visser shidlofsky llp

insurance law newsletter

August 9, 2007 volume 1, number 4

LEE H. SHIDLOFSKY
VISSER SHIDLOFSKY LLP
7200 N. MOPAC EXPY.
SUITE 430
AUSTIN, TEXAS 78731
512.795.0600
512.795.0632
LEE@VSFIRM.COM

IN THIS ISSUE:

PAST ISSUES OF THE INSURANCE LAW NEWSLETTER ARE ON OUR WEBSITE AT WWW.VSFIRM.COM

OUR WEBSITE ALSO INCLUDES LEGAL ARTICLES PUBLISHED BY OUR INSURANCE LAW PRACTICE GROUP.

The Trigger Issue: Is There a Change on the Horizon?

A. Background on Trigger Issue

Construction defect cases oftentimes involve latent damage or progressive damage that occurs over a period of time. This issue typically spawns fights among insurers, as well as between insureds and insurers, as to *when* the damage occurred and *which* policy or policies must respond. The reason for the fight is that most CGL policies are written on an "occurrence" basis.

In occurrence-based policies, the insuring agreement specifically requires that the "property damage" must take place during the policy period. Contrast that with a claims-made policy wherein it is the claim that must be made and oftentimes reported during the policy period, even if the particular act or omission that caused the property damage happened prior to the policy period. Many professional liability policies issued to architects and engineers are written on a claims-made basis. The trigger analysis for claims-made policies is straightforward—the policy in place at the time a "claim" is first made is the one (and typically the only one) that is triggered, provided that the claim is reported in a timely manner under the terms of the policy. The trigger analysis for occurrence-based policies, however, is less than straightforward and has produced a number of different approaches across the country and within Texas.

Policyholders oftentimes assume that the policy in place at the time of the alleged defective construction is the one that will be triggered for a construction defect loss. Traditionally, that has not been the case in Texas. Although the Texas Supreme Court has never adopted a particular trigger theory, the vast majority of cases that have addressed the issue hold that it is the policy in place at the time that the resulting damage becomes readily apparent that is triggered. *See Guar. Nat'l Ins. Co. v. Azrock Indus. Inc.*, 211 F.3d 239, 246–47 (5th Cir. 2000) (making an *Erie* guess that Texas would apply a manifestation trigger in the "Property damage" context); *Am. Home Assur. Co. v. Unitramp, Ltd.*, 146 F.3d 311, 313 (5th Cir. 1998); *Cullen/Frost Bank of Dallas, N.A. v. Commonwealth Lloyd's Ins. Co.*, 852 S.W.2d 252, 257 (Tex. App.—Dallas 1993, writ denied); *State Farm Mut. Auto. Ins. Co. v. Kelly*, 945 S.W.2d 905, 910 (Tex. App.—Austin 1997, writ denied) ("Texas courts have held that property loss occurs when the injury or damage is

(continued on next page)

CASES TO WATCH:

***Lamar Homes v. Mid-Continent Cas, Ins. Co.*, 428 F.3d 193 (5th Cir. 2005) (certified to the Supreme Court of Texas and argued on February 14, 2006) (whether allegations of faulty workmanship constitute "property damage" and "occurrence" under a CGL policy as well as whether the "prompt payment of claims" act of the Texas Insurance Code applies to liability insurers)**

***Excess Underwriters at Lloyd's, London v. Frank's Casing Crew & Rental Tools, Inc.*, 2005 WL 1252321 (Tex. May 27, 2005) (pending on rehearing) (whether Texas recognizes a right of recoupment by an insurer against its insured)**

***Fairfield Ins. Co. v. Stephens Martin Paving*, 381 F.3d 435 (5th Cir. 2004) (certified to the Supreme Court of Texas and argued on November 9, 2004) (whether an award of punitive damages is insurable under an employers liability policy)**

manifested."). Although it is always dangerous to place labels on trigger theories, this theory is commonly referred to as the "manifestation" trigger.

In a nutshell, the manifestation trigger provides that actual damage occurs when it becomes apparent or readily identifiable. Even so, damage does not automatically qualify as apparent or identifiable merely because it is "capable of being known by testing." *See Unitramp*, 146 F.3d at 313. In particular, an insured is not required or duty-bound to "conduct limitless tests and inspections for hidden defects." *Id.* Instead, although it is a somewhat murky concept that is decided on a case-by-case basis, damage will be considered apparent and/or identifiable at the point when it is "capable of being perceived, recognized and understood." *Id.* at 314. Adding to the confusion is the fact that courts have been careful to state that manifestation does not equate to discovery. *See id.* (noting that "it is important to understand that 'apparent' does not mean 'discovered'; just because something is unknown to an individual does not render it, in an objective sense, unapparent").

A common misconception surrounding the manifestation trigger is that only one policy can be triggered. In reality, although the manifestation trigger often results in only a single triggered policy, several policies can be triggered when allegations exist of separate and distinct manifestations of "property damage." *See Cullen/Frost*, 852 S.W.2d at 257 ("In cases involving continuous or repeated exposure to a condition, there can be more than one manifestation of damage and, hence, an occurrence under more than one policy."); *Encore Homes, Inc. v. Assurance Co. of Am.*, 2000 WL 798192 (N.D. Tex. June 21, 2000) ("Although Petroff bought her home in 1994, she alleges that '[a]dditional defects and problems with the home continue to arise on an almost daily basis' and that 'defects continue to become evident on almost a daily basis.' Given that the lawsuit was filed while the policy was still in effect, this allegation is sufficient to suggest that at least one occurrence became manifest during the policy period."); *see also Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833, 845–46 (Tex. App.—Dallas 2004, pet. filed) (holding that multiple policies were triggered based on a broad allegation of when the damages occurred). Still, for the most part, insurers take the position that the manifestation trigger is a "single policy" trigger.

B. Is There a Change on the Horizon?

Although the so-called manifestation trigger has been the majority rule in Texas, and certainly the one applied by insurers in Texas, it is not the *only* trigger theory that has been applied by courts in the context of a "property damage" case. *See Pine Oak Builders, Inc. v. Great Am. Lloyds Ins. Co.*, 2006 WL 1892669 (Tex. App.—Houston [14th Dist.] July 6, 2006, pet. filed.); *Pilgrim Enters., Inc. v. Md. Cas. Co.*, 24 S.W.3d 488 (Tex. App.—Houston [14th Dist.] 2000, no pet.); *see also Royal Indem.*

(continued on next page)

CASES TO WATCH:
(continued)

***Ulico Cas. Co. v. Allied Pilots Ass'n*, 187 S.W.3d 91 (Tex. App.—Ft. Worth 2005, pet. granted) (argued on April 11, 2007) (whether Texas recognizes coverage by waiver and/or estoppel when an insurer undertakes the defense without adequately reserving rights)**

***American Home Assur. Co., Inc. v. Unauthorized Practice of Law Comm.*, 121 S.W.3d 831 (Tex. App.—Eastland 2003, pet granted) (argued on September 28, 2005) (scope of the tripartite relationship between insurer, insured, and defense counsel retained by insurer)**

***OneBeacon Ins. Co. v. Don's Building Supply, Inc.*, 2007 WL 2258192 (5th Cir. Aug. 8, 2007) (certifying trigger issue to the Supreme Court of Texas)**

***Group v. Travelers Indem. Co.*, 2005 WL 2176896 (N.D. Cal. Sept. 6, 2005) (applying Texas law). At least three courts have applied a broader "exposure" trigger to determine which policy or policies are potentially triggered. Under an exposure trigger, it is the policy or policies in place at the time of the exposure to the conditions that cause the property damage that is triggered. Courts applying the broader exposure trigger note that the CGL policy itself contains no "manifestation" requirement and that applying a manifestation trigger essentially converts an "occurrence" policy into a claims-made policy. *See Pine Oak Builders*, 2006 WL 1892669, at *7; *Pilgrim*, 24 S.W.3d at 496. Under the broader exposure trigger, which has been applied in the "bodily injury" context, allegations of continuous and repeated exposure to conditions (e.g., water intrusion) might implicate more than one policy period. *See Pine Oak Builders*, 2006 WL 1892669, at *8. Despite these three cases, the federal district courts in Texas have steadfastly followed Fifth Circuit precedent and applied a manifestation trigger as have most state courts. *See, e.g., Bayou Bend Homes, Inc. v. Scottsdale Ins. Co.*, 2006 WL 2037564 (S.D. Tex. July 18, 2006); *Summit Custom Homes, Inc. v. Great Am. Lloyds ins. Co.,* 202 S.W.3d 823, 827 (Tex. App.—Dallas 2006, pet. filed).**

Yesterday, the Fifth Circuit decided that it was time to certify the trigger issue to the Supreme Court of Texas. *See OneBeacon Ins. Co. v. Don's Building Supply, Inc.*, 2007 WL 2258192 (5th Cir. Aug. 8, 2007). The case involved numerous lawsuits by homeowners asserting claims arising from water intrusion into the wall cavities of their homes due to allegedly defective EIFS. In each of the cases, the homeowners alleged that the damages likely began to occur on the first penetration of moisture, but that the damage was inherently undiscoverable until just prior to the filing of the lawsuits. The district court concluded, based on a manifestation trigger, that the policies in place prior to the time of the actual discovery of the damage were not triggered. The Fifth Circuit certified the following questions:

1. When not specified by the relevant policy, what is the proper rule under Texas law for determining the time at which property damage occurs for purposes of an occurrence-based commercial general liability policy?

2. Under the rule identified in the answer to the first question, have the pleadings in lawsuits against an insured alleged that property damage occurred within the policy period of an occurrence-based commercial general liability insurance policy, such that the insurer's duty to defend and indemnify the insured is triggered, when the pleadings allege that actual damage was continuing and progressing during the policy period, but remained undiscoverable and not readily apparent for purposes of the discovery rule until after the policy period ended because the internal damage was hidden from view by an undamaged exterior surface?

(continued on next page)

NOTE:

The Supreme Court of Texas went on summer recess without issuing any significant insurance-related decisions. The Supreme Court likely will not issue any opinions until the end of August or early September.

Commentary:

Assuming the Supreme Court accepts the certified questions, which it is likely to do, the outcome may have a major impact on Texas policyholders. That impact likely will be felt most in the construction industry. For years, insurers in Texas have taken the position that Texas is a "manifestation" state. A simple example shows how the outcome of the *OneBeacon* case could have a dramatic effect on insurance coverage. Assume a house is built in 1998 with EIFS. In December 2004, the homeowners discover water damage and mold and file a lawsuit against the homebuilder. In the lawsuit, the homeowners allege that, upon information and belief, the damage occurred each and every time it rained from the completion of the home through the present but that the damage was not discoverable until only recently (i.e., to avoid any statute of limitations issues). Under a manifestation rule, it would be the 2004 policy that would apply. Most likely, the 2004 policy contains an EIFS exclusion and a mold exclusion. Thus, no coverage. Under a broader exposure trigger, however, each policy from 1998 through 2004 potentially could be triggered. It is likely that the earlier policies (from 1998 through perhaps 2001) did not have either an EIFS exclusion or a mold exclusion. So, under an exposure trigger, the insured may have coverage for the alleged damages.

Although the outcome of *OneBeacon* may have the most dramatic effect in the construction defect arena, its implications could carry over to other types of coverage cases (e.g., pollution events). This case is so important that is has been added to the "Cases to Watch" list. Stay tuned for more details.

visser shidlofsky llp

The Insurance Law Practice Group Handles:

- Commercial General Liability
- Commercial Property
- Commercial Auto
- Crime
- D&O
- Employment Practices Liability
- Fiduciary Liability
- Inland Marine
- Professional Liability
- Specialized Manuscript Policies

GETTING TO KNOW LEE H. SHIDLOFSKY AND THE INSURANCE LAW PRACTICE GROUP ...

Lee Shidlofsky is a founding partner of Visser Shidlofsky LLP. His practice is devoted to representing and counseling corporate policyholders in the area of insurance law, risk management, contractual risk transfer, and extra-contractual issues. He holds council positions with the Insurance Law Section and the Construction Law Section of the State Bar of Texas. He is the author of numerous articles and seminar papers and is a frequent speaker at continuing legal education seminars in Texas and across the country. Mr. Shidlofsky has been named a "Super Lawyer" by Texas Monthly Magazine each year since 2004 and is ranked as a top insurance coverage lawyer by Chambers USA.

The Insurance Law Practice Group represents corporate policyholders that are in disputes with their insurance companies, provides advice to plaintiffs in complex litigation on how to best maximize an insurance recovery, and provides risk-management consultation in connection with a wide-variety of contractual risk transfer issues. The Insurance Law Practice Group handles first-party and third-party insurance claims in state and federal courts at both the trial and appellate court levels. The Insurance Law Practice Group is committed to practical and pragmatic solutions to insurance issues.

If this newsletter was forwarded to you and you would like to be placed on the e-mail distribution list for future newsletters, please e-mail Lee Shidlofsky at lee@vsfirm.com. The e-mail distribution list is confidential and will not be sold to third parties.

www.vsfirm.com

Serving Clients Across Texas and Nationwide

visser shidlofsky llp

Copyright (c) 2007 – Visser Shidlofsky LLP