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The *D.R. Horton* Case: The Supreme Court Gets It Right

In Volume 1, Number 2 of the *insurance law newsletter*, we wrote about the court of appeals' decision in *D.R. Horton—Texas, Ltd. v. Markel International Insurance Co., Ltd.*, 2006 WL 3040756 (Tex. App.—Houston [14th Dist.] Oct. 26, 2006, *pet. denied* (Tex. Feb. 13, 2009), *reh'g of pet. for review granted* (Tex. June 26, 2009)), and expressed our disagreement with the court's finding that no duty to defend necessarily means that no duty to indemnify can exist. *Id.* at *6. Later, in Volume 3, Number 2 of the *insurance law newsletter*, we wrote about the Supreme Court of Texas' re-affirmation of the application of the "eight corners" rule to the duty to defend. And, while the focus of that newsletter was on the Court's decision in *Pine Oak Builders, Inc. v. Great American Lloyds Insurance Co.*, 279 S.W.3d 650 (Tex. 2009), we also noted the Court's contemporaneous denial of a petition for review in *D.R. Horton*. We reiterated our concern that, by denying the petition for review, the Court upheld the court of appeals' holding that no duty to defend means no duty to indemnify. *See D.R. Horton*, 2006 WL 3040756, at *6. On March 2, 2009, a motion for rehearing of the petition for review was filed by D.R. Horton. On behalf of the Texas Association of Builders, the National Association of Homebuilders and the Associated General Contractors of America – Texas Building Branch, the Insurance Law Practice Group of Visser Shidlofsky LLP filed an amicus brief, addressing only the "no duty to defend, no duty to indemnify" issue. In a rare move, the Court requested a response to the motion for rehearing, withdrew its original denial of the petition for review, granted the petition for review and requested oral argument. On December 11, 2009, the Court issued its opinion in which it reversed the lower court in part, adopted in large part the amici curiae briefing and held that a duty to indemnify can arise even if the duty to defend never is triggered. *See D.R. Horton—Texas, Ltd. v. Markel Int'l Ins. Co., Ltd.*, 2009 WL 4728008 (Tex. Dec. 11, 2009).

A. Background Information

In *D.R. Horton*, the Houston Court of Appeals addressed the duty to defend and extrinsic evidence issue in the context of an additional insured tender. In 2002, James and Cicely Holmes sued D.R. Horton alleging that their house contained latent defects that led to the propagation of toxic mold. The Holmes' petition was silent about D.R.

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Recent Decisions Obtained by Our Insurance Law Practice Group:

***Harleysville Lake States Ins. Co. v. Granite Ridge Builders, Inc.*, 2009 WL 4843558 (N.D. Ind. Dec. 14, 2009) (finding that an insurer had waived coverage defenses by not timely reserving rights)**

***Middlesex Ins. Co. v. PBC Operations, L.P.*, 2009 WL 3756842 (W.D. Tex. Nov. 5, 2009) (finding the prior publication exclusion inapplicable to allegations of trade dress infringement where the allegations are unclear as to the timing of such alleged infringement)**

***Basic Energy Servs., Inc. v. Liberty Mut. Ins. Co.*, 2009 Wl 2998134 (W.D. Tex. Sept. 18, 2009) (holding that an insurer's obligation to reimburse defense costs is governed by Texas' "eight corners" rule even though no "duty" to defend exists in the policy)**

***ARM Prop. Mgmt. Group v. RSUI Indem. Co.*, 642 F. Supp. 2d 592 (W.D. Tex. 2009) (finding that an excess insurer was obligated to pay losses incurred as a result of Hurricane Katrina)**

News from the Insurance Law Group of Visser Shidlofsky LLP:

The Insurance Law Group currently represents the officers and directors of the Stanford Financial Group with respect to coverage issues.

Horton's use of subcontractors to construct the home. In particular, the Holmes' petition did not name any subcontractors, nor did it make any reference to damage caused by any of D.R. Horton's subcontractors. D.R. Horton, however, had extrinsic evidence that demonstrated that the alleged damages to the home were caused, at least in part, by work performed on D.R. Horton's behalf by its masonry subcontractor.

Accordingly, since D.R. Horton required its subcontractors to name it as an additional insured, D.R. Horton tendered the Holmes' lawsuit to the liability carriers for the masonry subcontractor. Those insurers, however, declined to defend D.R. Horton based on the fact that the Holmes' petition failed to mention the use of, or otherwise reference, any subcontractors. In particular, the additional insured endorsement limited the insurer's liability to those claims arising out of the named insured's (i.e., the masonry subcontractor) work for the additional insured (D.R. Horton).

In the coverage litigation against the additional insured carriers, D.R. Horton sought to introduce extrinsic evidence that the damages to the home were caused by the masonry subcontractor (i.e., the named insured). The trial court refused to permit the use of extrinsic evidence. The court of appeals, while recognizing that D.R. Horton "produced a significant amount of summary judgment evidence that . . . links [the masonry subcontractor] to the injuries claimed by the Holmeses," concluded that the trial court properly excluded the evidence. *D.R. Horton*, 2006 WL 3050756, at *5. In particular, without explaining its basis, the court of appeals side-stepped the extrinsic evidence debate by classifying the evidence before it as relating to *both* coverage and liability. *See id.* at *5 n.11. After ruling that no duty to defend existed, based on a strict "eight-corners" analysis, the court of appeals then ruled that there necessarily can be no duty to indemnify. *Id.* at *6.

B. D.R. Horton Waived Its Extrinsic Evidence Argument

In its opinion, the Supreme Court first noted that D.R. Horton's argument that the court of appeals erred by not recognizing an exception to the "eight corners" rule had been waived. *Id.* at *2. In particular, the Court noted that D.R. Horton did not argue for an exception to the "eight corners" rule in the trial court or in the court of appeals until its second motion for rehearing was filed, following the Court's issuance of its opinion in *GuideOne Elite Insurance Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006). The Court explained that, under Texas' summary judgment rules, issues not raised in the trial court cannot be grounds for reversal on appeal. *D.R. Horton*, 2009 WL 4728008 at *2. And, while D.R. Horton had argued in response to Markel's summary judgment motion that the trial court should apply the "eight corners" rule and liberally construe the underlying petition in its favor, the Court found that that was not the same as challenging the "eight corners" rule or urging an exception to the rule. *Id.* Accordingly, the court refused to disturb the court of appeals' duty to defend ruling in favor of Markel. *Id.*

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C. No Duty to Defend Does Not Mean No Duty to Indemnify

Turning to D.R. Horton's second argument, regarding the duty to indemnify, the Court explained that liability policies generally include two duties owed by the insurer to the insured: (1) the duty to defend; and (2) the duty to indemnify. *Id.* Importantly, those "are distinct and separate duties." *Id.* And, as the Court noted in *Farmers Texas County Mutual Insurance Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997), one duty may exist without the other. *D.R. Horton*, 2009 WL 4728008 at *2. Thus, "the duties enjoy a degree of independence from each other." *Id.* (citations omitted).

Elaborating on their differences, the Court reiterated that the duty to defend "has been strictly circumscribed by the eight-corners doctrine" while the duty to indemnify is controlled by the "facts actually established in the underlying suit." *Id.* at *3 (citing *Pine Oak*, 279 S.W.3d at 656; *GuideOne*, 197 S.W.3d at 310). Thus, while the duty to defend is determined by considering only the factual allegations in the pleadings and the terms of the insurance policy, the insurer's duty to indemnify its insured "depends on the facts proven and whether the damages caused by the actions or omissions proven are covered by the terms of the policy." *Id.* The Court explained that in order to determine the insurer's duty to indemnify, evidence is necessary in the coverage litigation and that is especially true when the underlying lawsuit is resolved prior to a trial on the merits and no opportunity to develop the evidence existed—as was the case in *D.R. Horton*. Thus, the Court held "that even if Markel has no duty to defend D.R. Horton, it may still have a duty to indemnify D.R. Horton as an additional insured under Ramirez's CGL insurance policy. That determination hinges on the facts established and the terms and conditions of the CGL policy." *Id.*

The Court specifically rejected the insurer's argument that, if the underlying pleadings do not trigger a duty to defend, then proof of all those same allegations likewise could not trigger the insurer's duty to indemnify. *Id.* The Court explained that Markel's reliance on *Griffin* was misplaced because that holding was "fact-specific and cannot be construed so broadly." *Id.* (citing *Griffin*, 955 S.W.2d at 84). The result in *Griffin*, in which "the duty to indemnify [was] justiciable before the insured's liability [was] determined in the liability lawsuit when the insurer ha[d] no duty to defend and the same reasons that negate[d] the duty to defend [] likewise negate[d] any possibility the insurer will ever have a duty to indemnify,"

> **was grounded on the impossibility that the drive-by shooting in that case could be transformed by proof of any conceivable set of facts into an auto accident covered by the insurance policy. It was not based on a rationale that if a duty to defend does not arise from the pleadings, no duty to indemnify could arise from proof of the allegations in the petition. These duties are independent, and the existence of**

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one does not necessarily depend on the existence or proof of the other.

Id. **In fact, the Court noted that, in *Griffin*, it recognized that sometimes resolving the duty to indemnify must wait until after the underlying litigation is completed because coverage may turn on the facts adjudicated in that lawsuit. *Id.* at *4.**

And, while the facts before the Court in *Griffin* allowed a ruling on the duty to indemnify prior to adjudication of the underlying facts, the *D.R. Horton* case was not as clear. Rather, D.R. Horton presented evidence in its response to Markel's motion for summary judgment that showed that D.R. Horton used a masonry subcontractor, Markel's insured, on the home and that the subcontractor's work and repairs allegedly contributed to the defects for which D.R. Horton was sued. Moreover, D.R. Horton presented evidence that the subcontractor had named D.R. Horton as an additional insured on its CGL policy. Thus, with respect to Markel's motion for summary judgment on the duty to indemnify, that evidence raised fact questions that needed to be addressed by the lower court. The Court acknowledged that other terms of the policy or other evidence presented by the insurer or the putative insured could establish or refute the insurer's duty to indemnify. Accordingly, the court affirmed the court of appeals' decision on the duty to defend, albeit for different reasons, and reversed the judgment as to the duty to indemnify, remanding the case to the trial court for proceedings consistent with its opinion. *Id.*

Commentary:

The Court's ruling in *D.R. Horton* is very significant. Since *Griffin*, insurance carriers consistently have attempted to stretch the Court's holding in that case in order to defeat the duty to indemnify whenever the underlying pleadings are insufficient to establish the insurer's duty to defend. In doing so, the carriers—and the courts that agreed with them—pulled indemnity from the insureds even when the *actual* facts would establish the insured's entitlement to indemnity. And, as such, those courts and carriers left insureds at the mercy of the pleadings filed by the underlying plaintiffs. Importantly, by reversing its denial of petition for review in this case, the Court took the opportunity to clarify this important aspect of insurance coverage law while upholding the general principles of Texas insurance law—the duty to defend is governed by a strict "eight corners" rule but the duty to indemnify is governed by the actual facts. In other words, the two duties truly are "separate and distinct."

We are proud to note that the Supreme Court adopted our reasoning on this issue *in toto*. In particular, while the lack of a duty to defend *sometimes* can negate the duty to indemnify, it is by no means an absolute rule.

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

Lee H. 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 is Secretary of the Insurance Law Section and holds a council position in 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. Lee has been named a "Super Lawyer" by Texas Monthly Magazine each year since 2004, including a ranking as a Top 50 attorney in the Central and West Texas Region since 2007. He is ranked as a top insurance coverage lawyer by Chambers USA and Who's Who Legal and Chambers USA also named Visser Shidlofsky LLP as a top insurance coverage law firm. Lee recently was elected a Fellow of the Texas Bar Foundation.

Douglas P. Skelley is an associate at Visser Shidlofsky LLP. He represents and counsels corporate policyholders in numerous insurance law matters. Doug is a member of both the Insurance Law Section and the Construction Law Section of the State Bar of Texas.

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.

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