Insurance Litigation & Coverage News

Volume 06 - 01 | Spring 2006

EXPERIENCED. EFFICIENT. EFFECTIVE.

THOMPSON COE

Contents

The Texas Supreme Court Hears Oral Arguments in the *Lamar Homes* case

The Fifth Circuit recently certified important questions to the Texas Supreme Court, in *Lamar Homes v. Mid Continent Casualty Company*, 2005 WL 2432029 (5th Cir. Tex., Oct. 3, 2005), regarding whether allegations of faulty workmanship constitute an "occurrence" or could result in "property damage." On February 14, 2006, the Texas Supreme Court heard oral arguments in this case. Now, carriers and policyholders alike wait with bated breath as the issue is decided once and for all.

In the *Lamar Homes* case, Vincent and Janice DiMare alleged that Lamar Homes was negligent and failed to design and/or construct the foundation of their home in a good and workmanlike fashion in accordance with implied and express warranties. During the oral arguments, the court asked questions geared towards clarifying the "accident" definition in faulty workmanship cases. Lamar Homes argues that it is the unintended and unexpected damage that results from the faulty workmanship that is the "accident." For example, if there is a claim alleging only that a contractor improperly installed windows, then there is no property damage and no accident. If, however, the claim alleges that the improperly installed windows leaked, causing water damage, then the resulting damage from the water intrusion is the unexpected and unintended result of the faulty workmanship, and thus, the "accident."

Mid Continent, on the other hand, contends that there was no "accident" in this faulty workmanship case because the resulting damage to Lamar Homes' work is the natural, probable and foreseeable result of failing to construct a building properly. More specifically, Mid Continent contends that the natural, probable and foreseeable result of negligently constructing a foundation is cracks and water intrusion, and thus, cannot constitute an "accident." The court repeatedly commented on how it found it difficult to imagine how building a foundation improperly or breaching a contract, for example, could be an accident.

Moreover, the court was concerned about the effect of adopting Lamar Homes' position on the contractual responsibility of general contractors. Specifically, the court was concerned that if general contractors were provided coverage for faulty work-

See *Lamar Homes* on Page 7

CONFIDENTIALITY: BUT AT WHAT COST?

A 2003 tax court case has recently been making the rounds among plaintiffs' lawyers and causing concern regarding the tax consequences of confidentiality provisions. It has long been accepted that settlements involving physical injuries or sickness are excluded from gross income for tax purposes. It is not uncommon for settlement agreements to contain confidentiality provisions. However, those confidentiality provisions may now subject the plaintiffs to adverse tax consequences. In *Amos v. Commissioner of Internal Revenue*, 86 T.C.M. (T.C.C.H. 663 2003), a cameraman, who was kicked during an NBA basketball game by Chicago Bulls forward Dennis Rodman, filed suit against Mr. Rodman for the injuries received as a result of the altercation. Shortly thereafter, he reached a $200,000 settlement that contained a confidentiality provision. When Amos filed his tax return for that year, he excluded from his gross income the $200,000 he received from Rodman as personal injury damages. After an audit, the IRS determined that except for a minimal amount, Amos was not entitled to exclude the remaining proceeds from his gross income because the payment was almost exclusively for the confidentiality provision and not for personal injuries. Amos appealed the decision to the U.S. Tax Court which determined that $80,000 of the $200,000 was attributable to the confidentiality provision and was therefore taxable income.

> " The taxpayer must demonstrate that the underlying cause of action giving rise to their recovery was based upon tort or tort type rights, and the tax payer must show that the damages were received on account of personal injuries or sickness."

The Tax Court focused on the fact that it was Amos' burden to prove that the IRS had been erroneous in its assessment that the income excluded by the claimant under Section 104(a)(2) was actually taxable income. The court noted that, "the taxpayer must demonstrate that the underlying cause of action giving rise to their recovery was based upon tort or tort type rights; and the taxpayer must show that the damages were received on account of personal injuries or sickness." The *Amos* court then noted that where damages were received pursuant to a confidential settlement agreement, the following factors should be considered in determining whether such damages are excludable from gross income:

(1) the name and character of the claim that was the actual basis for the settlement and its factual basis;

(2) the existence of any express language in the settlement agreement stating what amount was paid by the defendant to settle the plaintiff's personal injury claim;

(3) the defendant's dominant intent in making the payment, which is a critical factor; and

(4) the belief of the plaintiff in receiving the payment.

The *Amos* court held that though Rodman's dominant purpose for paying the settlement amount was to compensate Amos for his personal injuries, the fact that the settlement agreement expressly provided a portion of the settlement proceeds were paid by Rodman for Amos' promise not to defame Rodman, disclose the terms of settlement agreement, publicize facts related to the accident or assist in any criminal prosecution against Rodman was evidence that an amount was also paid to Amos for non-physical injuries. *Id*.

This holding and its recent notoriety is causing great concern among the plaintiffs' bar with regard to confidentiality provisions in settlement agreements. More and more plaintiffs' lawyers are either refusing to allow their clients to sign settlement agreements with confidentiality provisions or are requiring a premium be paid for such provisions. Alternatively, a number of plaintiffs' counsel are currently requesting that an amount that is paid for the confidentiality agreement be specifically set forth in the settlement agreement so that their client's tax liability is fixed. Finally, a segment of plaintiffs' lawyers are also requesting indemnification for their clients from the defendants when the defendants are insistent upon the confidentiality provisions but refuse to provide additional safeguards.

However the parties choose to deal with the issue, one thing is for sure. The costs of confidential settlements has just gone up.

Lisa A. Songy
lsongy@thompsoncoe.com
214.871.8215

"Sufficiently Definite" Contract is Close Enough — Owner Qualifies as Additional Insured

In mid-December, the Texas Supreme Court issued an opinion in *ATOFINA Petrochemicals, Inc. v. Continental Casualty Co.*, No. 04-0170, 2005 WL 3445514 (Tex. Dec. 16, 2005) (per curiam), and held that a property owner was an additional insured under a contractor's comprehensive general liability policy with respect to an accident injuring the contractor's employee. In that case, A&B Builders, Inc. ("A&B") was hired to erect steel for construction on property owned by ATOFINA Petrochemicals, Inc. ("Fina"). The first day that A&B was scheduled to work, Larry Don Wisdom, an A&B employee, was injured while unloading steel.

Following the accident, Wisdom sued Fina and two other defendants for negligence, alleging his injuries were caused "by the total negligence and carelessness of Defendants." *Id. at *1*. Fina subsequently sought a defense and coverage as an additional insured under A&B's comprehensive general liability policy, issued by Continental Casualty Company.

A&B's policy contained an endorsement providing that, if A&B was required to add another person or organization as an additional insured under a written contract and issue a certificate of insurance listing that person, that person or organization was added as an "additional insured." The trial court granted partial summary judgment, holding that Fina was an additional insured and coverage was not barred by a limitation within the additional insured endorsement. The First District Court of Appeals of Houston reversed the trial court's decision.

In reversing the court of appeals and reinstating the trial court's judgment, the Texas Supreme Court found that A&B and Fina had a written contract requiring A&B to provide insurance covering Fina. The court noted that even though the contract obligating A&B to "furnish . . . insurance" did not specify the type of coverage or the policy limits to be provided, it contained all the material terms. Further, Fina and A&B had worked together before and had an understanding that Fina was to be added to A&B's existing policy as an additional insured. Therefore, the court held that the contract between A&B and Fina was "sufficiently definite for the parties to understand their obligations." *Id. at *2* (citing *T.O. Stanley v. Boot Co. v. Bank of El Paso*, 847 S.W.2d 218, 221 (Tex. 1992)).

The Texas Supreme Court also made several other rulings in finding coverage for Fina. First, the court did not fault Fina for not obtaining a certificate of insurance before beginning work, holding that nothing in the record indicated that the parties attempted to manufacture coverage after the accident, and that the issuance of a certificate was not a condition precedent to Fina attaining coverage as an additional insured.

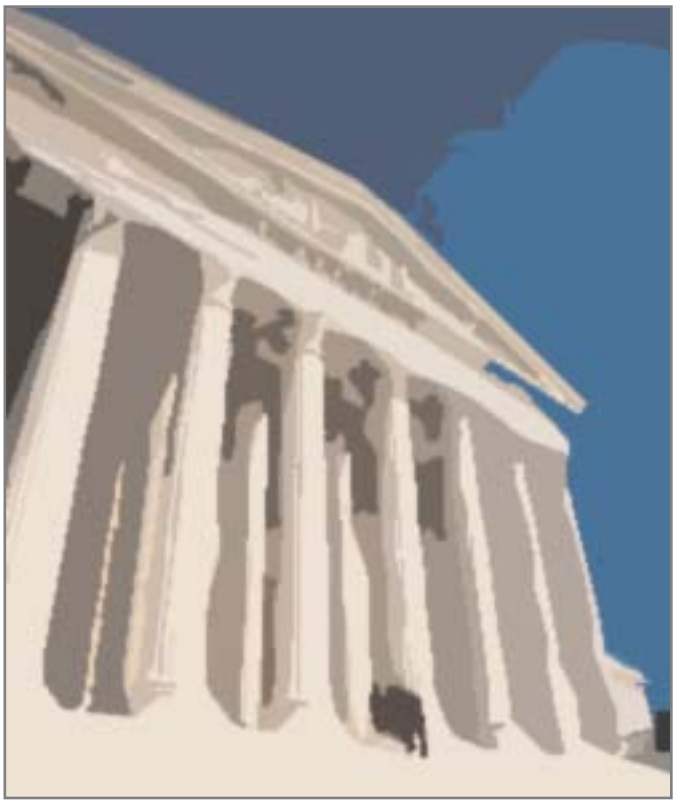
Significantly, the court also ruled that a paragraph in the policy stating that the additional insured endorsement "does not apply to . . . any liability arising out of any act, error or omission of the additional insured, or any of its employees" excluded only Fina's sole negligence. Because the pleadings alleged that the injuries were caused at least in part by A&B's negligence, additional insured coverage was afforded to Fina under the policy.

A petition for rehearing of the case was filed on January 16, 2006.

Stephanie S. Rojo
srojo@thompsoncoe.com
713.403.8291

THE RIGHT TO REIMBURSEMENT APPEARS TO BE ANYTHING BUT SETTLED: *EXCESS UNDERWRITERS AT LLOYD'S LONDON, ET. AL. V. FRANK'S CASING CREW & RENTAL TOOLS*

One of the most important issues in Texas insurance law is center-stage at this moment: whether a liability insurer has a right to recoup from its insured settlement amounts or defense costs paid in connection with a third-party claim when coverage is disputed. Despite opinions by the Supreme Court of Texas in two recent cases, this issue is now anything but settled, especially since the court recently granted rehearing and heard oral argument for a second time in one of those cases. *See Excess Underwriters at Lloyd's London, et al. v. Frank's Casing Crew & Rental Tools*, No. 02-0730, 2005 WL 1252321 (Tex. May 27, 2005)(reh'g granted).



Texas law appeared to take a turn in the insured's favor on the reimbursement issue in 2000, thanks to the supreme court's ruling in *Texas Association of Counties County Government Risk Management Pool v. Matagorda County*, 52 S.W.3d 128 (Tex. 2000). In *Matagorda County*, the court held that an insurer could not seek reimbursement from its insured for paying a settlement unless the insured expressly agreed to the settlement and to the insurer's right to seek reimbursement. The court refused to imply consent based upon the insured's silence in responding to the insurer's reservation of rights letter or the insured's stipulation acknowledging no dispute as to the reasonableness of the settlement.

In May 2005 in *Frank's Casing*, however, the Supreme Court of Texas appeared to essentially abandon its holding in *Matagorda County*, even though they claimed they were not overruling it. The court held that if a liability insurer timely reserves rights, notifies the insured it intends to seek reimbursement, and pays to settle a claim that is not covered, a right of reimbursement will be implied at law in *at least two circumstances*:

> (1) when an insured has demanded that its insurer accept a settlement offer that is within policy limits, or
>
> (2) when an insured expressly agrees that the settlement offer should be accepted.

The majority opinion was authored by Justice Priscilla Owen, who subsequently left the court to become a judge on the U.S. Court of Appeals for the Fifth Circuit. Additionally, only seven justices participated in the decision because of one vacancy at the court and because one of the justices, Scott Brister, wrote the court of appeals' opinion before joining the court. Two of the seven participating justices, Justices Harriet O'Neill and Dale Wainwright, agreed that the insurer was entitled to reimbursement under the facts of the case, but wrote separate opinions concurring only in part with the court's opinion. Finally, although Justice Nathan Hecht fully agreed with the court's opinion, he wrote a separate concurring opinion to express his belief that *Matagorda County* was wrongly decided and was effectively overruled by the court's decision in *Frank's Casing*.

The *Frank's Casing* decision has sparked much heated debate between the insurance industry and consumers. The industry has welcomed the decision as necessary to prevent insureds from receiving the windfall that results when a liability insurer pays to settle claims which are ultimately proven to be not covered. On the other hand, insureds have criticized the decision on the grounds that it creates an extra-contractual right in favor of insurers and removes the incentive for insurers to decide and litigate coverage issues before the underlying suit is tried.

Moreover, insurance defense attorneys have expressed the concern that the decision creates conflicts of interests by potentially embroiling them in disputes between the carrier and insured over settlements.

After Frank's Casing filed a motion for rehearing, many outside groups filed amicus briefs with the Supreme Court of Texas in response to the May 2005 opinion. The controversy over the opinion and turnover at the court in the interim (Justice Owen has left the court and two new justices have been appointed) set the stage for the court to reconsider its decision.

On January 6, 2006, the Supreme Court granted Frank's Casing's motion for rehearing and took the somewhat unusual step of ordering a second oral argument, which was held on February 15, 2006. Eight of the court's nine justices participated in the oral argument. (Justice Brister did not participate because he wrote the court of appeals' decision.)

The justices questioned the insurer's counsel about the possibility of including a right to reimbursement provision in policies and charging lower premiums because of the provision. They also asked whether a right to reimbursement removes the incentive for early settlement.

The justices also questioned Frank's Casing's counsel as to why the insured should be able to receive a windfall in the form of the insurer's settlement of a non-covered claim. Perhaps the most intriguing question posed to the insured's counsel was whether the liability determination in the underlying suit against the insured should be postponed until the coverage is determined.

At oral argument, the insurer's counsel argued as follows: Reimbursement is a remedy, and no new right to reimbursement is being created. Rather, an insurer has a right under Texas law to litigate whether coverage exists, even if a coverage determination cannot be made prior to the resolution of the underlying suit. Simply put, the insurer has no duty to settle non-covered claims. Insureds benefit from the reasonable early settlement of a claim, which limits any potential for further liability and defense costs. Under the court's decision, insurers are still required to act in good faith and timely reserve rights.

In response, Frank's Casing's counsel vigorously argued that: An insurer should not be allowed to put off its coverage decision, pay to settle a claim to avoid bad faith liability, and then sue the insured for reimbursement. In settling a non-covered claim, the insurer did something that is not contemplated by the policy, and is now seeking something (reimbursement) that is not mentioned in the policy. A demand by the insured to settle a claim within policy limits should not give rise to a reimbursement claim because of the resulting conflict between the insured and its defense counsel.

Frank's Casing also contended that an implied right to reimbursement would arguably create additional leverage for the insurer to put pressure on insureds at a critical time to either contribute to settlements or face a reimbursement claim, along with the attorney's fees required to defend. Finally, Frank's Casing argued that a coverage determination must be made early in the process or it is waived, as a claimant's settlement offer necessarily reflects availability of insurance, which can be implied when no coverage determination has been made.

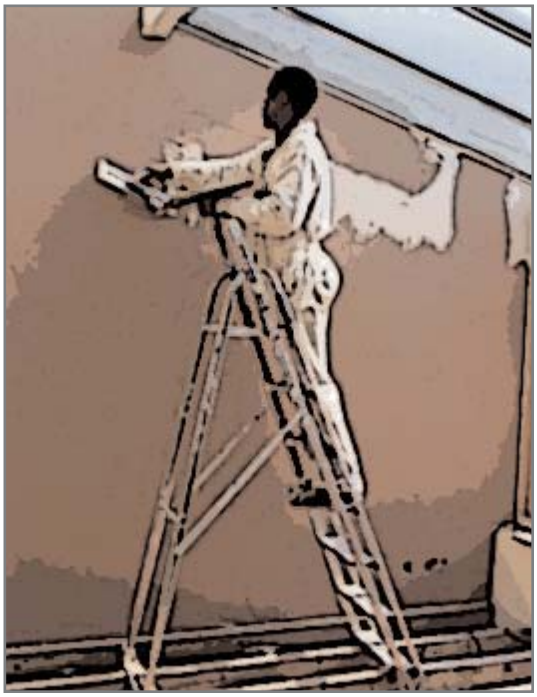
" ...the most intriguing question posed to the insured's counsel was whether the liability determination in the underlying suit against the insured should be postponed until the coverage is determined."

The decision to grant rehearing in *Frank's Casing* and the questions and comments of the justices at the oral argument suggest that the court intends to alter its original opinion. But it remains to be seen whether the court's opinion on rehearing will substantially limit or even eliminate the right of reimbursement, or simply rewrite the May 2005 opinion to address some of the concerns raised by the amicus briefs while still preserving some form of reimbursement right. Whatever the court does, one thing is certain: Not everyone will be happy.

Melanie Elisabeth Durst
mdurst@thompsoncoe.com
214.871.8265

Construction Defect Coverage Revisited — With A Twist: *Lennar Corp. v. Great Am. Ins. Co., et. al.*

The Fourteenth Court of Appeals in Houston recently reissued its opinion on the always interesting, always controversial issues regarding coverage for construction defect claims. Lennar Corporation is a general contractor responsible for building hundreds of homes in and around Houston in the 1990's. On many of these homes, Lennar used a synthetic stucco product called Exterior Insulation and Finish System ("EIFS"). Lennar contends that it later discovered that EIFS was a defectively designed product that trapped water behind it, causing water damage to other portions of the home. Lennar undertook a major warranty program to replace the EIFS on all of the Lennar built homes in the Houston area and to repair any resultant water damage. All of the carriers denied coverage to Lennar, and the coverage case was resolved at the trial court on cross-motions for summary judgment.



In a substantial change from the first opinion, the court declined to make a choice-of-law analysis between Florida and Texas, opining that the state of the law on "occurrence" for construction defect claims was unsettled in both Florida and Texas -- thus, no material differences existed between the two states necessitating such analysis. The majority of the opinion, then, details an extensive analysis of what constitutes an "occurrence" under Texas law with particular regard to construction defect claims. First, acknowledging that this very issue is before the Texas Supreme Court in *Lamar Homes*, the court determined that the structure of the policy, which includes certain business risk exclusions designed to bar coverage for the insured's own work, required an evaluation of an "occurrence" as potentially covering construction defect claims if such defective construction was inadvertent, unintended and unexpected. The court remarked that in the insuring agreement to a general liability policy, there is no language eliminating coverage for damage to the insured's own work -- i.e., a claim sounding in contract. The court emphasized that the inquiry should be whether the damage was unintended and unexpected, not whose work was damaged when considering the "occurrence" analysis.

The court then examined the variety of business risk exclusions contained in the policies. Tracing the history of the "your work" exclusion, which contains an exception for work done by a subcontractor, the court found that the current versions of the policies demonstrate an intent by insurers to cover some defective construction. The court rejected the carriers' argument that allowing a warranty project like the one undertaken by Lennar to be covered by the policies turned these policies into performance bonds. The court held that it was constrained to read the policies as providing the coverage, by the carriers' own choice of language, regardless of the overlapping effect with performance bonds.

The court did, however, hold that costs to simply replace the EIFS were not covered as property damage despite the fact that the decision by Lennar to undertake such a warranty program was prudent in reducing the overall scope of its damages. Furthermore, Lennar's overhead costs, inspection costs, personnel costs and attorneys' fees associated with their program were not covered damage "because of" property damage to be reimbursable under the policy. Lennar's costs to repair water damage to the homes were, however, covered so long as Lennar could apportion its costs between covered and non-covered damage as required by the policy.

Despite the generally unfavorable rulings on the occurrence question, the case ultimately resolved in favor of most of the carriers due to the court's decision on the number of occurrences and the application of self-insured retentions. The court held that each home constituted a separate "occurrence" under the liability policies following the "cause" analysis under Texas law. Holding that Lennar's liability stems from the fact that it built and sold homes with EIFS, the court found that Lennar was exposed to new and separate liability for each home on which EIFS was applied. With this application of "occurrence," the existence of a $250,000 per occurrence self-insured retention under many of the

Lennar policies, and the reality that no one home experienced more than or close to $250,000 in damage, no coverage was afforded under any of the policies applying a per occurrence self-insured retention. Two policies, namely, the Great American and Markel policies, have an aggregate self-insured retention of $1 million; therefore, the potential for coverage still exists under those policies.

The last significant ruling in this opinion was a determination by the court in response to Lennar's request for bad faith damages and damages under art. 21.55 (now Texas Insurance Code art. 542.055), the "prompt payment" statute. The court rejected the bad faith claims out of hand. The court also found that the indemnity payments made by Lennar for which it sought reimbursement did not qualify as a first-party claim under the terms of Texas Insurance Code art. 21.55. The court ruled that even though Lennar made the payments itself, the thrust of the claim still remained a third-party claim in that Lennar had made payments and/or experienced expenses attributable to the damages suffered by individual homeowners. This question of the application of art. 21.55 in third-party context, whether on defense (*Lamar Homes*) or indemnity (*Evanston v. ATOFINA*), is currently pending before the Texas Supreme Court. As is the case in the "occurrence" analysis, this rather well-reasoned opinion is likely to be reviewed carefully by the supreme court justices in making their final determination.

Ellen Van Meir
evanmeir@thompsoncoe.com
214.871.8220

Thompson Coe represents ICSOP in this case.

FIFTH CIRCUIT ANALYZES CGL AUTO USE EXCLUSION: *EMCASCO INSURANCE COMPANY V. AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE*

In January, the United State Fifth Circuit Court of Appeals addressed the automobile usage exclusion in a commercial general liability policy. Jaime Langston was driving down a paved, public country road when she skidded on a patch of slick mud, clay, or sand. Her car swerved off the road and struck a tree. She suffered serious injuries and her passenger died. Ms. Langston sued the operator of a sand pit located immediately adjacent to the accident site.

The sand pit operator had two different insurance policies, a commercial automobile liability policy and a commercial general liability ("CGL") policy. The CGL policy contained an exclusion for injury or damage arising out of "the ownership, maintenance, use or entrustment to others of any aircraft, auto or watercraft owned or operated by or rented or loaned to any insured." Additionally, use included operation and loading or unloading. The automobile liability policy covered damages from injury or property "caused by an accident and resulting from the ownership, maintenance of use of a covered auto."

The auto carrier eventually settled the case. The auto carrier then sued the CGL carrier for subrogation, seeking to recover all or part of the settlement. Ultimately, both parties filed cross-motions for summary judgment. The district court granted the CGL carrier's motion, finding that the damages were covered by the auto policy and were explicitly excluded by the CGL policy.

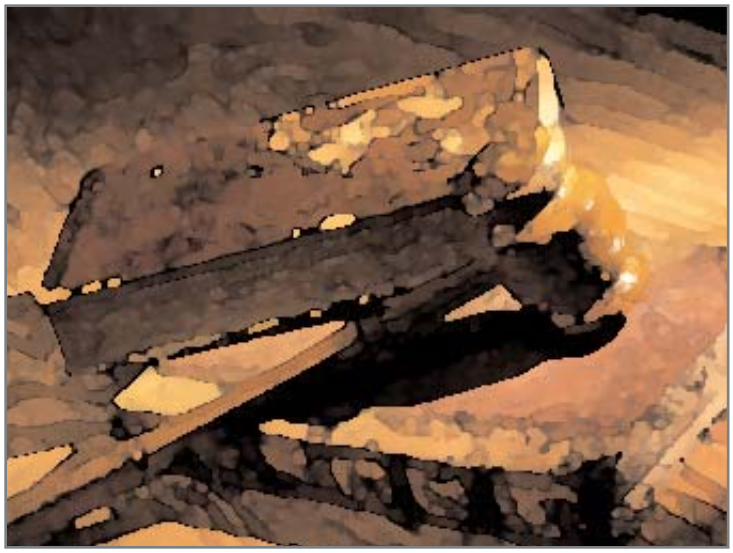
On appeal, the Fifth Circuit initially concluded that the pleadings did not preclude a duty to defend but spent the bulk of its opinion analyzing the duty to indemnify. The court summarized the complete operation test in two parts: (1) whether the insured's act was an act incident to and having a connection with the use of the truck and (2) whether the act proximately caused a plaintiff's injury. Turning to the CGL policy, the court noted that it would cover the allegations with respect to the washing of the mud by the rain, which were allegations unrelated to the use of the trucks (and a separate claim for negligence per se based on the obstruction of the road adjacent to the sand pit worksite). The court reasoned that the non-excluded event, the washing of mud from the unpaved roadway, would be covered by the general liability policy if it would have independently caused the injuries. In other words, when two separate events—one that is excluded and one that is covered by the general liability policy—independently caused an accident, Texas law mandates the general liability also provides coverage despite the exclusion.

Ultimately, the court concluded that there was, at least, a genuine issue of material fact on the issue of causation and remanded the case to the trial court.

John Sepehri
jsepehri@thompsoncoe.com
214.871.8251

COURT OF APPEALS FINDS INSURER OVERPAID CLAIM: *FIRE INSURANCE EXCHANGE V. SULLIVAN*

The Fourteenth Court of Appeals in *Fire Ins. Exch. v. Sullivan*, recently reversed a trial court judgment and rendered judgment in favor of the insurer, finding that the insurer overpaid an insured's mold and property damage claim and did not engage in bad faith. *See Fire Ins. Exch. v. Sullivan*, 2006 Tex.App. Lexis 976 (Tex. App. -- Houston [14th Dist.] Feb. 2, 2006, no pet.). Fire Insurance insured the Sullivans' home under a standard Texas homeowners policy, Form B. In late May or early June of 2001, a pipe in the Sullivans' attic burst. The Sullivans reported this leak to their agent on July 2, 2001 and also informed him of a second leak in the master bathroom shower. After an inspection, Fire Insurance estimated that repairs attributable to the attic leak would cost $2,944.75. Subtracting the Sullivans' $880 deductible, he offered a net payment of $2,064.75. The Sullivans commissioned a second inspection, which estimated the repairs at $7,290. Because of the discrepancy, the Sullivans hired an attorney.



On July 31, 2001, the Sullivans sent a written claim to Fire Insurance for mold growth and water damage. In September 2001, the Sullivans hired a contractor to investigate the damage and discovered additional leaks to the air conditioner, the master shower and the hall bath. The contractor advised the Sullivans to leave the house because it was contaminated with mold and the Sullivans relocated on September 8, 2001. Fire Insurance initiated payment of additional living expenses and requested additional testing for the residence which was performed on January 3, 2002. The test revealed that mold growth consumed the entire house and on March 6, 2002 and April 3, 2002, Fire Insurance issued two checks to the Sullivans in the amounts of $66,734.02 and $15,696.55, respectively. The Sullivans then sued Fire Insurance alleging that the delay and mishandling of their claims resulted in the deterioration of their home. In their lawsuit, the Sullivans asserted claims for breach of contract, bad faith, insurance code violations and violations of the Deceptive Trade Practices Act.

After trial, the jury found that Fire Insurance breached the dwelling coverage portion of the policy, but not the personal property and additional living expenses coverage provisions. The jury found the total amount to repair the dwelling and replace the contents to be $98,565.11. (The court considered the prior payments Fire Insurance made to the Sullivans and attributed a credit to Fire Insurance in the amount of $84,495.32). The jury also found that the Sullivans were entitled to recover damages for their breach of contract and DTPA claims in the amount of $13,189.79 and were entitled to recover penalties under former Texas Insurance Code art. 21.55 of $31,450.67, pre-judgment interest of $1,798.28, and attorneys' fees of $39,426.04, for a total judgment of $85,864.78.

Fire Insurance appealed the verdict arguing the trial court erred in including personal property costs in the judgment when the Sullivans failed to obtain findings that Fire Insurance breached the personal property coverage portion of the policy and that their loss was a covered named peril, in including the full amount of the remediation and repair cost in the judgment when the jury found that only 45% of these costs were attributable to a covered peril, and in finding that the Sullivans were entitled to interest, penalties under art. 21.55 and attorneys' fees.

The Sullivans' policy states that it does not cover loss caused by "rust, rot, mold or other fungi." The Fourteenth District Court found that the policy does provide coverage for ensuing loss caused by water damage if the loss would otherwise be covered under the policy. The court, however, concluded that the trial court erred in awarding the full amount of the mold remediation costs found by the jury because the jury attributed only 45% of these costs to the cause covered by the policy, and reduced the award by these damages. The Court of Appeals also held that because the jury did not find that Fire Insurance had breached its contract regarding the Sullivans' personal property, the trial

court erred in not rendering a take-nothing judgment as to the Sullivans' breach of contract and DTPA claims. Accordingly, the trial court should have stopped calculating penalty interest on April 3, 2002, the date the amount tendered by Fire Insurance exceeded the amount of coverage. Finally, the Court of Appeals recognized that the Sullivans could not recover attorneys' fees based on their breach of contract and DTPA claims.

As of publication date of this article, the Sullivans have not filed a petition of review with the Texas Supreme Court.

Mariah Baker Quiroz
mquiroz@thompsoncoe.com
214.871.8258

LAMAR HOMES (CONTINUED FROM PAGE 1)

manship arising out of work performed by subcontractors, then the general contractors may be less concerned about following specifications or may be less inclined to expend the proper resources to ensure adequate supervision of subcontractors because the CGL policy would cover any mistakes. The court also pointed out that lawyers, doctors and other professionals are required to carry professional liability and general liability insurance coverage, and asked why a CGL carrier should be responsible for professional mistakes of general contractors. The court asked whether it was Lamar Homes' intent when it purchased the CGL policy to have someone else pay for it if it built a defective house. Lamar Homes responded affirmatively, provided that the work was performed by a subcontractor.

In addition, the court asked questions regarding the intent of the subcontractor exception to exclusion (1)—*Damage to Your Work*. The court pointed out that surely the CGL policy intended to cover some types of "accidents," otherwise, the exception to the exclusion would be meaningless. Mid Continent responded by providing examples of the types of "accidents" the exception to the exclusion was intended to cover. For example, if someone is called out to a completed home to perform warranty work and after completing the work, flicks a match causing the home to burn down, this is an "accident" contemplated by the CGL policy. Another example is if a tree falls on a house while it is being built, this is an "accident" contemplated by the CGL policy. Mid Continent stated that ISO's creation of the CG 2294 further supports the proposition that CGL policies are not intended to cover allegations of faulty workmanship. Specifically, Mid Continent pointed out that the form was created to try to reverse the effect of many courts' interpretations of the subcontractor's exception—that the exception creates coverage under the policy that never existed.

Lastly, the court engaged in a discussion about the dichotomy between contract and tort claims and negligent and intentional tort claims. Mid Continent urged the court to follow its previous holdings *Farmers Texas County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 82 (Tex. 1997) and *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997), where the Texas Supreme Court held that the focus is on the factual allegations rather than the legal theories asserted when determining an insurer's duty to defend. In this case, while the plaintiffs allege negligence, Mid Continent argued that the plaintiff only has a claim for breach of contract because the duties and damages arise under a contract. As a result, Mid Continent argued that like damages flowing from an intentional tort are not accidental damages, damages from a breach of contract are not accidental damages. The court commented that it thought Mid Continent's intentional tort argument extended too far and wondered why, if the answer was so clear, the Fifth Circuit certified these questions to the court?

> " ...if someone is called out to a completed home to perform warranty work and after completing the work, flicks a match causing the home to burn down, this is an 'accident' contemplated by the CGL policy."

At this time, we do not know when the court will issue an opinion in this case. We cannot predict how the court might rule based on the questions asked during the oral arguments. Regardless of whether the court adopts Lamar Homes' or Mid Continent's position or comes down somewhere in the middle, the court's opinion will undoubtedly have a significant impact on both general contractors and CGL carriers.

Wade C. Crosnoe
wcrosnoe@thompsoncoe.com
512.703.5078

Selena T. Donaldson
sdonaldson@thompsoncoe.com
214.871.8254

Virtual Representation is a Virtual Reality: Texas Supreme Court Weighs In On An Insurer's Right To Intervene In A Liability Lawsuit

On February 3, 2006, the Texas Supreme Court issued an opinion affirming the virtual representation doctrine thereby allowing an insurer to intervene in the insured's appeal in order to assert a potentially dispositive issue that the insured had agreed with the plaintiff to abandon on appeal. *See In re Lumbermens Mut. Cas. Co.*, 49 Tex. Sup. Ct. J. 329 (February 3, 2006).

The *Lumbermens* case is significant for several reasons. First, it provides clarification from the Texas Supreme Court regarding the existence of the virtual representation doctrine, specifically in the insurance context. Second, it outlines the requirements for utilizing the doctrine. Lastly, the opinion also clarifies the standard for obtaining mandamus relief where a court has denied intervention under the virtual representation doctrine.

> " The *Lumbermens* case...provides clarification from the Texas Supreme Court regarding the existence of the virtual representation doctrine, specifically in the insurance context."

In *Lumbermens*, the Texas Supreme Court notes that although generally only parties of record may appeal a trial court's judgment, occasionally courts have allowed unnamed parties to pursue an appeal in order to vindicate important rights. In Lumbermens, the court ultimately finds that the insurer's interest in appealing a choice-of-law issue which is potentially dispositive to coverage issues in the case is sufficient to invoke the equitable doctrine. The court first looks to whether the insured and insurer have the same interest in the case. Although the insured and insurer now disagreed regarding the issues on appeal, the court specifically notes that in light of the $29 million supercedeas bond posted by the insurer, both parties still had the ultimate goal in the case—to reverse the underlying judgment. The court also looks at other factors, such as the post-judgment action of the parties, including the timeliness of the intervention. The Texas Supreme Court notes that although the application of the virtual representation doctrine is a case specific inquiry, the ten week delay in the insurer's intervention on appeal was not untimely given the uncertainty in the standard for allowing such intervention.

In granting the petition for mandamus in *Lumbermens*, the Court applied an abuse of discretion standard. We note though that although the Texas Supreme Court found that the court of appeals had abused its discretion in not allowing the insurer to intervene, because the doctrine is an equitable one, courts nevertheless have wide discretion to look at the particular facts of each case to determine whether the doctrine applies.

The Texas Supreme Court also notes the factors recently outlined by the Fifth Circuit Court of Appeals in *Ross v. Marshall*, 426 F.3d 745 (5th Cir. 2005). In *Ross*, the insured entered into a settlement with the plaintiffs wherein the plaintiffs agreed to not execute on the insured's property in exchange for the insured's agreement to not pursue his appeal of the underlying judgment and to assign the plaintiffs his bad faith claims against the carrier. In determining whether the insurer properly intervened in the case in order to pursue the insured's abandoned appeal, the Fifth Circuit looked to the length of time in which the would-be intervenor knew of its interest before intervening, the extent of the prejudice the existing parties may suffer because of the delay in intervention, the extent of prejudice that will occur if intervention is denied, and the existence of unusual circumstances militating against or for the timeless of the intervention.

In both *Lumbermens* and *Ross*, the courts applied the virtual representation doctrine to allow the insurer to intervene on appeal. Accordingly, these cases provide another avenue, beyond a lack of cooperation defense, for insurers to challenge findings in the trial court which their insured fails to pursue. Insurers, however, should be timely in asserting the doctrine and must likely be prepared to post a suprecedeas bond on appeal, which may ultimately bind their liability in the case.

Lisa A. Songy
lsongy@thompsoncoe.com
214.871.8215

Jacquelyn Chandler
jchandler@thompsoncoe.com
214.871.8237

Thompson Coe represented the insurer in ***Ross v. Marshall*** *case at the Fifth Circuit.*

CONGRESS EXTENDS THE TERRORISM RISK INSURANCE ACT

In the aftermath of the September 11, 2001 terrorist attacks, Congress passed the Terrorism Risk Insurance Act (TRIA). The Act established a shared responsibility between the insurance industry and the federal government for commercial property and casualty exposures against "acts of terrorism" in the United States.

TRIA was due to expire in December 2005, and in the months prior to the expiration, there was intense debate regarding whether to extend or revise TRIA. With the possibility that TRIA might not be extended, 47 states and the District of Columbia approved specific optional exclusions for terrorism coverage. The exclusions resembled the exclusions approved for use by insurance regulators following September 11, but before TRIA was enacted in 2002. However, with the expiration of TRIA just days away, on December 16, 2005, House and Senate negotiators agreed to extend TRIA through 2007. The extension is known as the Terrorism Risk Insurance Extension Act (TRIEA).

Significant Conditions of TRIEA:

- TRIA no longer applies to commercial auto insurance, burglary and theft insurance, surety insurance, professional liability insurance (other than D&O), and farm owners multi-peril insurance.
- The triggering event increases from $5 million to $50 million after March 2006; and will increase to $100 million in 2007.
- Insurer deductibles will increase from 15 percent to 17.5 percent in 2006, and 20 percent in 2007.
- Federal share of insured losses exceeding the deductible will remain at 90 percent in 2006, but will decrease to 85 percent in 2007.
- The insurance industry must cover $25 billion in 2006 and $27.5 billion in 2007 before federal assistance is available. The difference between this amount and the aggregate amount the insurers pay in deductibles and co-payments can be recouped from policyholders through a surcharge not to exceed 3 percent of the premium for covered lines per year.
- The President's Working Group on Financial Markets is required to report to Congress by September 30, 2006 regarding the long-term availability and affordability of terrorism insurance.

Jennifer L. Gibbs
jgibbs@thompsoncoe.com
214.871.8294

PERSONAL LINES INSURANCE: CHANGES IN 2006

The Texas Supreme Court is currently considering the following issues which could impact personal auto and homeowners coverage and litigation in Texas:

State Farm Mut. Auto. Ins. Co. v. Nickerson, 130 S.W.3d 487 (Tex. App.—Texarkana 2004, pet. granted).

Whether an insured seeking UM/UIM benefits can recover attorney's fees when the insured prevailed at trial on her benefits claim and the insurer paid the judgment within fifteen business days of the jury verdict.

Brainard v. Trinity Universal Ins. Co., 2004 WL 384380 (Tex. App.—Amarillo 2004, pet. granted);

State Farm Mut. Auto. Ins. Co. v. Norris, 2004 WL 811722 (Tex. App.—Waco 2004, pet. granted).

Whether prejudgment interest is recoverable as damages under the UM/UIM provision of the standard Texas personal auto policy.

Fiess v. State Farm Lloyds, certified question accepted, 48 Tex. Sup. Ct. J. 338-39 (January 21, 2005).

Whether the ensuing loss provision contained in a standard homeowners policy, when read in conjunction with the remainder of the policy, provides coverage for mold contamination caused by water damage that is otherwise covered under the policy.

Thompson, Coe, Cousins & Irons
Insurance Litigation & Coverage Section

Partners

Bradford K. Burdette	214.871.8289	bburdette@thompsoncoe.com
Jacquelyn Chandler	214.871.8237	jchandler@thompsoncoe.com
Darrell S. Cockcroft	214.871.8252	dcockcroft@thompsoncoe.com
Wade C. Crosnoe*	512.703.5078	wcrosnoe@thompsoncoe.com
Rodrigo Garcia, Jr.	713.403.8206	dgarcia@thompsoncoe.com
J. Richard Harmon	214.871.8227	rharmon@thompsoncoe.com
Roger D. Higgins**	214.871.8256	rhiggins@thompsoncoe.com
James L. Hordern, Jr.	713.403.8286	jhordern@thompsoncoe.com
Franklin M. Kennedy	214.871.8222	fkennedy@thompsoncoe.com
Robert O. Lamb	214.871.8202	rlamb@thompsoncoe.com
Brian S. Martin	713.403.8282	bmartin@thompsoncoe.com
Jay S. Simon	214.871.8217	jsimon@thompsoncoe.com
Lisa A. Songy	214.871.8215	lsongy@thompsoncoe.com
Ellen M. Van Meir	214.871.8220	evanmeir@thompsoncoe.com
Robert B. Wellenberger	214.871.8257	bwellenberger@thompsoncoe.com
Harrison H. Yoss	214.871.8259	hyoss@thompsoncoe.com

Associates

Daniel P. Buechler	214.871.8262	dbuechler@thompsoncoe.com
Jamie R. Carsey	713.403.8209	jcarsey@thompsoncoe.com
Selena T. Donaldson	214.871.8254	lchen@thompsoncoe.com
Melanie E. Durst	214.871.8265	mdurst@thompsoncoe.com
Jennifer L. Gibbs	214.871.8294	jgibbs@thompsoncoe.com
R. Tate Gorman	214.871.8250	tgorman@thompsoncoe.com
Mariah Baker Quiroz	214.871.8258	mquiroz@thompsoncoe.com
Stephanie S. Rojo	713.403.8291	srojo@thompsoncoe.com
Alan J. Rosenberg	713.403.8288	arosenberg@thompsoncoe.com
John Sepehri	214.871.8251	jsepehri@thompsoncoe.com
Jody Stasney	214.871.8274	jstasney@thompsoncoe.com
Linda M. Szuhy	214.871.8261	lszuhy@thompsoncoe.com
Rhonda J. Thompson	214.871.8273	rthompson@thompsoncoe.com
Donnie Wisenbaker	214.871.8230	dwisenbaker@thompsoncoe.com

* Certified in Civil Appellate Law, Texas Board of Legal Specialization

** Certified in Civil Trial Law and Civil Appellate Law, Texas Board of Legal Specialization

700 North Pearl
25th Floor
Plaza of the Americas
Dallas, TX 75201
214.871.8200 - Tel
214.871.8209 - Fax
www.thompsoncoe.com

THOMPSON COE

Austin

Dallas

Houston

Saint Paul

FIRST CLASS MAIL
U.S. POSTAGE
PAID
DALLAS, TX
PERMIT NO. 4209

How to Reach Us

If you would like more information about the issues discussed in this newsletter, or you have a suggestion for a future article, or you want to request additional copies or back issues, please contact Mark Blaha at mblaha@thompsoncoe.com or 214.880.2598.

Insurance Litigation & Coverage News may also be found online at www.thompsoncoe.com.

Thompson Coe's Insurance Litigation & Coverage Section counsels insurers on coverage issues and represents clients in a broad range of insurance-related litigation, including coverage disputes, bad faith and other extra-contractual liability litigation.