage first occurred as late as the third policy issued by Great American, but the EIFS exclusion on which Great American relied to dispute coverage was only present in the fourth and fifth policies—after damage already had occurred.[1] *Id.* In rejecting Great American's allocation argument, the court quoted the Supreme Court of Texas at length:

> If a single occurrence triggers more than one policy, covering different policy periods, then different limits may have applied at different times. In such a case, the insured's indemnity limit should be whatever limit applied at the single point in time during the coverage periods of the triggered policies when the insured's

[1] Because of this, Great American's complaint in issue three regarding the interpretation of the EIFS exclusions was moot. *Id.* at 809.

> limit was highest. The insured is generally in the best position to identify the policy or policies that would maximize coverage. Once the applicable limit is identified, all *insurers* whose policies are triggered must allocate funding of the indemnity limit among themselves according to their subrogation rights.

Id. (quoting *Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2 842, 855 (Tex. 1994) (emphasis added)). Simply put, neither Texas law nor the terms of the policies entitled Great American to a *pro rata* allocation based on the single continuing occurrence. *Id.*

D. Mental Anguish Damages

Finally, the court addressed Great American's argument in issue five that the Hamels should not have been entitled to recover mental anguish damages associated with its "property damage" claim. *Id.* The court agreed with Great American. In doing so, the court found Great American's case law and the Hamels' case law lacking on the issue before it. *See id.* at 809–11. Instead, the court found guidance in *City of Tyler v. Likes*, 962 S.W.2d 489, 492, 497 (Tex. 1997), where the Supreme Court held that "mental anguish based solely on negligent property damage is not compensable as a matter of law." *Id.* at 492, 497. Because the injury suffered by the Likes was not intentional or malicious, or even grossly negligent, the Court refused to decide whether such damages could be compensable in connection with a heightened degree of misconduct. *Id.* at 497.

In the case before it, the El Paso Court of Appeals noted that TMB merely was found negligent for his conduct in connection with the inspection and construction of the Hamels' home. *Hamel*, 444 S.W.3d at 811. Thus, even though Great American was bound by the liability lawsuit judgment, the court found that the Hamels' mental anguish was not compensable as a matter of law because it was not the result TMB's intentional, malicious or grossly negligent behavior. *Id.*

Commentary:

In *Hamel*, the court properly applied the precedent established in *ATOFINA* and noted that *Gandy* only applies in certain narrow circumstances that did not exist before the court. Additionally, the court correctly rejected Great American's claim that it had not breached the duty to defend because the "manifestation" trigger allegedly was the correct trigger for CGL policies at the time the damage occurred. Rather, the court was clear that that is not how the law works and nothing about Great American's policy was different than what was found in *Don's Building Supply* and, therefore, the "actual injury" trigger always was the proper trigger for standard CGL policies with regard to "property damage" claims. And, although not clearly stated, the court reaffirmed the insured's ability to select any triggered policy to provide the coverage sought, noting that, while damage existed in later policies that had EIFS exclusions that would have negated coverage, the earlier policies also were triggered and no such exclusions applied. Great American filed a petition for review on the *Gandy* issue, and, after requesting full briefing, the Supreme Court of Texas set the matter for oral argument on February 28, 2017. The sole basis for Great American's appeal to the Supreme Court is the *Gandy* issue. In other words, at the Supreme Court, Great American has acknowledged that it breached the duty to defend and it has dropped its argument that the assignment was invalid. Accordingly, in contrast to earlier

cases, the *Gandy* decision and the scope of the "fully adversarial trial" language is front and center and will have to be addressed by the Court. Stay tuned as this will be an important decision as to what an insured must do, if anything, to preserve coverage after an insurer wrongfully denies a defense.

II. *Liberty Surplus Insurance Corp. v. Exxon Mobil Corp.*, 483 S.W.3d 96 (Tex. App.—Houston [14th Dist.] 2015, pet. filed)

In late 2015, the Fourteenth Court of Appeals in Houston had the opportunity to apply the Supreme Court of Texas's recent decision in *In re Deepwater Horizon*, 470 S.W.3d 452 (Tex. 2015), in regard to the scope of additional insured coverage that existed for a party to a services contract. *See Liberty Surplus Ins. Corp. v. Exxon Mobil Corp.*, 483 S.W.3d 96 (Tex. App.—Houston [14th Dist.] 2015, pet. filed). Finding that the scope of additional insured coverage was not limited by the terms of the parties' services contract, the appellate court affirmed the district court's summary judgment verdict in favor of coverage.

A. Background Facts

Exxon Mobile Corporation ("Exxon") and Wyatt Field Service Company ("Wyatt") entered into a five-year contract under which Wyatt would perform "Services" as set forth in work orders from Exxon's affiliates. The contract required Wyatt to maintain $5 million of commercial general liability insurance covering Exxon and its affiliates "as additional insureds in connection with the performance of Services." Additionally, the contract required that the additional insured coverage had to be primary to all other policies, including deductibles or self-insured retentions. *See id*. at 98.

In 2008, Wyatt was assigned to work on a "flexicoker" unit at Exxon's Baytown refinery. Wyatt was assigned to reinstall dummy nozzles and chains after an intensive maintenance period called a "turnaround." Wyatt completed the services around the end of October 2008. Three years later, one of the dummy nozzles unexpectedly pulled all the way free from its packing, and the escaping steam and coke burned several employees of a contractor, LWL, Inc., who were working on the unit. It was subsequently discovered that the safety chain had been installed in the wrong location such that it did not properly secure the dummy nozzle. *See id*. at 98–99.

The injured workers sued Exxon in the 125th District Court in Harris County, and Exxon designated Wyatt as a responsible third party. The plaintiffs then added Wyatt as a defendant. Exxon and Wyatt asserted cross-claims against each other, which were severed from the injured workers' suit. Exxon demanded defense and indemnity from Wyatt's primary commercial general liability and excess umbrella insurers—Liberty Surplus Insurance Corporation ("Liberty") and Commerce & Industry Insurance Company ("Commerce"), respectively (collectively, the "Insurers"). The Insurers denied additional insured coverage to Exxon for the injured workers' claims, did not contribute to Exxon's costs of defense, and did not contribute the settlement with the injured workers. *See id*. at 99.

Exxon sued the Insurers and Wyatt in the 215th District Court of Harris County. Exxon filed a traditional motion for partial summary judgment concerning the Insurers' liability, arguing that the policies covered the injured workers' claims against Exxon as an additional

insured. The trial court ruled in Exxon's favor. The parties entered into stipulations resolving all other matters, and the trial court rendered final judgment in accordance with its earlier order on the partial summary judgment and the stipulations. The Insurers appealed the final judgment. *See id*.

B. Scope of Additional Insured Coverage—Who and How Much?

Liberty's commercial general liability policy contained three endorsements potentially providing additional insured status to Exxon. Commerce's excess umbrella policy insured any entity or person qualifying as an additional insured under the Liberty policy, but it specified that it provided no broader coverage than afforded under the Liberty Policy. As such, the court's analysis regarding Exxon's additional insured coverage under the Liberty policy equally applied to the Commerce policy. *See id*. at 101.

The Insurers argued that Exxon only was an additional insured with respect to Wyatt's ongoing operations and not with respect to Wyatt's completed operations. In analyzing the arguments, the court started with Endorsement No. 3, because it was the first additional insured endorsement on which Exxon relied. The endorsement provided as follows:

> ENDORSEMENT NO. 3
>
> WHO IS AN INSURED (Section II) is amended to include as an insured any person or organization with whom you have agreed to add as an additional insured by written contract but only with respect to liability arising out of your operations or premises owned by you.

The parties agreed that Wyatt and Exxon entered into a contract requiring Wyatt to provide additional insured coverage to Exxon; therefore, the only issue was the scope of the coverage provided to Exxon. *See id*.

In determining the scope of additional insured coverage, the court had to determine whether the endorsement should be read by itself or whether the endorsement incorporated any coverage restrictions that may be found in the contract between Wyatt and Exxon. The Insurers argued that, because the endorsement required reference to the underlying contract for purposes of determining additional insured status, it also required reference to the underlying contract for purposes of determining the *scope* of that additional insured coverage. The court rejected this argument. In doing so, the court acknowledged that a policy generally may limit the scope of additional insured coverage to the coverage required in an underlying contract, but it disagreed that the policy necessarily incorporated the entire contract and all of its terms merely by referencing the underlying contract for a single purpose. In support of its findings, the court looked to *In re Deepwater Horizon*, in which the Supreme Court of Texas stated, "we determine the scope of coverage from the language employed in the insurance policy, and if the policy directs us elsewhere, we will refer to an incorporated document *to the extent required by the policy*." *Id.* at 101 (quoting *In re Deepwater Horizon*, 470 S.W.3d at 460 (emphasis added)). The court determined that the endorsement only required the court to reference the underlying

contract to determine whether the parties agreed to add a party as an additional insured, "but it does not direct us to the contract to determine the scope of coverage." *Id.* at 101–02. "Thus, it refers the reader to the written contract when identifying who is an insured, but not when limiting the circumstances under which such a person or organization is considered to be an insured." *Id.* at 103. Notably, in a lengthy footnote, the court stated that even if the endorsement required it to refer to the underlying contract to determine the scope of coverage, the underlying contract did not limit the scope of coverage. *See id.* at 104 n.5 (finding that the terms of the policy were not ambiguous and where two additional insured endorsements are applicable, coverage is governed by the endorsement that provides the insured the greatest amount of coverage). Accordingly, the court held that the only limitation on the scope of coverage is those limitations found in the endorsement, not in the underlying contract. *See id*. at 102–03.

C. Dependence of Coverage on the Named Insured's Negligence

In the liability litigation, Exxon settled with the injured claimants, who then proceeded to trial against Wyatt. The jury found that Wyatt was not negligent and that Exxon, who was no longer in the litigation, was solely responsible for the workers' injuries. The Insurers argued that such findings negated coverage for Exxon. In the coverage litigation, though, the court rejected the Insurers' assumption that the existence of additional insured coverage for Exxon depended on Wyatt's negligence. The court noted that the Supreme Court of Texas had rejected the same argument in *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660 (Tex. 2008). In that case, the Court explained that it rejected the "fault-based interpretation of 'arising out of operations'" adopted in *Granite Construction Co. v. Bituminous Insurance Cos.*, 832 S.W.2d 427, 428 (Tex. App.—Amarillo 1992, no writ). Instead, the Court in *ATOFINA* stated its interpretation of "arising out of operations" as follows:

> [R]egardless of the underlying service agreement's terms, we do not follow *Granite* because the fault-based interpretation of this kind of additional insured endorsement no longer prevails. Instead, we interpret "with respect to operations" under a broader theory of causation. Generally, an event "respects" operations if there exists "a causal connection or relation" between the event and the operations; *we do not require proximate cause or legal causation . . . . The particular attribution of fault between insured and additional insured does not change the outcome*.

Id. at 666 (footnotes omitted, emphasis added). Turning back to the language of the endorsement before it, the *Exxon Mobil Corp.* court stated that Exxon's "additional-insured coverage was neither dependent on a finding that Wyatt was negligent nor excluded if Exxon's negligence were found to be the sole proximate cause of the workers' injuries." *Exxon Mobil Corp.*, 483 S.W.3d at 106.

The court then looked at the summary judgment evidence Exxon introduced in the coverage case supporting its motion and the trial court's order granting partial summary judgment in Exxon's favor. That evidence showed that Wyatt was tasked with reinstalling the dummy nozzle and that no one other than Wyatt had done the work. Exxon also produced evidence of an accident report showing where the chains had been attached, where the chains

should have been attached, and how much slack was created by the improper placement. The conclusion of the report was that but for the improper placement of the dummy nozzle chains, the accident would not have happened. Moreover, the Insurer had admitted in their reservations of rights letters that Wyatt had worked on the "flexicoker" unit. Base on this evidence, the court found that "Exxon was sued because of the work that Wyatt did" and concluded that "Exxon met its burden to establish that the claims against it fall within its additional-insured coverage 'with respect to liability arising out of' Wyatt's operations." *Id*. at 107.

Commentary:

The typical automatic additional insured endorsement provides additional insured status to any person or organization with whom the insured has agreed, in a "written contract," to add as an additional insured. Not surprisingly, that language requires the reader to look to the underlying written contract to determine whether the named insured on the policy agreed to provide additional insured coverage to a third party. However, that clause referencing the underlying contract to determine additional insured status does not automatically incorporate all the terms of the underlying contract into the policy. Cases like *In re Deepwater Horizon* and *Exxon Mobil Corp.* make clear that courts only will incorporate those parts of the underlying contract the policy requires. In *In re Deepwater Horizon*, the Court incorporated the limitations on liability found in the underlying contract because the language in the policy at issue specified "that additional-insured coverage is extended as 'obliged' and 'where required'" in an underlying contract. In other words, the policy required reference to the underlying contract for the scope of coverage. In contrast, the additional insured endorsement in *Exxon Mobil Corp.* did not have any language referencing the underlying contract with regard to scope of coverage. In short, these cases stand for the proposition that the reference to a written contract for deeming who is an additional insured is insufficient to incorporate other terms from the underlying contract and that a careful reading of the policy language is required to determine whether the policy incorporates other terms from the underlying contract, including scope of coverage. The latest ISO Additional Insured Endorsement—CG20 10 04 13—addresses head on the issue of whether limitations on scope of coverage are incorporated from an underlying contract. It states in relevant part: "If coverage provided to the additional insured is required by a contract or agreement, the insurance afforded to such additional insured will not be broader than that which you [the insured] are required by the contract or agreement to provide for such additional insured." In sum, the policy incorporates those parts of an underlying contract to which the policy refers, but only those parts; therefore, whether an underlying contract is incorporated and to what degree requires a careful reading of the endorsement.

The causation requirements in an additional insured endorsement can greatly impact the scope of coverage for the additional insured. The endorsement at issue in *Exxon Mobil Corp.* provided coverage "only with respect to liability arising out of [the named insured's] operations." The "arising out of" language is interpreted broadly as demonstrated by the holding in *Exxon Mobil Corp.* wherein additional insured coverage was provided even though the named insured was not negligent, so long as there was some causal connection between the named insured's work and the injury or damage. In short, then, the causation language in an additional insured endorsement necessarily impacts whether additional insured coverage is available.

III. *Evanston Insurance Co. v. Lapolla Industries, Inc.*, 634 F. App'x 439 (5th Cir. 2015)

At the end of 2015, the United States Court of Appeals for the Fifth Circuit found that no obligation to defend an insured existed under Texas law. *See Evanston Ins. Co. v. Lapolla Indus., Inc.*, 634 F. App'x 439 (5th Cir. 2015). The court found that the pollution exclusion in the policy before it applied and extrinsic evidence could not be utilized to create a duty to defend where one did not exist by application of the "eight corners" rule.

A. Background Facts

In April 2010, Michael and Kimberly Commaroto (the "Commarotos") were renovating their home. Their renovation contractors installed spray polyurethane foam ("SPF") insulation manufactured by Lapolla Industries, Inc. ("Lapolla"). The Commarotos and their houseguest, Gretchen Schlegel, were living in the part of the home not undergoing renovations. Shortly after the insulation was installed in a renovated room, the Commarotos "smelled odors and suffered respiratory distress, causing them to leave the home. Attempts to return triggered the same respiratory distress symptoms." *Id*. at 441. As a result, the Commarotos moved out of their home permanently and left their personal property behind. *See id*.

In April 2012, the plaintiffs sued the general contractor and various subcontractors for negligence and breach of contract in state court in Connecticut. In July 2012, the contractors filed an apportionment complaint and a third-party complaint against Lapolla, and in April 2013, the Commarotos and Schlegel also asserted a products-liability claim directly against Lapolla, alleging that it manufactured, sold, and marketed its SPF insulation in a defective and unreasonably dangerous manner. *See id.* at 441.

Evanston Insurance Company ("Evanston") issued to Lapolla three insurance policies, two commercial general liability ("CGL") policies and one excess liability policy. Under the terms of the policies, Evanston was obligated to defend and indemnify Lapolla against underlying suits seeking damages for bodily injury or property damage caused by Lapolla's products. The policies contained total pollution exclusions, excluding coverage for damages for bodily injury or property damage that "would not have occurred in whole or in part but for the actual, alleged or threatened discharge, dispersal, seepage, migration, release or escape of pollutants at any time." *Id*. The policies defined "pollutants" as "any solid, liquid, gaseous or thermal irritant or contaminant, including smoke, vapor, soot, fumes, acids, alkalis, chemicals, electromagnetic fields and waste." *Id*.

In 2013, Evanston filed a declaratory judgment action seeking a declaration that it had no duty to defend or indemnify Lapolla because of the policies' pollution exclusions. Lapolla answered and counterclaimed for a declaratory judgment that Evanston was obligated to defend and indemnify it in connection with the liability lawsuit. In April and May 2014, Evanston and Lapolla filed cross-motions for summary judgment and Evanston prevailed. *See id*. Lapolla then filed its appeal.

B. The "Eight Corners" Rule

Whether Evanston owed Lapolla a defense turned on the application of the "eight-corners rule," which "provides that when an insured is sued by a third party, the liability insurer is to determine its duty to defend solely from [the] terms of the policy and the pleadings of the third-

party claimant." *Id*. at 442 (citations omitted). Looking at the four corners of the policies and the four corners of the operative pleading, the court stated "Lapolla is entitled to coverage if it can demonstrate any covered, non-excluded claim asserted in the Commaroto complaint." *Id*.

Initially, Lapolla argued that the court should only look at the counts alleged against Lapolla and the factual background specifically incorporated into that count to determine the operative facts. The court rejected that argument as irrelevant because the there was no material difference between the totality of the facts alleged and the subset to which Lapolla argued the court should limit its inquiry. *Id*.

Having rejected Lapolla's argument, the court looked to the operative facts alleged in the Commarotos' pleading. The court quoted the operative facts as they were summarized by the district court as follows:

> The plaintiffs' operative pleading alleges that vapors from the SPF insulation caused their bodily injuries and property damage. According to the second amended complaint, the defendants "failed to seal off completely areas in which vapors could be transported from the areas under renovation and construction to the existing area[ ] of the house[,] in which the Commarotos, their three minor children, and their houseguest, Schlegel, were living and sleeping during the construction process."

Id. at 443 (quoting *Evanston Ins. Co. v. Lapolla Industries, Inc.*, 93 F.Supp.3d 606, 618 (S.D. Tex. 2015)). Reviewing these facts, the court held that "all of plaintiffs' injuries, both personal injury and property damage, were alleged to have been caused by 'pollution' as defined by the policies." *Id.* Accordingly, the court agreed with the district court's conclusions that the complaint fell under the pollution exclusion and that Evanston was entitled to final judgment declaring it owed neither a duty to defend nor duty to indemnify Lapolla. *Id*.

The court also rejected Lapolla's argument that there was a distinction between damages resulting from exposure to vapors and damages resulting from direct contact with the insulation. Lapolla argued that the allegation of exposure to the insulation "suggests harm from physical contact or the mere presence of the SPF." (citations omitted). The court rejected Lapolla's argument because the allegations were clear that the insulation was installed in an unoccupied portion of the home, vapors migrated to the occupied portion of the home, and the damages occurred in the occupied portion of the home after the vapors migrated there. *Id*. at 443–44.

Lapolla made two additional arguments for coverage. First, it argued that the Commarotos could allege the insulation negatively impacted the value of their home. The court rejected this argument because it "misses the point of the eight-corners rule," which requires the court to examine the pleading as it exists not as it may exist under other circumstances. *Id.* at 444. Second, Lapolla argued that the court should consider extrinsic evidence, in particular the deposition testimony of two plaintiffs who stated that they physically touched the insulation. Lapolla conceded that *Star–Tex Resources, L.L.C. v. Granite State Insurance Co.*, 553 F. App'x. 366 (5th Cir. 2014), controlled and that under *Star-Tex* the court may only look beyond the eight corners of the complaint and policy to extrinsic evidence "when it is initially impossible to

discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." The court rejected Lapolla's extrinsic evidence argument because the "Commaroto complaint entirely concerns damages from vapors and says nothing to suggest damages from physical contact with the spray foam insulation"; thus, because it was not initially impossible to discern whether coverage was potentially implicated, no exception to the "eight corners" rule could apply. *Id*. at 444–45.

Commentary:

The *Lapolla* decision reinforces the application of the "eight corners" rule in determining whether an insurer owes its insured a defense to a lawsuit. Courts look to the four corners of the live pleading and the four corners of the applicable policy. The limited exception to the "eight-corners" rule that has been followed primarily in federal courts in Texas only applies "when it is initially impossible to discern whether coverage is potentially implicated and when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case." It does not apply to permit the introduction of evidence that may support a covered claim in the event that non-coverage is discernible based on the alleged facts. In other words, the live pleading controls even if there may be extrinsic evidence of a covered claim. Importantly, though, the lack of a duty to defend does not mean that no duty to indemnify will ever exist, as those are distinct and separate duties owed to the insured.

IV. *U.S. Metals, Inc. v. Liberty Mutual Group, Inc.*, 490 S.W.3d 20 (Tex. 2015), *reh'g denied* (June 17, 2016).

On December 4, 2015, in *U.S. Metals, Inc. v. Liberty Mutual Insurance Corp.*, 490 S.W.3d 20 (Tex. 2015), *reh'g denied* (June 17, 2016), the Supreme Court of Texas (i) rejected the so-called "incorporation theory" and held that the mere installation of faulty materials into a larger whole does not cause "physical injury" to that larger whole and, therefore, does not cause "property damage"; but also (ii) held that otherwise unimpaired property destroyed during repair/replacement of the faulty materials may be covered "property damage" under a standard form commercial general liability ("CGL") policy.

A. Background Facts

Exxon Mobil Corporation ("Exxon") filed suit against U.S. Metals, Inc. ("U.S. Metals") in Texas state court, alleging that U.S. Metals agreed to manufacture standard, weld neck flanges meeting industry standards for installation in Exxon refineries. These flanges were irreversibly incorporated into the facilities by welding and bolting the flanges into insulated pipes of non-road diesel units at the refineries. Exxon discovered a leak in one of the installed flanges while conducting testing before putting the systems into operation. Exxon's subsequent investigation revealed that U.S. Metals had subcontracted to a third-party the manufacturing of the flanges, and that the flanges had been improperly manufactured, not meeting the contractually required industry standards. *Id.* at 21–22.

Exxon alleged that the only way to mitigate its damages and to avoid the risk of fire and explosion was to order new flanges from a different manufacturer and replace all the flanges supplied by U.S. Metals. Replacement of the flanges involved stripping the temperature coating and insulation (which were destroyed in the process), cutting the flange out of the pipe, removing the gaskets (which also were destroyed in the process), grinding the pipe surfaces smooth for re-welding, replacing the flange and gaskets, welding the new flange to the pipes, and replacing the temperature coating and insulation. The replacement process required portions of the refineries to be shut down for several weeks, resulting in the loss of use of the refineries. *Id.* at 22.

In June 2011, Exxon sued U.S. Metals seeking damages for the costs associated with investigating the flange defect, acquiring replacement flanges, removing and replacing the defective flanges, and the resulting loss of use of Exxon's property, and incidental and consequential damages. Exxon alleged the replacement damages were $6,345,824 and the loss of use damages were $16,656,000. In August 2011, Exxon and U.S. Metals reached a settlement for $2.2 million. *Id.*

U.S. Metals then claimed indemnification from its CGL insurer, Liberty, for the amount paid. U.S. Metals claimed coverage with Liberty based on a policy providing coverage for "bodily injury" and "property damage" (the "Policy"). Liberty denied U.S. Metals' request based on the "your product" and "impaired property" exclusions in the Policy. *Id.* at 22–23.

B. The Certified Questions

U.S. Metals sued Liberty on December 8, 2011, in Texas state court, and the case ultimately was removed to federal district court. U.S. Metals' First Amended Complaint alleged, among other causes of action, breach of contract regarding Liberty's duty to defend and indemnify. Liberty filed a motion for summary judgment and U.S. Metals filed an amended partial motion for summary judgment on the issue of liability. The district court granted Liberty's motions and denied U.S. Metals' motions. After U.S. Metals appealed, the Fifth Circuit certified the following four questions to the Supreme Court of Texas:

1. In the "your product" and "impaired property" exclusions, are the terms "physical injury" and/or "replacement" ambiguous?
2. If yes as to either, are the aforementioned interpretations offered by the insured reasonable and thus, must be applied pursuant to Texas law?
3. If the above question 1 is answered in the negative as to "physical injury," does "physical injury" occur to the third party's product that is irreversibly attached to the insured's product at the moment of incorporation of the insured's defective product or does "physical injury" only occur to the third party's product when there is an alteration in the color, shape, or appearance of the third party's product due to the insured's defective product that is irreversibly attached?
4. If the above question 1 is answered in the negative as to "replacement," does "replacement" of the insured's defective product irreversibly attached to a third party's product include the removal or destruction of the third party's product?

Id. at 23.

C. The Court's Analysis

The Supreme Court of Texas stated that these four questions boiled down to two issues. "One is whether property is physically injured merely by installing a defective product into it. . . . The other issue is whether replacing the flanges restored the refinery property to use when some of the property was destroyed in the process." *Id.* at 21.

The Court began its analysis by reviewing the "convoluted provisions of the standard form CGL policy." *Id.* at 22. In particular, the Court set out the terms of the insuring agreement; the definitions of "property damage," "your product" and "impaired property;" and the exclusions upon which Liberty relied—the "your product" and "impaired property" exclusions.

The Court then looked at what constitutes "physical injury." The Court discussed the plain meaning of "physical" and "injury," and the Court then reviewed a pair of cases that "explored" the meaning of "physical injury" under Illinois law. According to the Court, "the salient point to be drawn from *Eljer II* [out of Illinois] is that physical injury, for purposes of the same CGL policy provision at issue here, resulted not from the mere installation but from the leak. Leaks from U.S. Metals' flanges never caused injury because ExxonMobil replaced them to avoid any risk of injury." The Court agreed with the Supreme Court of Illinois and the vast majority of courts that have read the standard form CGL policy to mean "that physical injury requires tangible, manifest harm and does not result merely upon the installation of a defective component in a product or system." The Court recognized that its rejection of the incorporation theory results in a "perverse aspect" insofar as there is no coverage for a diligent and responsible insured that repairs defective work whereas there may be coverage for the negligent or reckless insured that allows the flanges to explode injuring people and property. Nonetheless, the Court concluded that the text of the policy was clear and that its role is "to determine not what coverage should be available but what the CGL policy here provided." As such, the Court held that there was no physical injury "merely by the installation of U.S. Metals' faulty flanges." In doing so, the Court rejected the so-called "incorporation theory" and any life/safety exception to the "physical injury" requirement of the definition of "property damage." *Id.* at 24–27.

Having concluded that there was no physical injury as a result of the installation of the faulty flanges, the Court then held that there was physical injury as a result of replacing the faulty flanges. The faulty flanges could not be easily removed and replaced with new flanges. "Because the flanges were welded to pipes rather than being screwed on, the faulty flanges had to be cut out, pipe edges resurfaced, and new flanges welded in. The original welds, coating, insulation, and gaskets were destroyed in the process and had to be replaced. The fix necessitated injury to tangible property, and the injury was unquestionably physical." *Id.* at 28. In other words, the Court held that physical damage caused by the repair of merely defective work constitutes "property damage" under the terms of the CGL policy. Having found "property damage" caused by the repair, the Court then had to turn to the two exclusions raised by Liberty Mutual. *Id.*

With respect to the "your product" exclusion, the Court noted that the defective flanges were unquestionably U.S. Metals' product and, thus, there was no coverage for the flanges

themselves. That, however, did not end the inquiry as the replacement of the flanges caused physical damage beyond the flanges. At least implicitly, the Court held that the "your product" exclusion is limited to the defective product itself. *Id.* at 22.

Next, the Court turned to the ever-so-clear "impaired property" exclusion. U.S. Metals argued that the repairs involved much more than simply replacing the flanges, and as such, the refineries were not "impaired property"—property that could be "restored to use by the . . . replacement" of the faulty flanges. The Court rejected that argument, finding that replacing the faulty flanges is exactly what was required to restore the use of the refineries, and the policy made no distinction between an easy fix and a difficult one. The Court explained as follows:

> The diesel units were restored to use by replacing the flanges and were therefore impaired property to which Exclusion M [i.e., the "impaired property" exclusion] applies. Thus, there loss of use is not covered by the policy. But the insulation and gaskets destroyed in the process were not restored to use; they were replaced. They were therefore not impaired property to which Exclusion M applied, and the cost of replacing them was therefore covered by the policy.

Id. at 28.

In sum, the faulty flanges did not create physical injury merely by being incorporated into the final project. Further, the loss of use of the refineries during the course of replacing the faulty flanges also was not covered because the refineries were "impaired property" subject to the "impaired property" exclusion. However, the gaskets and insulation that were destroyed during the process of cutting out the faulty and otherwise non-covered flanges suffered "property damage" that was covered by the policy.

Turning to four certified questions, the Court found that the terms "physical injury" and "replacement" are not ambiguous. The second question did not require an answer because it was conditioned on a "yes" answer to the first question. Further, the incorporation theory and the mere installation of faulty flanges into a larger project is not a "physical injury" and, therefore, not "property damage." With regard to the fourth question, the answer was a convoluted "it depends." *Id.* at 29.

Commentary:

The Court's rejection of the "incorporation theory" is not surprising as the vast majority of courts across the country have done so. Likewise, it is not at all surprising that the Court concluded that the terms "physical injury" and "replacement" are not ambiguous. That being said, the "impaired property" exclusion as a whole is utterly confusing.

The "rip and tear" ruling, however, is a potentially monumental sea-change in insurance coverage law in Texas. While some commentators thought the Court would find "physical injury" by way of the incorporation doctrine in situations where life/safety issues exist, the Court was not willing to rewrite the "convoluted" CGL policy—the Court's words, not ours—to achieve that result. Nevertheless, the Court did find that the repair of *uncovered* defective work could cause *covered* "property damage." In doing so, Texas arguably joins only a handful of other courts that have done so (see footnote 26 of the Court's opinion).

Further, while some will argue that the Court's holding simply follows from its prior ruling in *Lennar Corp. v. Markel American Insurance Co.*, 413 S.W.3d 750 (Tex. 2013), the two cases are different. In *Lennar Corp*, the Supreme Court of Texas found coverage for removing defective EIFS and replacing it with traditional stucco. The Court, in that case, found that the cost to remove the EIFS and replace it with traditional stucco was damage *because of* "property damage" because the defective EIFS had caused covered water damage to the homes. Here, on the other hand, the defective flanges had not caused any resulting damage upon installation. Rather, the only physical damage occurred during the replacement of the defective flanges themselves. Accordingly, if anything, the *U.S. Metals* decision is an expansion of *Lennar Corp.* and a good one at that—at least for policyholders.

Notably, on remand to the Southern District of Texas, Liberty filed a motion for partial summary judgment on October 3, 2016. In its motion, Liberty contends that the potentially recoverable amount of damages is limited to the costs to replace / repair the gaskets and insulation. A ruling in that regard, Liberty argues, "can narrow the discovery that is necessary in order to answer the ultimate question to be submitted to the jury on the amount of the covered damages under the policy." *See U.S. Metals, Inc. v. Liberty Mut. Group, Inc.*, No. 4:12-cv-00379 (S.D. Tex. Oct. 3, 2016) (Def.'s Mtn. for Partial Summ. J.). Additionally, Liberty contends that it is entitled to summary judgment on any extra-contractual claims made by U.S. Metals, as there clearly was a bona fide dispute as to coverage, barring any such recovery. *Id.* Finally, Liberty seeks a ruling that it has paid all defense costs, interest and penalties under the Prompt Payment of Claims Act, rendering U.S. Metals' claims for such damages moot. *Id.*

U.S. Metals filed a cross-motion for summary judgment on October 12, 2016. In its motion, U.S. Metals argued that the "law of the case" established that Liberty breached its insurance contract, as the case was now one about allocation and a trial of the insurer's alleged violations of the Texas Insurance Code. *See U.S. Metals, Inc. v. Liberty Mut. Group, Inc.*, No. 4:12-cv-00379 (S.D. Tex. Oct. 12, 2016) (Pltf.'s Mtn. for Partial Summ. J.). The parties' motions have been fully briefed and the issues remain pending before Judge Gilmore.

In the meantime, on June 17, 2016, the same day that the Court denied a pending motion for rehearing, the Eastern District of Texas was the first court to address the Supreme Court's holdings in *U.S. Metals*. *See Vinings Ins. Co. v. Byrdson Servs., LLC*, No. 1:14-CV-525, 2016 WL 3584715 (E.D. Tex. June 17, 2016). In that case, the issue was whether the laying of a concrete slab such that it had cold spots or joints was a claim for "property damage." *Id.* at *5. The insurer argued that a cold joint is not physical injury to tangible property but is simply a "poor bond between two pours of concrete." *Id.* Further, citing to *U.S. Metals*, the insurer argued that "physical injury" within a CGL policy requires "tangible, manifest harm and does not result merely upon the installation of a defective component in a product or system." *Id.* The court, however, rejected that interpretation and turned, instead, to the second prong of the definition of "property damage" that applies to the "loss of use of tangible property that is not physically injured." *Id.* at *6. Resolving all doubts in favor of the insured, as required by Texas law, the court found that the allegations of loss of use were sufficient to constitute "property damage" even if there was not "physical injury." *Id.* Nevertheless, the court still ruled in favor of Vinings, as it pointed to other language in the policies that specifically excluded coverage for "property damage" arising from Byrdson's work on the property. In that regard, the court addressed exclusions j.(5) and j.(6), which negated coverage for:

> "'Property damage' to . . . [t]hat particular part of real property on which you or any contractors or subcontractors working directly on your behalf are performing operations, if the 'property damage' arises out of those operations; or [t]hat particular part of any property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it."

Id. As the definition of "your work" included the operations performed by Byrdson—*i.e.*, the reconstruction of the residence—and because that work included the problematic slab that caused the need for Byrdson to tear down construction work that already had been complete and, therefore, displaced the homeowner from his residence, the court found that they fell squarely within the exclusions cited above. *Id.* Put differently, the "loss of use" damage was "property damage" to the particular part of the work being performed by Byrdson—the reconstruction of the home—and, therefore, the exclusions applied to negate coverage for the "rip and tear" damages associated with tearing out completed work in order to fix the defective concrete slab. Although the court made no mention of the "rip and tear" coverage allowed in *U.S. Metals*, a distinction between the two cases appears to exist in that this case involves a general contractor and, therefore, all the work is the general contractor's work. In *U.S. Metals*, on the other hand, the work that was damaged and had to be replaced in order to replace the defective flanges was work of others and, therefore, arguably would not have fallen within the scope of exclusions j.(5) and j.(6).

V. *TIC Energy and Chemical, Inc. v. Martin*, 498 S.W.3d 68 (Tex. 2016)

On June 3, 2016, the Supreme Court of Texas decided *TIC Energy and Chemical, Inc. v. Martin*, 498 S.W.3d 68 (Tex. 2016), which addressed the issue of the applicability of the "exclusive remedy" defense in the context of workers' compensation insurance within an owner-controlled insurance program ("OCIP"). Finding that the subcontractor at issue was entitled to the exclusive remedy defense, the Court held that the claimant's claim for recovery against the subcontractor was barred.

A. Background Facts

Dow Chemical Company secured the OCIP for the project, and one of its subsidiary's (Union Carbide) employees, Martin, was injured and ultimately lost his leg while working on the project. He collected workers' compensation benefits as a Union Carbide employee through the OCIP. Despite that recovery, he sued another subcontractor on the project, TIC Energy and Chemical, alleging that the company's employees negligently caused his injury. *Id.* at 70.

TIC filed a motion for summary judgment, claiming that the exclusive remedy defense applied to bar Martin's claim. TIC argued that it was Martin's deemed fellow employee under § 406.123 of the Texas Labor Code, "which deems a general contractor the statutory employer of a subcontractor and its employees when the general contractor agrees in writing to provide workers' compensation insurance to the subcontractor." *Id.* In support of its argument, TIC produced a copy of a contract with Union Carbide in which workers' compensation coverage was extended under the OCIP to TIC and its employees, with the cost of that coverage excluded from TIC's bid. *Id.*

In response, Martin claimed that the defense did not apply because TIC was an independent contractor. Under § 406.122(b) of the Labor Code, then, the subcontractor and its employees are not employees of the general contractor. *Id.* Effectively, Martin's positon was that § 406.122(b) was an exception to the application of § 406.123 even though it preceded it in the statutes. *Id.* at 71.

The trial court denied TIC's summary judgment motion but authorized an interlocutory appeal. The court of appeals found that the two statutes "irreconcilably conflict" because one states that the general contractor is the "employer" of the subcontractor for purposes of workers' compensation, but the other is clear that the subcontractor is *not* the employee of the general contractor for such purposes. *Id.* Although it did not address the conflict in detail, the court of appeals affirmed the order denying TIC's motion on the basis that it had not established its affirmative defense because it failed to negate the applicability of § 406.122(b).

B. The Court's Analysis

After discussing the layout of the statutes of the workers' compensation act, the Court noted that the question before it is "the extent to which statutory benefits and protections afforded to a subscribing general contractor and its employees may be shared with subcontractors and their employees." *Id.* at 73. The court harkened back to its decision in *HCBeck, Ltd. v. Rice* in which the Court explained that a "general contractor who has, pursuant to a written agreement, purchased a workers' compensation insurance policy covering its subcontractors and its subcontractors' employees . . . becomes the statutory employer of its subcontractor's employees, and is thus entitled to the benefits conferred on employers by the Act." *Id.* at 74 (quoting *HCBeck*, 284 S.W.3d 349, 354 (Tex. 2009)). Further, because a contractor can "provide" insurance to others even when it has not purchased it directly, "multiple tiers of subcontractors [thereby] qualify as employers entitled to the exclusive-remedy defense." *Id.* (quoting *HCBeck*, 284 S.W.3d at 359). The Court also explained that construing the statuates to provide blanket coverage to all workers on a job site accords with legislative intent and the Texas Legislature's "decided bias for coverage." *Id.* (quoting *HCBeck*, 284 S.W.3d at 358–59).

Turning to the facts before it, the Court acknowledged the following: (1) Union Carbide and TIC had an agreement that complied with § 406.123; and (2) TIC does not dispute that it Union Carbide's independent contractor under an agreement that also met the criteria in § 406.122(b). Thus, the sole disputed matter was the legal effect when the agreement in question meets both statutes. *Id.*

The Court explained that TIC's position was that § 406.122 was the general rule to which § 406.123 provided a permissive exception. *Id.* at 75. In support of its position, TIC urged that its reading was in line with legislative intent "because reading section 406.123 as an exception to the exclusion in section 406.122(b) results in comprehensive coverage of workers at a single site in pursuit of a common objective and, therefore, extends the Workers' Compensation Act's benefits and protections both vertically and horizontally among multiple tiers of contractors that may be working side-by-side at a job site." *Id.* It also was consistent with the Court's observation that an employee can have more than one employer entitled to the exclusive remedy defense. *Id.* And, looking to the statutory structure, having the general rule stated before its exceptions is logical. In fact, the Court found that "the only plausible reading of the statute is that section

406.122 states a general rule of employment status for workers' compensation purposes and section 406.123 deviates from that rule by creating the fiction of another." *Id.* at 76.

While Martin insisted that the opposite was true and made several arguments (along with amicus curiae) to support a construction of the statutes where § 406.122(b) is the exception to § 406.123, the Court found none of them "compelling enough to overcome the natural and logical reading of the statute" advocated by TIC, "which is consistent with the subchapter's structure, section 406.123's purpose, and our precedent." *Id.* By way of example only, Martin's interpretation would only allow lower-tier subcontractors' employees the right to prompt payment of their claims, but not protection from personal-injury claims brought by co-employees. *Id.* Boiled down, Martin's interpretation would mean that lower-tier subcontractors would not be "employees" but the defense is one that bars only claims by an "employee" against an "employer," and, therefore, none of the higher-tier contractors would be able to claim the defense. *Id.* That would be contrary to the holding in *HCBeck*, and run counter to the reciprocal benefit scheme of the Workers' Compensation Act and defy logic. *Id.* For those reasons and others, the Court rejected Martin's arguments and rendered judgment in favor of TIC on its affirmative defense of exclusive remedy.

Commentary:

Following the decision in *HCBeck*, the Court's decision in *TIC* is not necessarily surprising. Importantly, though, it further clarifies the Court's interpretation of the Workers' Compensation Act and reinforces the most important aspect of that Act, which is to provide coverage to as many employees as possible, while also extending benefits to the contractors that provide such coverage. Moreover, it clarified that the inclusion of workers' compensation insurance in an OCIP or CCIP will enable all the participants to receive the benefit of the "exclusive remedy" defense. Before the Supreme Court even decided the case, the same result was applied in two similar cases in Austin and Beaumont. *See Kershner v. Samsung Austin Semiconductor LLC*, No. 03-15-00529-CV, 2016 WL 3974783 (Tex. App.—Austin July 22, 2016, no pet.) (finding that § 406.122(a) did not supersede § 406.123, as such an argument was contrary to the plain language of the statute); *Palmer v. Newtron Beaumont, LLC*, No. 09-15-00248-CV, 2016 WL 637926 (Tex. App.—Beaumont Feb. 18, 2016, pet. denied) (rejecting the claimant's reliance on the court of appeals' decision in *TIC* that ultimately was reversed by the Supreme Court, finding that it did not follow the rules of statutory construction).

VI. *Patton v. Mid-Continent Casualty Co.*, No. H-15-1371, 2016 WL 3900799 (S.D. Tex. July 19, 2016)

In July of 2016, the Southern District of Texas had the occasion to review a coverage dispute regarding the "Your Work" exclusion found in standard CGL policies. *See Patton v. Mid-Continent Casualty Co.*, No. H-15-1371, 2016 WL 3900799 (S.D. Tex. July 19, 2016). In finding that no duty to indemnify existed, the court adopted the magistrate judge's report and recommendation in full.

A. Background Facts

Black Diamond Builders, L.L.P. ("Black Diamond") was the builder or general contractor of Grier and Camille Patton's (the "Pattons") house. *See id*. at *2. The Pattons also constructed a swimming pool using an independent third-party contractor, who apparently was sued in a separate proceeding. The Pattons initiated arbitration against Black Diamond, alleging "their house was damaged due to significant differential movement of the foundation of the house." On October 21, 2014, the arbitrator found "that both design and construction errors led to the damage to the residence and that Black Diamond's 'failure to build the house slab/foundation to the elevation shown on the plans' prevented drainage away from the structure." *Id*. Moreover, the arbitrator's award was "for damages to the residence caused by foundation issues and that those responsible for the pool were not part of the arbitration." Upon obtaining the arbitration award and not being able to collect against Black Diamond, the Pattons filed suit in Texas state court to confirm and enforce the arbitration award. The court entered a judgment affirming the award, then issued a turnover order and appointed a receiver to collect on Black Diamond's assets, in particular its insurance policies issued by Mid-Continent Casualty Company ("Mid-Continent"). *Id*. at *2–*3.

Mid-Continent issued four consecutive commercial general liability policies to Black Diamond beginning July 7, 2004. Mid-Continent disclaimed liability and refused to pay. The Pattons and the receiver sued Mid-Continent in state court, Mid-Continent removed the case to federal court, and the federal district court referred the case to a magistrate judge for pretrial matters. Mid-Continent filed a motion for judgment on the pleadings and the magistrate judge recommended that the motion be granted in its entirety. Adopting the recommendation in full, the district court agreed. *See id*. at *1.

B. The "Your Work" Exclusion

Mid-Continent argued that the "Your Work" exclusion applied to negate coverage for the arbitration award against Black Diamond. The policy contained CG 22 94 10 01—the "Exclusion – Damage to Work Performed By Subcontractors on Your Behalf Endorsement"—that replaces the "Your Work" exclusion found in standard-form CGL policies. By its terms, the endorsement removes the subcontractor exception found in the standard "Your Work" exclusion, barring coverage for " 'property damage to 'your work' arising out of it and included in the 'products-completed operations hazard.'" Notably, "your work" was defined, in part, to mean "work or operations performed by [Black Diamond] or on [Black Diamond's] behalf." *Id*. at *1–*2.

The court, having reviewed the terms of the policy, looked at the arbitrator's award to determine coverage. The arbitrator acknowledged that Black Diamond's "actions seriously affected the work of other contractors on the project (including both subcontractors of [Black Diamond], and the separate contractors hired by the [Pattons])." However, the arbitrator did not discuss any damages to the pool, instead discussing only lifting of the house and damages to the home. The arbitrator did not determine the damages associated with the pool and specifically stated that those damages were being litigated in a separate proceeding, making it clear that "the award was for the damage to the house only." Because the construction of the pool was the only "work" that fell outside the scope of Black Diamond's work and those damages were not included in the award, the "Your Work" exclusion applied. *See id*. at *4. Moreover, because of

the removal of the subcontractor exception to the exclusion, the fact that Black Diamond utilized subcontractors to perform the work in question did not reinstate coverage for the damages at issue.

Commentary:

The court's reasoning in *Patton* appears to be sound and highlights the importance of the development of thorough facts and findings in litigation of construction defect claims. The court analyzed the arbitrator's factual findings in the arbitration award, focusing its inquiry entirely on whether Mid-Continent owed a duty to indemnify Black Diamond for the arbitration award. With regard to the court's holding, the court correctly concluded that the addition of CG 22 94 10 01 to the policy resulted in no coverage for the claim. Had the policy not contained the endorsement and, instead, contained only the standard "Your Work" exclusion with the subcontractor exception, the policy may have provided coverage. Further, had the arbitration award addressed any damages that existed on the property that exceeded the scope of Black Diamond's work, the lack of a "subcontractor exception" would have been irrelevant and coverage would have existed—at least in part.

VII. *Coreslab Structures (Texas), Inc. v. Scottsdale Insurance Co.*, 496 S.W.3d 884 (Tex. App.—Houston [14th Dist.] 2016, no pet.)

The Fourteenth Court of Appeals in Houston issued an opinion in late July addressing an insured's ability to recover defense costs from its subcontractor's insurer despite payment of those defense costs by its own insurer. *See Coreslab Structures (Texas), Inc. v. Scottsdale Ins. Co.*, 496 S.W.3d 884 (Tex. App.—Houston [14th Dist.] 2016, no pet.). Because the insured's defense costs had been paid in full, the so-called "*Mid-Continent* Rule" applied to bar Coreslab's claim.

A. Background Facts

Memorial Hermann Tower, owned by Memorial Hermann Hospital System ("Memorial") suffered water damage during two separate rain storms, giving rise to two lawsuits which were consolidated ("Underlying Lawsuit"). Memorial sued Coreslab Structures (Texas), Inc. ("Coreslab") and its subcontractor, CN Construction, Inc. ("CN Construction"). Coreslab tendered the defense of the lawsuit to CN Construction and sought additional insured coverage under CN Construction's commercial general liability insurance policy issued by Scottsdale Insurance Company ("Scottsdale"). Scottsdale denied that additional-insured coverage existed for Coreslab. Lexington Insurance Company ("Lexington"), Coreslab's commercial general liability carrier, defended Coreslab and paid $825,642.32 in attorneys' fees and defense costs. *See id*. at 885.

Coreslab filed a third-party petition in the Underlying Lawsuits against Scottsdale, claiming that the Scottsdale policy provided additional-insured coverage to Coreslab, but Lexington was not included as a party with its insured. In addition to seeking a declaration regarding coverage, Coreslab also asserted claims for breach of contract, statutory bad-faith under the Texas Insurance Code, and violations of the Prompt Payment of Claims Act. The Underlying Lawsuits settled, the court severed Coreslab's claims against Scottsdale into a new

lawsuit (the "Coverage Lawsuit"), and the trial court granted Coreslab's partial motion for summary judgment holding that Scottsdale owed Coreslab a duty to defend the Underlying Lawsuits. As a result, Scottsdale paid a total of at least $409,509.53 to Coreslab's defense counsel or to Lexington. Coreslab agreed that Scottsdale was entitled to a credit for the amount it paid but argued that Scottsdale was required to pay the total amount of $882,909.92 that it had incurred for defense costs (and of which Lexington actually paid $825,642.32). There was no evidence that Coreslab paid any defense costs out of its own pocket. Nevertheless, Coreslab wanted Scottsdale to pay the full defense "to avoid a negative impact on Coreslab's 'loss history.'" *See id*. at 885–86, 888.

B. The "*Mid-Continent* Rule" Applies to Prevent Recovery

The court first expressed what it called the "*Mid-Continent* Rule," stating that "under Texas law, after an insured has recovered the full amount of its loss as a result of payments from two insurers under two different policies, the insured may not recover from one insurer under its policy based on the insurer's alleged failure to pay its appropriate share of the loss." *Id*. at 889 (citing *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 775 (Tex. 2007)). Thus, even if one insurer paid too much or the other paid too little, once the full amount of the defense has been paid, the insured has no right of recovery against the insurer that paid too little. The court acknowledged, however, that the insurer that paid too much in defense costs may have a right to recover its overpayment, but the insured does not. *See id*.

Coreslab further argued that it could recover from Scottsdale because, under Texas law, it was entitled to a "complete defense" rather than a "pro rata" defense. The court recognized the Texas cases cited by Coreslab stand for the proposition that if a petition or complaint contains both covered and uncovered claims, the insurer owes a complete defense. Those cases and that rule, however, do not "hold that an insured may recover against an insurer for failure to pay defense costs after one or more insurers whose policies provide coverage pay all the defense costs." *Id*. at 890 (citations omitted). The court noted two additional reasons for denying Coreslab's arguments. First, Coreslab did not present any summary judgment evidence about its "loss history" or whether Lexington's payment of all or part of the defense costs would impact Coreslab's future insurance premiums. Thus, Coreslab presented no evidence to support its primary argument for recovery. Second, Coreslab suggested it would forward any recovery it obtained from Scottsdale to Lexington; however, the court remarked, a "normal money judgment . . . would not require Coreslab to forward any such amounts to Lexington." *Id.* Regardless, even if such a judgment could be crafted that would force Coreslab to forward its recovery to Lexington, the court held that as a matter of law that Coreslab was not entitled to recover damages from Scottsdale based on that insurer's failure to pay the full amount of Coreslab's defense costs in the Underlying Lawsuits because the total amount paid by Lexington and Scottsdale exceeded the sum of Coreslab's defense costs. *See id*.

Commentary:

The *Coreslab* court dubbed the decisional rule in the case the "*Mid-Continent* Rule" but did not expressly discuss one of the fundamental bases for the holding in that case. In that regard, the court did not discuss in any depth that its holding prevented the possibility of Coreslab obtaining a double recovery, although the court alluded to the prevention of possible double

recovery in its discussion regarding the trial court's potential difficulty in fashioning a judgment forcing Coreslab to forward any payment from Scottsdale to Lexington.

Additionally, the court discussed Coreslab's failure to introduce summary judgment evidence regarding loss history and possible future premium increases; however, no explanation existed of how producing such evidence would have impacted the application of the "*Mid-Continent* Rule" or the reasoning supporting it. Evidence of loss history and possible future premium increases would not resolve the problem of Coreslab potentially obtaining a double recovery, nor would that evidence modify the contractual obligations in the policies. Accordingly, it is not entirely clear what would happen in a similar case if the insured could produce summary judgment evidence of it loss history and possible future premium increases. Simply put, where an insurer has paid an insured's defense costs in full, that insured simply has no further cause of action against any other insurer for those same defense costs under the "*Mid-Continent* Rule." No amount of evidence on loss history or potential premium increases should affect that analysis.

VIII. *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-15-00230-CV, 2016 WL 4486656 (Tex. App.—Dallas Aug. 25, 2016, pet. filed)

In August 2016, the Dallas Court of Appeals decided the second appeal in *Great American Lloyds Insurance Co. v. Vines-Herrin Custom Homes, L.L.C.*, No. 05-15-00230-CV, 2016 WL 4486656 (Tex. App.—Dallas Aug. 25, 2016, pet. filed). Having already determined that a duty to defend was owed by two insurers, the appeal after remand addressed the trial court's finding that the insurers were jointly and severally liable for the defense costs incurred in the underlying arbitration, the full amount of the arbitration award and the attorneys' fees the insured incurred in prosecuting the coverage litigation. This time around, the appellate court reversed the trial court's judgment and remanded for further proceedings.

A. Background Facts

In 1998 or 1999, Vines-Herrin Custom Homes, L.L.C., Herrin-Custom Homes, Inc. ("Vines-Herrin") built a residence in Plano, Texas, and, in May 2000, it sold that residence to Emil Cerullo ("Cerullo"). Almost immediately, Cerullo began noticing problems with the house, including "water not draining from the courtyard, doors not closing properly, damages to sheetrock and baseboards, cracks in the ceiling, a window sinking into the frame, and finally, in 2002, the roof and the ceiling began to sag." *Id*. at *1.

In January 2003, Cerullo sued Vines-Herrin alleging that various construction defects caused damage. Vines-Herrin demanded Great American Lloyds Insurance Company ("Great American") and Mid-Continent Casualty Company ("Mid-Continent") (collectively the "Insurers") defend the lawsuit under the terms of the commercial general liability policies they issued between 1998 and 2002. Great American issued the first two policies, which together covered Vines-Herrin from November 9, 1998 to November 9, 2000. Mid-Continent issued the second two policies, which overlapped briefly, but covered Vines-Herrin from November 9, 2000 through September 18, 2002. The Insurers both denied there was any coverage and refused to defend Vines-Herrin. Vines-Herrin then sued the Insurers seeking a declaration that they owed it a duty to defend and a duty to indemnify under the policies. *See id*. at *1–*2.

During the pendency of Cerullo's suit, Vines-Herrin repeatedly requested the Insurers provide it a defense, and they refused. In 2006, in order to avoid a costly jury trial, Vines-Herrin and Cerullo agreed to arbitrate the dispute. Before entering into the agreement, Vines-Herrin attempted to obtain the Insurers' input. They took no position and again denied coverage. Vines-Herrin notified the Insurers of the arbitration hearing and invited them to attend, but they did not.

The arbitrator held an evidentiary hearing, found in favor of Cerullo, and awarded him more than $2.4 million in damages. "After the arbitrator entered its award, Cerullo and Vines-Herrin entered into a settlement agreement in which Cerullo agreed not to confirm the arbitration award in exchange for an assignment of Vines-Herrin's claims against the Insurers." *Id.* Cerullo then intervened in the declaratory judgment action filed by Vines-Herrin against the Insurers. *See id*.

The coverage court held a bench trial, at which the arbitrator, Russell Bowman, testified that the arbitration hearing was adversarial and was based on Cerullo's allegations that the house contained construction defects requiring numerous repairs. Bowman further testified that Cerullo's "major complaints concerned the roof structure, which was collapsing, moisture entering the house due to stucco not being properly installed, windows not being properly installed, and foundation problems." *Id.* Cerullo testified that he noticed problems with the house in May 2000, within a week of moving in. *See id*.

The trial court rendered judgment against the Insurers and in favor of Vines-Herrin. While post-judgment motions were pending, however, the Supreme Court of Texas decided *Don's Building Supply Inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20 (Tex. 2008), adopting the "actual injury rule" for determining when "property damage" occurs under a commercial general liability policy. The trial court concluded that Vines-Herrin's evidence was insufficient to trigger a particular policy and, therefore, set aside its judgment; however, the trial court allowed Vines-Herrin to reopen the evidence to show when Cerullo's damages occurred. The trial court, however, believed the lay testimony of Cerullo on that issue was insufficient because it interpreted *Don's Building* as "requiring expert testimony on causation and evidence of the exact date property was physically injured." *Vines-Herrin*, 2016 WL 4486656 at *2. The trial court also concluded that the Insurers did not owe Vines-Herrin a duty to defend because Cerullo's petition failed to allege the exact dates of a physical injury. Thus, the court rendered judgment that Vines-Herrin take-nothing. *Id.*

Vines-Herrin appealed and the court of appeals reversed. *See Vines–Herrin Custom Homes, LLC v. Great Am. Lloyds Ins. Co*., 357 S.W.3d 166, 174 (Tex. App.—Dallas 2011, pet. denied) ("*Vines-Herrin I*"). In that first appeal, the court of appeals held that the Insurers owed Vines-Herrin a duty to defend because Cerullo's petition in the underlying liability lawsuit alleged property damage that potentially occurred during both Great American's and Mid-Continent's policy periods. The court of appeals further rejected the trial court's conclusion that Vines-Herrin was required to show the exact date of physical injury in order to trigger the duty to indemnify. Instead, Vines-Herrin was required to show only that damages occurred during the Insurers' policy period or periods. The court of appeals found that property damage occurred during at least one of Great American's policy periods, and, thus, that insurer owed Vines-Herrin indemnification. As a result, the matter was remanded to the trial court for further proceedings. *See Vines-Herrin*, 2016 WL 4486656 at *3.

On remand, the trial court reversed its previous decision and entered judgment in favor of Vines-Herrin against both Great American and Mid-Continent, jointly and severally, for the entire arbitration award. In its findings of fact and conclusions of law, the trial court found that the arbitrator's award represented actual damages and that Cerullo had "noticed" property damages during three policy periods at issue, the second Great American policy and both of Mid-Continent's policies. "The trial court found that Vines-Herrin was not required to allocate the damages that occurred during the respective policy periods because all of the damages were covered under one of the policies." *Id.*

B. Occurrence of Property Damage

In this second appeal, the Insurers argued that Vines-Herrin failed to sufficiently show property damage occurred during the applicable policy periods as required by the insuring agreements in the commercial general liability policies. Noting that it already determined in the first appeal that an occurrence caused damage within Great American's policy period, and that the Supreme Court of Texas had rejected an appeal from that prior opinion and order, the court of appeals' prior rulings regarding Great American were the "law of the case." Nonetheless, the court of appeals reviewed the issue again because the Insurers claimed that no finding of fact was made by the trial court on which the court of appeals had based its prior ruling. The trial court found that property damage "stemmed 'at least in part' from defective framing" and from "defective plumbing." Moreover, Cerullo noticed the property damage shortly after moving into the house. Great American covered the time period when the home was constructed until after Cerullo first noticed the damages. The court explained: "Great American provided coverage to Vines-Herring during the entire period the house was constructed until the time damages first manifested. As [a] consequence, 'actual damages must have occurred during the coverage provided by Great American.' Therefore, as this Court has already held, Great American owed Vines-Herrin a duty to indemnify." *Id*. at *5 (citations omitted).

With regard to Mid-Continent, the court of appeals noted that the trial court found that "Cerullo noticed property damages during both of Mid-Continent's policy periods and also that the property damages occurred during those policy periods." *Id.* at *6. Cerullo specifically testified regarding when he noticed various damages. The Insurers argued that such testimony and findings by the trial court could only mean that it applied the "manifestation rule" rejected in *Don's Building*. The court of appeals rejected that argument, recognizing that when damages are visible, the actual injury rule and the manifestation rule are the same, for all practical purposes. Cerullo testified that he noticed cracks in the ceiling, windows beginning to bow, and ceilings beginning to sag during Mid-Continent's policy period and that because he was living in the house at the time, he knew "they occurred at about the same time he noticed them." *Id.* Viewing this evidence in the light most favorable to Cerullo, the court of appeals held the evidence was legally sufficient to show that Mid-Continent's duty to indemnify was triggered. *See id*.

C. Joint and Several Liability

The Insurers also argued that the evidence was legally and factually insufficient to support the trial court's judgment because Vines-Herrin presented no evidence allocating the damages the arbitrator awarded to the specific policy period in which they occurred, relying on the policies' insuring agreements that required the damage to occur "during the policy period."

Vines-Herrin's failure to do so, the Insurers argued, entitled them to rendition of a take-nothing judgment. On the other hand, Vines-Herrin asserted that the evidence was both legally and factually sufficient to support the trial court's judgment that the Insurers each had the duty to indemnify Vines-Herrin for the entire arbitration award. The court of appeals disagreed with both the Insurers and Vines-Herrin.

The court of appeals started from the principle that "[w]hen covered and non-covered perils *combine* to create a loss, the insured is entitled to recover only that portion of the damage caused solely by the covered peril(s)." *Id*. at *7 (citation and quotation omitted). In other words, for coverage to exist there must be evidence showing the damage was caused solely by the covered peril. The Insurers argued that, applying this principle, Vines-Herrin's failure to apportion the award between the policies meant that that it failed to prove coverage existed. The court noted that such principles do not apply in a scenario such as this—*i.e.*, "when multiple insurers have been shown to have liability for a loss." *Id.* (citing *Mid-Continent Cas. Co. v. Castagna*, 410 S.W.3d 445, 449–50 (Tex. App.—Dallas 2013, pet. denied); *see also Am. Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 855 (Tex. 1994)). Continuing, the court found that Vines-Herrin did meet its burden to prove that the Insurers' duty to indemnify was triggered; thus the alleged "failure to segregate implicates damages, not coverage." *Id*. "An unsegregated damages award is some evidence of damages." *Id.* (citing *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 314 (Tex. 2006)).

Having rejected the argument that a failure to allocate or apportion damages negated coverage, the court of appeals nonetheless agreed with the Insurers that the "trial court's findings do not support a judgment against both Great American and Mid-Continent, jointly and severally, for the entire arbitration award." *Id*. In that regard, the trial court found *separate* occurrences, each of which caused damages in a separate policy period. As such, the insurers "were not required to indemnify Vines-Herrin for property damages caused by occurrences and damages, both of which occurred outside [Insurers'] respective policy periods." *Id.* Accordingly, the court of appeals reversed and remanded the trial court's judgment with instructions for the trial court to determine the amount of indemnification owed by each Insurer. *See id*.

D. Legally Obligated to Pay

A commercial general liability policy obligates an insurer to pay sums the insured becomes "legally obligated to pay" as damages because of property damage or bodily injury. The Insurers argued that an arbitration award is not a legal obligation to pay damages. In support of their position, the Insurers emphasized that the arbitration award never was confirmed because of the settlement between Cerullo and Vines-Herrin. *See id*.

The court rejected that position. In doing so, the court noted that the term "legally obligated" is not defined in a commercial general liability policy, but held that the term is not limited to immediately enforceable obligation or judgments. Other obligations, such as those established in a judgment and those created by settlement agreements and statutes can satisfy the term. No dispute existed that the arbitration was binding and that no valid basis existed for vacating the arbitration award. The only reason the award was not confirmed was that Cerullo agreed not to confirm the award in exchange for Vines-Herrin assigning its claims against the Insurers. Because a trial court would be required by statute to confirm the award, the court of

appeals concluded that "an arbitration award constitutes a legal obligation to pay the award." *Id*. at *8.

E. "Actual Trial"

Finally, the Insurers argued that the arbitration award was not the result of an "actual trial" or a "fully adversarial trial" as required by *State Farm Fire & Casualty v. Gandy,* 925 S.W.2d 696, 700-01 (Tex. 1996), and, therefore, not binding against the Insurers. Importantly, the Insurers breached their duties to Vines-Herrin by wrongfully denying coverage and failing to defend the liability lawsuit filed by Cerullo, leaving Vines-Herrin to defend itself at its own expense. Vines-Herrin agreed to arbitrate the claims in an effort to minimize its costs and the coverage court found that the proceeding was a fully adversarial trial. According to the court of appeals, the Insurers disregarded the testimony of Cerullo and the arbitrator regarding the adversarial nature of the arbitration, and instead, they asserted that the "agreement to arbitrate was inherently suspect." Citing *Evanston Insurance Co. v. ATOFINA Petrochemicals, Inc*., 256 S.W.3d 660, 672 (Tex. 2008), the court of appeals stated that "it is well-settled that an insurance company may not insist on an actual trial requirement when it has breached its duty to defend its insured." *Vines-Herrin*, 2016 WL 4486656 at *8. Accordingly, because "the Insurers had every opportunity to protect their interests by offering Vines-Herrin a defense" and had the duty to do so but wrongfully refused, the court rejected their argument. *Id.*

Commentary:

The court of appeals' holdings in *Vines-Herrin* are not surprising. The fact that the homeowner noticed the commencement of property damage and was able to pinpoint property damage in different policy periods was sufficient to trigger Great American's and Mid-Continent's policies covering different policy periods. Moreover, a finding that separate occurrences causing separate damages in separate policy periods should not form the basis of joint and several liability between or among various insurers. As the court of appeals held, under these facts each carrier is liable to indemnify its insured for the damages occurring in the applicable policy period. Importantly, this does not change the result in cases like *Lennar Corp. v. Markel American Insurance Co.*, 413 S.W.3d 750 (Tex. 2013) or *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2 842, 855 (Tex. 1994), in which a single occurrence spans several years and the insured is able to select a single policy period for full indemnification. This case differs because the court found *separate* occurrences.

The court also correctly rejected Great American's contention that an unconfirmed arbitration award is not a legal obligation for which a commercial general liability policy provides coverage. Based on the strong policy in favor of arbitration and the courts' obligation to confirm arbitration awards, the court of appeals' holding that an arbitration award is a legal obligation only makes sense. With regard to the application of *Gandy* and its "fully adversarial trial" requirement, the court properly held that, once a carrier wrongfully denies coverage, the insured is allowed to protect itself as it sees fit. Such guidance by the court of appeals should help avoid prolonged litigation on these issues in future cases.

Notably, the parties filed cross-petitions for review on November 9, 2016. Briefing was finalized on January 24, 2017, and the petitions remain pending before the Supreme Court of Texas.

IX. *Mid-Continent Casualty Co. v. Petroleum Solutions, Inc.*, No. 4:09-0422, 2016 WL 5539895 (S.D. Tex. Sept. 29, 2016)

"This insurance coverage case raises various legal issues suitable for a law school examination." *Mid-Continent Cas. Co. v. Petroleum Solutions, Inc.*, No. 4:09-0422, 2016 WL 5539895 (S.D. Tex. Sept. 29, 2016). That is the first sentence of an opinion spanning more than 90 pages and, if affirmed on appeal—as both parties disagree with aspects of the court's rulings (including Petroleum Solutions, Inc. ("PSI"), which prevailed at trial on the duty to cooperate), it will be appealed—it will have a significant impact on how the duty to cooperate applies in the context of general liability coverage in Texas and bars coverage for attorneys' fees as "damages because of . . . 'property damage.'" Thus, it is worthy of an in-depth review.

A. Background Facts

The facts in this case span nearly two decades and include a jury trial in the underlying liability lawsuit, an appeal to the Corpus Christi Texas Court of Appeals, an appeal to the Supreme Court of Texas, a hearing in the trial court on remand, and a coverage dispute that has now been pending in the Southern District of Texas for nearly eight years. The background facts here are taken almost verbatim from the district court's Amended Memorandum and Order issued September 29, 2016. *See id*. at *2.

In 1997, Bill Head ("Head") contracted with PSI to construct and install an underground fuel storage system at his Silver Spur Truck Stop ("Silver Spur") in Pharr, Texas. PSI purchased a component part for the fuel tank from Titeflex Commercial Products ("Titeflex"). In October 2001, Head discovered that 20,000 gallons of diesel fuel had seeped into the soil under the truck stop. Head attributed the damage to a leak in the fuel storage system and contacted PSI. PSI notified Mid-Continent Casualty Company ("Mid-Continent") of the fuel spill, believing any resulting liability would be covered by the commercial general liability policy Mid-Continent issued to PSI (the "Policy"). *See id*.

In 2002, Mid-Continent retained counsel to represent PSI in any potential litigation arising out of the fuel leak. PSI and Mid-Continent believed that a flex connector manufactured by Titeflex in the fuel tank was faulty. Counsel submitted the flex connector to an expert for testing. The expert inspected the flex connector but found no visual, conclusive evidence that the part was defective. The expert stored the flex connector in W.H. Laboratories' storage facility, which was torn down in 2006, causing the part to be lost. *See id*. at *3.

On February 13, 2006, more than four years after the leak was discovered, Head filed suit against PSI in the 398th District Court of Hidalgo County (the "State Court Litigation"). Head alleged claims for Breach of Warranty of Fitness, Breach of Implied Warranty of Good and Workmanlike Services, and Negligence. Head alleged that PSI had contended that the fuel leak was caused by a faulty flex connector, but the Original Petition alleged more broadly that PSI was at fault because it sold and installed the fuel storage tank, including the flex connectors and

the leak detection system. Mid-Continent assumed PSI's defense under a reservation of rights. *See id*.

On October 5, 2006, PSI filed a third-party action against Titeflex, in which it alleged that Titeflex was responsible for the failure of the fuel storage system and, therefore, PSI was "entitled to contribution and/or indemnity" from Titeflex (the "Affirmative Claim") under the Texas Products Liability Act, specifically, § 82.002 of the Texas Civil Practice and Remedies Code ("Section 82.002"). Several months later, on January 30, 2007, Head filed a First Amended Original Petition, which added a strict products liability claim against Titeflex. *See id*.

During discovery in the State Court Litigation, on January 4, 2008, Titeflex moved for a spoliation instruction against PSI for PSI's failure to produce the flex connector. On March 7, 2008, Head non-suited his claims against Titeflex without prejudice and shortly thereafter filed an amended petition that alleged claims only against PSI. *See id*.

In the first half of 2008, PSI and Mid-Continent debated whether to dismiss PSI's Affirmative Claim against Titeflex. Mid-Continent had retained trial counsel to represent PSI in the trial court and appellate counsel to prepare for the possibility of an appeal. Appellate counsel also offered legal advice during the trial court proceedings. After Head non-suited his claims against Titeflex without prejudice, trial counsel advised that PSI similarly should dismiss its Affirmative Claim without prejudice to simplify the State Court Litigation because Titeflex was "vigorously defending itself," and the defense was undercutting PSI's position with regard to Head. *See id*. at *4.

On May 19, 2008, Titeflex filed a counterclaim against PSI (the "Titeflex Counterclaim") requesting indemnification of "costs of court, reasonable expenses, and attorney's fees arising subsequent to the entry of [Head's] Notice of Non-Suit [on March 7, 2008] which were expended in defense of this action and in prosecution of this demand for indemnity." PSI's trial counsel relayed to Mid-Continent and PSI that Titeflex offered to dismiss its Counterclaim if PSI dismissed its Affirmative Claim. As a result, on August 12, 2008, PSI dismissed its Affirmative Claim without prejudice. On August 13, 2008, Titeflex explained that it only would dismiss its Counterclaim if PSI would agree to mutual dismissal of their claims *with* prejudice (the "Settlement Offer"). Titeflex gave PSI two days, until August 15, 2008, to accept the Settlement Offer. *See id*.

PSI's trial counsel advised Mid-Continent and PSI that PSI's dismissal of its claims against Titeflex likely disposed of the Titeflex Counterclaim because it was merely a reformulation of Titeflex's Answer to PSI's Affirmative Claim. Nevertheless, Titeflex maintained that its Counterclaim remained valid despite PSI's dismissal. PSI's trial counsel, as well as Mid-Continent personnel, urged PSI to accept the Settlement Offer. PSI decided to reject the Settlement Offer because PSI wanted to retain the option to pursue an indemnity action against Titeflex, if necessary, in light of Mid-Continent's reservation of rights regarding the defense of PSI against Head's claims. *See id*.

On September 15, 2008, a month after Titeflex's Settlement Offer had expired, Titeflex amended its counterclaim. As amended, the Titeflex Counterclaim asserted a Section 82.002 claim, which requested "all past and future costs of court, reasonable expenses, and reasonable

and necessary attorney's fees which were expended in defense of this action and in prosecution of this demand for indemnity." *See id*. at *5.

The State Court Litigation proceeded to trial on Head's and Titeflex's respective claims against PSI. The judge instructed the jury that PSI had "destroyed, lost, or failed to produce . . . material evidence" and that the jury could presume that this evidence was unfavorable to PSI. On September 29, 2008, the jury returned verdicts in favor of Head and Titeflex. Head was awarded $1,131,321.26 in damages and prejudgment interest and $91,500.00 in attorney's fees against PSI. The jury awarded Titeflex $382,334.00 in attorneys' fees, $68,519.12 in expenses, $12,393.35 in costs, and post-judgment interest at 5% from the day of the judgment until its satisfaction (the "Titeflex Judgment"). *See id*.

PSI appealed the judgment in favor of Head, contending that the trial judge's spoliation sanctions were in error. PSI also appealed the Titeflex Judgment on the ground that Titeflex could not satisfy the requirements of Section 82.002, the statute pursuant to which it sought indemnification from PSI. The Corpus Christi Court of Appeals affirmed, and PSI petitioned for review by the Supreme Court of Texas. The Court issued an opinion on July 11, 2014, but substituted a new opinion on reconsideration on December 19, 2014. The Court reversed the judgment in favor of Head, holding the trial court's spoliation instruction was error, and remanded for retrial on Head's claims. At the same time, the Court rejected PSI's challenges to the Titeflex Judgment, finding that the erroneous spoliation instruction did not affect the verdict in favor of Titeflex. Accordingly, the Court affirmed the Titeflex Judgment. In June of 2016, on remand, the trial court entered summary judgment for PSI on Head's claims. *See id*.

Over the course of the State Court Litigation, Mid-Continent sent six reservation of rights letters to PSI—the the fifth and sixth of which are relevant in the coverage case. The fifth letter, which was sent on August 26, 2008, did not address the Titeflex Counterclaim specifically, but stated that "Mid-Continent reserves its right to decline any duty to PSI, including, but not limited to, PSI's failure to cooperate in our investigation and defense of this claim/suit." In the sixth letter, sent on September 19, 2008, Mid-Continent explained that its coverage position in the fifth letter applied to the Titeflex Counterclaim. Noting that Titeflex sought indemnification only of attorney's fees, costs of court, and reasonable expenses, Mid-Continent reserved the right in the sixth letter to disclaim coverage because these items "may not constitute damages because of 'property damage' or 'bodily injury' caused by an 'occurrence' as defined by the Mid-Continent Policy." *See id*. at *6.

After the Supreme Court of Texas affirmed the Titeflex Judgment in its July 11, 2014 opinion, Mid-Continent denied coverage for the Titeflex Counterclaim on July 30, 2014. In the denial letter, Mid-Continent took the position that PSI's rejection of the Settlement Offer constituted a failure of cooperation that permitted Mid-Continent to deny coverage. Mid-Continent further cited "Exclusion q" of the Policy, which excludes losses "caused intentionally by or at the direction of the insured." *See id*.

On February 12, 2009, Mid-Continent filed a declaratory judgment action in the United States District Court for the Southern District of Texas seeking declaratory relief that the judgment against PSI in the State Court Litigation was not covered under the Policy. The case was stayed pending completion of the state court appellate process. When the Titeflex Judgment

became final after the Supreme Court of Texas' December 19, 2014 decision, the coverage case was reopened to resolve the coverage issues regarding the Titeflex Judgment. *See id*.

Mid-Continent sought a declaratory judgment that the Titeflex Judgment is not covered by the Policy on the grounds that (1) the language of the Policy does not support a finding of coverage, (2) Exclusion q applies to the Titeflex Judgment, and (3) PSI breached its duty to cooperate with Mid-Continent when PSI rejected the Settlement Offer. PSI counterclaimed on the grounds that Mid-Continent's denial of coverage constituted (1) a breach of contract and (2) a breach of Chapter 541 of the Texas Insurance Code. PSI and Mid-Continent filed cross-motions for summary judgment. *See id*.

B. The Court's Analysis.

1. Titeflex claimed attorneys' fees and costs incurred as a result of three claims.

PSI's Affirmative Claim and the Titeflex Counterclaim were both based on Chapter 82.002, establishing a manufacturer's duty to indemnify an innocent seller. The court first analyzed the separate components comprising the damages alleged and recovered by Titeflex in the State Court Litigation. The entirety of Titeflex's damages was attorneys' fees and costs of litigation:

> The evidence submitted to the jury in the State Court Litigation and the Titeflex Judgment compensated Titeflex for its attorney's fees, expenses and costs incurred as a result of litigation of three claims: (1) defense against Head's products liability claims; (2) defense against PSI's Affirmative Claim under Section 82.002(a); and (3) prosecution against PSI pursuant to Section 82.002(g) for recovery of Titeflex's Section 82.002(a) indemnity claim. The Titeflex Judgment did not segregate these components. Analysis of coverage under the Policy requires consideration of each component separately.

Id. at *11. Titeflex's attorneys' fees incurred in defending against Head were recoverable from PSI under Section 82.002(a). Titeflex's attorneys' fees incurred in defending against PSI's affirmative claim were, according to the court, not properly awarded because the "statutory obligation does not extend to losses (such as fees and expenses) caused by litigation between manufacturers/sellers asserting competing Section 82.002 claims against each other." *Id.* at *12. From August 12, 2008, when PSI dismissed its Affirmative Claim without prejudice through the end of trial, the only attorneys' fees Titeflex incurred were for prosecuting its Section 82.002(a) indemnification action, and those fees were recoverable under the fee-shifting provision in Section 82.002(g). Accordingly, the court isolated PSI's obligation under 82.002(a) to the "losses incurred by Titeflex while Head's claim against Titeflex was pending between January 30, 2007, and March 7, 2008." *Id.* at *13.

2. The duty to cooperate encompassed PSI's decision whether to settle its Affirmative Claim and is a fact issue for the jury.

Mid-Continent complained that PSI failed to satisfy its contractual duty to cooperate by refusing to acquiesce to Mid-Continent's request to agree to the Settlement Offer and dismiss its Affirmative Claim with prejudice. PSI, on the other hand, argued that the dismissal of the Affirmative Claim would have been a bad bargain considering the legal advice of trial counsel and appellate counsel and the fact that Mid-Continent had issued a reservation of rights, potentially leaving Titeflex as the only source of indemnification for Head's claim. Moreover, PSI argued that the application of the duty to cooperate to an insured's affirmative claim would be an "unprecedented expansion of the duty." *See id*. at *14.

The duty to cooperate is contractual and states in pertinent part that the insured must "[c]ooperate with [the insurer] in the investigation or settlement of the claim or defense or defense against the 'suit'[.]" "Claim" means a request for relief against the insured. "'Suit' means a civil proceeding in which damages because of 'bodily injury', 'property damage' or 'personal and advertising injury' to which [the] insurance applies are alleged." Accordingly, the court stated that "[b]ecause 'suit is defined to include the entire 'civil proceeding,' the assertion of, or retention of a right to assert, a right of action by PSI in response to a claim against it is part of 'defense against' a 'suit' under the Policy." *Id.* at *14. In doing so, the court rejected PSI's textual argument that the term "settlement of *the* claim" in the cooperation clause limited its scope to purely defensive actions. Instead, the court stated that the whole clause must be read in light of the broad definition of "suit," which includes the entire "civil proceeding." As the Affirmative Claim was an item of value that could be used "as a part of a 'settlement of the claim,'" the court held that the cooperation clause applied to PSI's rejection of the Settlement Offer. *See id*. at *14–*15.

Having decided the cooperation clause applied, the court then held that neither party carried its burden to show the absence of a genuine issue of material fact "regarding the reasonableness of PSI's rejection of the Settlement Offer." *Id.* at *16. The court found that the record contained support for both PSI's and Mid-Continent's positions. As such, the court denied both parties' motions for summary judgment on the cooperation clause. The court, however, did find as a matter of law that, if a jury finds PSI acted unreasonably, Mid-Continent was prejudiced by PSI's rejection of the Settlement Offer because PSI "deprived Mid-Continent of the opportunity to avoid liability entirely." *Id*. at *19.

In a subsequent opinion, the court reversed its earlier decision that Mid-Continent had not waived the right to rely on the duty to cooperate, finding that a fact issue existed that should go to the jury. *See Mid-Continent Cas. Co. v. Petroleum Solutions, Inc.*, No. 4:09-CV-0422, 2016 WL 7733054, at *3 (S.D. Tex. Dec. 16, 2016). At issue was the fact that Mid-Continent, while generically referencing portions of the duty to cooperate in some of its reservation of rights letters, waited until 2014 to notify PSI that it considered the refusal to accept the Settlement Offer to be a breach of the cooperation clause. In the same opinion, the court also agreed with PSI that the proper standard on the application of the duty to cooperate was whether PSI's conduct was "reasonable and justified" in light of the surrounding circumstances. *Id.* at *4. Mid-Continent, in contrast, had asked for a simple instruction such that the mere refusal to accept the Settlement Offer would be deemed a breach of the cooperation clause.

At trial on the issue of the duty to cooperate, the jury found that PSI had not violated the duty to cooperate. Moreover, even if it had, the jury determined that Mid-Continent had waived the right to rely on that duty to cooperate by its conduct.

3. Coverage for the Titeflex Judgment under the insuring agreement.

The scope of commercial general liability coverage for bodily injury and property damage is established by the Policy's "Insuring Agreement" at section I(A)(1)(a):

> We [Mid-Continent] will pay those sums that the insured [PSI] becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies.

To carry its burden with respect to coverage on summary judgment, PSI had to show that there was no genuine issue of material fact that (1) there was "'property damage' to which this insurance applies" and (2) the Titeflex Judgment was awarded as "damages because of" that property damage." The court found that the damage to Head's property resulting from the 20,000 gallons of leaked diesel established "property damage." *Id*. at *21–*26. Importantly, the court rejected Mid-Continent's claim that the "legally obligated to pay" language was not satisfied because there was no tort claim, finding that the case arose out of a tort-based obligation—"namely, Head's allegation that PSI installed a defective fuel storage system that damaged Head's property." *Id.* at *40. *See also id.* at *40, n.275 (acknowledging that doubt had been cast on Fifth Circuit authority on the issue).

With regard to whether there were "damages because of property damage," the court had a mixed answer based on its analysis of the components of the Titeflex Judgment. The court first looked at what constitutes damages, distinguishing between compensatory and non-compensatory damages as explained in *In re Nalle Plastics Family Limited Partnership*, 406 S.W.3d 168, 171 (Tex. 2013). The court held that Titeflex's Section 82.002(a) award constituted damages because they were compensatory in nature. In contrast, Titeflex's Section 82.002(g) award for costs incurred in prosecuting its indemnification claim against PSI were non-compensatory because 82.002(g) is a "fee-shifting provision for successful claims against a product manufacturer" and, as such, are not damages "because of property damage" under the Policy. *See Mid-Continent*, 2016 WL 5539895, at *26–*37.

4. The Professional Liability Endorsement in the Policy did not provide coverage.

The Policy also contained a Professional Liability Endorsement, which PSI argued provided coverage for the Titeflex Judgment. The endorsement stated, in pertinent part, as follows:

> COMMERCIAL GENERAL LIABILITY COVERAGE PART
>
> The following is added to SECTION I - COVERAGES, Coverage A. Bodily Injury and Property Damage Liability, 1. Insuring Agreement:
>
> d. "Bodily Injury", "Property Damage" or "Money Damages"

> arising out of the rendering or failure to render professional services shall be deemed to be caused by an "occurrence".
>
> * * *
>
> The following is added to SECTION V - DEFINITIONS
>
> 20. "Money Damages" means a monetary judgment, award, or settlement and does not include:
>
> a. Punitive or exemplary damages which are a multiple of compensatory damages or penalties;
>
> b. The restitution of compensation and expenses paid to you for services or goods;
>
> c. Judgments or awards arising from acts deemed uninsurable by law.

PSI argued that the endorsement provided additional coverage for Monetary Damages arising out of professional services. Notably, PSI pointed out that there would be no reason to actually define the term "Money Damages" and provide exceptions to the definition if there was no intent to actually provide coverage for "Money Damages." The court disagreed and held that the endorsement merely provided "an alternative definition of 'occurrence'" and that satisfying that definition "obviates the need to point to an actual event" or accident to satisfy the "occurrence" requirement. As such, the endorsement did not provide, in the court's opinion, additional coverage. *See id*. at *25.

The court, however, recognized that both 82.002(a) and 82.002(g) damages would fall squarely within the definition of Monetary Damages, which is broader than the term "damages." Nevertheless, the court held as "a threshold matter, PSI's claim for coverage under the 'Money Damages' provisions fails because the Professional Liability Endorsement does not explicitly amend the Insuring Agreement, section I(A)(1), to include 'Money Damages.'" The Court also determined that even if the parties had intended for the endorsement to add a separate grant of coverage, coverage would be unavailable under the Policy because "the relevant date for the policy period for Money Damages . . . is the date on which the Money Damages occur." PSI sought coverage under the 2001–2002 Policy in which the October 2001 property damage occurred; however, the Titeflex Judgment did not "occur" until November 2008 when the Supreme Court's decision became final, which would fall within the 2008–2009 policy that Mid-Continent also issued. Although PSI argued that it should prevail because Mid-Continent issued both the 2001 and the 2008 policies, the court rejected that argument on the grounds that PSI had only filed its counterclaim on the 2001 Policy. Ultimately, the Court concluded that the Endorsement failed to create a new insuring agreement to extend coverage for "Money Damages," but it also acknowledged that "Mid-Continent's position that the Professional Liability Endorsement offers absolutely no coverage for Money Damages is also problematic" and that "[h]ad PSI sued under the 2008–2009 Policy, there would be a question regarding whether the addition of the definition of occurrence based on Money Damages altered the scope of the Insuring Agreement." *See id*. at *37–*39 & n.271.

Briefly, the court also addressed Mid-Continent's reliance on exclusion q., which was added to the policy by way of the Professional Liability Endorsement. That exclusion precluded coverage for any:

> Loss caused intentionally by or at the direction of the insured; or any dishonest, fraudulent, criminal, malicious and knowingly wrongful acts.

Id. at 40. Mid-Continent argued that PSI's rejection of the Settlement Offer was intentional and caused the loss in question—*i.e.*, the Titeflex Judgment. The court found that Mid-Continent's contention was merely a "repackaging of its duty to cooperate argument as part of the initial coverage analysis," and found that its "approach is contrary to the Policy language." *Id.* Thus, the court held that Mid-Continent failed to establish that the exclusion applied to negate coverage.

Commentary:

As the authors of this paper are counsel for PSI and the litigation remains pending before the Southern District of Texas—trial on the outstanding issues pertaining to the duty to cooperate was held in early January, and, as noted above, the jury ruled in favor of PSI, finding that it had not violated the duty to cooperate and, even if it did, the insurer had waived the right to rely on that condition of the policy, but the court's plenary power is still in effect—our commentary will be short and to the point. First, as noted at the outset, we have no doubt that the court's ultimate judgment will be appealed by one or perhaps both parties. In fact, the court even acknowledged as much: "The Court recognizes that this case raises several novel and complex questions of Texas law. Further guidance from the Texas Supreme Court would be valuable if appellate input is sought by the parties." *Id.* at *43. Second, in that vein, should the court's interpretation of the cooperation clause be upheld, it will expand the scope of the duty to cooperate far beyond any scenario previously considered by insureds, potentially creating a chilling effect in the relationship between an insured and its insurer. Third, and just as importantly, at least by analogy, the court's decision calls into question the availability of coverage for an award of attorneys' fees under Chapter 38.001 of the CPRC as "damages because of . . . 'property damage.'" Because many owners sue general contractors under a contract theory in order to recover attorneys' fees, and because of the economic loss rule, the impact of this holding could have major consequences. Simply put, it remains a case to watch in the coming months as the issues involved—and the holdings reached on those issues—will reverberate throughout Texas insurance law.

X. Honorable Mention:

A. *Colony National Insurance Co. v. United Fire & Casualty Co.*, No. 5:14CV10-JRG-CMC, 2016 WL 3896832 (E.D. Tex. Apr. 14, 2016)

In *Colony National*, an insurer for a general contractor defended and indemnified its insured in connection with construction defect litigation that ultimately was settled. In a subsequent coverage action, that insurer filed suit against its insured's subcontractor's insurer, claiming that it was entitled to recover one half of the defense costs it incurred from that insurer because additional insured coverage had been triggered. The court agreed and, as the prevailing

party the general contractor's insurer moved for an award of attorneys' fees under Section 38.001 of the Texas Civil Practice and Remedies Code for prosecuting its coverage claim. Citing to several cases allowing a subrogee to recoup fees under the same section of the CPRC, the court held that the general contractor's insurer was entitled to recover its attorneys' fees and costs under the fee shifting provision as the subrogee of its insured.

The court's conclusion is unsurprising in that it allowed an insurer-subrogee to recover its attorneys' fees pursuant to Section 38.001 after successfully prosecuting the contractual claims of its insured-subrogor. The decision provides potential additional insureds more leverage when arguing for additional insured coverage because, if their own insurer funds the defense and latter successfully prosecutes a subrogation claim against the additional insured carrier for wrongful denial, the claim can include an award of attorneys' fees for prosecuting that claim.

B. *Mid-Continent Casualty Co. v. Christians Development Co.*, No. A-16-CA-31-LY, 2016 WL 1734114 (W.D. Tex. Apr. 28, 2016)

In *Mid-Continent Casualty*, the Western District of Texas applied the "eight corners" rule in dismissing the insurer's lawsuit seeking a declaration that it did not owe a defense or indemnity to its insured in connection with an underlying lawsuit. The court agreed with the insured and the underlying claimant that no justiciable controversy existed because Mid-Continent had failed to demonstrate that there was no possibility that it owed a duty to defend or indemnify its insured in the underlying lawsuit. On the duty to defend, Mid-Continent admitted that it needed discovery to establish that no duty to defend or indemnify existed. Thus, it had failed to show that the facts alleged in the underlying lawsuit negated any *possibility* that it would have a duty to indemnify. As such, the duty to defend existed and a ruling on the duty to indemnify was premature.

While the court's conclusion that a duty to defend existed may have been accurate—the fact that Mid-Continent needed extrinsic evidence to *defeat* the duty to defend necessarily implies that the allegations against the insured triggered the duty to defend—the court's decision to dismiss Mid-Continent's claim that no duty to defend existed on a lack of ripeness or jurisdiction basis is peculiar. In other words, although the court explained the "eight corners" rule, it seemingly never applied it. Instead, the court simply dismissed Mid-Continent's complaint in its entirety.

C. *Colony Insurance Co. v. Adsil, Inc.*, No. 4:16-CV-408, 2016 WL 4617449 (S.D. Tex. Sept. 2, 2016)

In September, the Southern District of Texas addressed an insurer's claim for defense costs purportedly owed by its insured's indemnitee and the same insurer's claim that it did not owe its insured a defense or indemnity. *See Colony Ins. Co. v. Adsil, Inc.*, No. 4:16-CV-408, 2016 WL 4617449 (S.D. Tex. Sept. 2, 2016). On the indemnitee's motion to dismiss the insurer's claim for defense costs, the court agreed that the indemnity provision did not include a duty to defend, only a duty to indemnify, and that such duties are distinct and separate. Moreover, because the indemnitee's negligence had not yet been adjudicated, indemnification for defense costs was not yet ripe. The court denied the insured's motion to dismiss its insurer's claim for failure to state a claim on which relief could be granted because the insured failed to

make any argument in support of its position. Nevertheless, the court did entertain the merits of its claim to dismiss Colony's lawsuit on ripeness grounds, ultimately finding that Colony's duty to defend claim was justiciable, but the duty to indemnify was not and was dismissed.

On the merits of whether Colony had an obligation to defend its insured, the court analyzed an exclusion barring coverage for claims "arising directly or indirectly out of the installation, service or repair of 'your product(s)' performed by independent contractors or subcontractors of an insured . . . ." *Id.* at *6. The court rejected Colony's argument that the exclusion should apply to bar "coverage for all claims asserted against Adsil, even those alleging that Adsil negligently provided insufficient instructions for application of its product," because the phrase "arising directly or indirectly out of" should be given broad meaning. Simply put, because it was not clear that *all* the claims against the insured arose out of the installation of its product by a subcontractor, Colony's motion for summary judgment was denied. On this point, the court's decision is a victory for insureds facing broad "lead-in" language in exclusions; however, it must be noted that the court did not hold that a defense was owed, only that a genuine issue of material fact existed that precluded summary judgment. That, in of itself, is an odd holding as the duty to defend is a question of law for the court's determination.