

HANNA & PLAUT LLP

ATTORNEYS AT LAW

***Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 2007 WL 2459193 (Tex. Aug. 31, 2007): A Bleak Day for Liability Insurers – Contractor’s Defective Construction Constitutes an “Occurrence” and “Property Damage” Under the CGL Policy and the Duty to Defend is a First-Party Claim for Statutory Prompt Payment Penalties.**

In a long-awaited opinion, the Texas Supreme Court recently resolved three issues that had caused consternation and inconsistency among the intermediate state courts of appeals and the federal bar. Lamar Homes arose out of claims that Lamar Homes and its subcontractor failed to properly design and construct a foundation for homeowners Vincent and Janice DiMare and that this negligence caused further problems with the home. Mid-Continent denied defense and indemnity to Lamar Homes in the underlying suit and Lamar Homes sued for a declaration that the CGL policy provided coverage and that Mid-Continent was also liable for penalties and attorney’s fees under the prompt payment statute. The federal district court granted summary judgment for Mid-Continent, concluding that it had no duty to defend Lamar Homes for construction errors that harmed only Lamar Homes’ own product. On appeal, the Fifth Circuit submitted three certified questions to the supreme court: (1) Does a general contractor’s construction defects that cause damage to or loss of use of a home constitute an “accident” or “occurrence” under a CGL policy that triggers a duty to defend or indemnify? (2) Does a general contractor’s construction defects that cause damage to or loss of use of a home constitute “property damage” under a CGL policy that triggers a duty to defend or indemnify? (3) If the answers to the first two question are affirmative, does the prompt-payment statute apply to a CGL insurer’s breach of the duty to defend? The supreme court, in a 6-3 decision, answered “yes” to each question.

Accident or Occurrence

With regard to whether defective construction can constitute an accident or occurrence, Mid-Continent argued that defective work which causes damage only to the project itself is not accidental because the contractor should expect and foresee this result. Mid-Continent also argued, as it did with regard to “property damage,” that extending CGL coverage in this instance transforms the policy into a performance bond that protects the contractor from contractual economic loss rather than tort liability. In rejecting these arguments the court noted that the policy does not define “occurrence” in terms of either property ownership or the legal theories under which damages are sought. The court also found the possibility of overlapping coverage with a performance bond unpersuasive and held that “[n]o rule of construction operates to eliminate coverage simply because similar protections may be available through another insurance product.” Finally, the court held that “foreseeability” was not the boundary between accidental and intentional conduct. Only in cases of intentional tort, in which the intent to injure is presumed, and cases in which “the resulting damage . . . was highly probable whether the insured was negligent or not” would the injury not be considered an “accident.” The court opined that Mid-Continent’s argument included the false assumption that the failure to perform under a contract was always intentional. Because no one asserted that Lamar intended or expected its work or its subcontractor’s work to damage the DiMares’ home, the “occurrence” condition was satisfied.

Property Damage

As with the “occurrence” requirement, the court rejected Mid-Continent’s argument that damage to the insured’s own work is not “property damage” but contractual economic loss. The court concluded that the economic loss rule is a liability defense or remedies doctrine that restricts contracting parties to contractual remedies, not a test for insurance coverage. The court further noted that the policy definition of “property damage” did not exclude the insured’s work and that the underlying plaintiffs’ allegations of cracking sheetrock and stone veneer constituted “physical injury to tangible property” as required by the definition. In support of its holding, the court also relied on an analysis of the so-called “business risk” exclusions and their history. Noting that these exclusions eliminate coverage for many construction-related losses, the court also agreed with Lamar Homes that the “subcontractor exception” to the “your work” exclusion – which reinstates coverage for the general contractor for damage caused or liability that arises from a subcontractor’s work – would be superfluous if defective workmanship were not “property damage” caused by an occurrence in the first place.

Prompt Payment

After holding that the allegations of defective construction constituted both an “occurrence” and “property damage” sufficient to invoke Mid-Continent’s duty to defend, the court turned to the question of whether Mid-Continent’s breach of that duty was a “first-party claim” to which the prompt payment statute applied. Breaking rank with the majority of Texas appellate courts to consider the issue, the supreme court held that the duty to defend was a “first-party claim” under the statute because the loss “belongs only to the insured and is in no way derivative of the any loss suffered by a third party.” The court also rejected the notion that defense benefits are not a first-party claim because they are typically paid directly to the attorney as a “distinction without a difference” since other first-party claims are also often assigned or paid to service providers. The court further noted that “first-party claim” as used in the statute was not synonymous with a claim under a first-party policy and rejected the contention that the statute was unworkable in the context of defense benefits. The court held that the receipt of invoices for the legal services would be the last piece of information needed to value the claim and trigger the payment deadlines of the statute.

The Dissent

While the dissent conceded that the CGL policy does not distinguish between contract and tort claims or mention “economic loss,” it still concluded that allegations of defective construction do not constitute “property damage” because “[s]elling damaged property is not the same as damaging property.” Accordingly, the dissent characterized the homebuyers’ claims for construction defects as “broken promises and breached duties connected with the sale” rather than claims for “property damage.” Under the dissent’s view, only damage to a third person or property or damage to the home that the builder causes after the sale would constitute “property damage” as envisioned by the CGL policy.

The dissent charged that the majority’s holdings will “turn the construction industry on its head” since the duty to make necessary repairs and stand behind subcontractors’ work is shifted from the builders to insurers. The majority disagreed with the dissent’s arguments and characterizations and accused the dissent of creating a “code” for interpretation of the CGL policy rather than following the policy’s plain language. The dissent did not address the prompt payment issue.

Comment

Lamar Homes will have far-reaching effects not only in construction coverage cases, but in all liability cases involving tangible products due to the court’s interpretation of “property damage.” With this issue decided, we expect to see increased focus on the exclusions as the next line of defense. Moreover, the court’s holding that the prompt payment statute’s penalties and attorney’s fees apply to the duty-to-defend adds pressure on carriers to reach a correct coverage decision at the outset of liability claims.