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J. Price Collins

Blake H. Crawford

Vanessa Durante

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*J. Price Collins**
*Blake H. Crawford***
*Vanessa Durante****

TABLE OF CONTENTS

I. INTRODUCTION

DURING this Survey period, Texas courts addressed several interesting issues, including (1) whether an insurer may have a duty to indemnify even it has no duty to defend, (2) the scope of various exclusions under a standard commercial general liability policy, and (3) whether the *Stowers* doctrine is implicated when a settlement demand requires funding from multiple insurers and no single insurer can fund the settlement within the limits that apply under its particular policy. The effect of an insured's failure to provide timely notice of a lawsuit under the notice condition of a claims made insurance policy was the subject of

* B.M., Baylor University; J.D., Baylor School of Law. Partner, Wilson, Elser, Moskowitz, Edelman & Dicker LLP.
** B.B.A., Texas Tech University; J.D., Texas Tech University School of Law. Associate, Wilson, Elser, Moskowitz, Edelman & Dicker LLP.
*** B.A., Cornell University; J.D., New York University School of Law. Associate, Wilson, Elser, Moskowitz, Edelman & Dicker LLP.

two significant Texas Supreme Court opinions during last year's survey period. This area of the law continued to evolve during this Survey period as Texas courts continued to interpret and apply the holdings from those cases. Further, the Fifth Circuit addressed the implications of the "in fact" language of certain provisions of a directors' and officers' liability policy, and whether the "eight corners rule" prevents an insurer from examining extrinsic evidence in determining whether it should reimburse its insured for defense costs under a policy that imposes no duty to defend. Additionally, the Texas Supreme Court resolved the question of whether coverage under a standard homeowners' policy exists for damage to a dwelling caused by mold from plumbing leaks.

II. NOTICE PROVISIONS

A. NOTICE UNDER A CLAIMS-MADE AND REPORTED POLICY

The United States District Court for the Southern District of Texas examined the consequences of an insured's failure to comply with a notice condition under a "claims-made and reported" policy.[1] In *Pennzoil-Quaker State Co. v. American International Specialty Lines Ins. Co.*,[2] American International Specialty Lines Insurance Company (AISLIC) issued to Pennzoil-Quaker State Company (Pennzoil) a pollution legal liability insurance policy for the policy period of October 1, 1999 to October 1, 2002.[3] The policy provided coverage for various pollution-related claims under nine separate coverage provisions.[4] One of the coverage forms obligated AISLIC to:

> [P]ay Loss on behalf of the Insured that the Insured becomes legally obligated to pay as a result of Claims first made against the Insured and reported to the Company in writing during the Policy Period . . . for Bodily Injury or Property Damage beyond the boundaries of the Insured Property that result from Pollution Conditions.[5]

The terms of that particular insuring agreement also provided that AISLIC had the duty to defend Pennzoil against any claim that was covered under certain coverage provisions of the policy.[6]

Five separate lawsuits were filed against Pennzoil between January 2001 and May 2001.[7] In each lawsuit, the plaintiffs alleged various personal injuries and property damage resulting from pollutants allegedly released by Pennzoil from its refinery in Shreveport, Louisiana.[8] The separate lawsuits were consolidated in June 2003.[9] Pennzoil timely noti-

1. 653 F. Supp. 2d 690, 693 (S.D. Tex. 2009).
2. *Id.*
3. *Id.*
4. *Id.*
5. *Id.* at 693–94.
6. *Id.* at 694.
7. *Id.* at 693.
8. *Id.*
9. *Id.*

fied AISLIC of four of the five lawsuits, but it allegedly did not provide notice of the fifth (the *Shepard* suit) until November 28, 2007.[10] Pennzoil nevertheless sought coverage for the *Shepard* suit, arguing that its failure to provide timely notice did not preclude coverage under the policy.[11] Specifically, Pennzoil argued that because it provided timely notice of one of the other suits involving the same plaintiffs as those in the *Shepard* suit, its notice of that other suit was "*de facto* notice of the *Shepard* action."[12] Pennzoil further argued that all the suits were consolidated in 2003, thus removing the need to separately report the *Shepard* suit to AISLIC.[13] Finally, Pennzoil argued that its failure to provide timely notice did not prejudice AISLIC.[14]

In examining Pennzoil's arguments and determining whether AISLIC had a duty to defend Pennzoil in the *Shepard* suit, the district court initially noted that the policy at issue was a "claims-made and reported" policy rather than an "occurrence" policy.[15] According to the district court, this distinction was important, as under an occurrence policy, "any notice requirement is subsidiary to the event that triggers coverage."[16] Thus, "timely notice is not an essential part of the bargained-for exchange."[17] In contrast, under a claims-made and reported policy, the notice condition is determinative of whether coverage is implicated, as "notice itself constitutes the event that triggers coverage."[18] As such, the notice provision of a claims-made and reported policy defines the scope of coverage for which the insurer may be liable.[19] Thus, it is essential that the claim be both made and reported by the insured to the insurer during the policy period or other specified time frame.[20] "Allowing coverage beyond that [specific time frame] would grant the insured more coverage than he bargained for and would require the insurer to cover risks for which it had not bargained."[21]

Thus, according to the district court, for Pennzoil to be entitled to coverage for the *Shepard* suit, it must have demonstrated that it (1) received the claim AND (2) provided notice of the claim to AISLIC within the applicable policy period or extended reporting period.[22] In denying Pennzoil's motion for summary judgment, the district court found that

10. *Id.* at 695.
11. *Id.*
12. *Id.* at 695–96.
13. *Id.* at 697.
14. *Id.*
15. *Id.*
16. *Id.* at 698 (quoting PAJ, Inc. v. Hanover, Inc., 263 S.W.3d 630, 636 (Tex. 2008)).
17. *Id.*
18. *Id.* (quoting Matador Petroleum Corp. v. St. Paul Surplus Lines Ins. Co., 174 F.3d 653, 659 (5th Cir. 1999)).
19. *See id.* at 698.
20. *See id.* (citing E. Tex. Med. Ctr. Reg'l Healthcare Sys. v. Lexington Ins. Co., 575 F.3d 520 (5th Cir. 2010)).
21. *Id.* (citing Komatsu v. U.S. Fire Ins. Co., 806 S.W.2d 603, 607 (Tex. App.—Fort Worth 1991, writ denied) and Yancey v. Floyd West & Co., 755 S.W.2d 914, 923 (Tex. App.—Fort Worth 1988, writ denied)).
22. *Id.* (emphasis added).

AISLIC was not required to show that it was prejudiced by Pennzoil's failure to comply with the notice condition under the policy.[23] Specifically, the court noted that although the *Shepard* suit was filed during the policy period, presumably meaning that Pennzoil received the claim during the policy period, Pennzoil did not provide AISLIC with notice of the suit prior to the expiration of the extended reporting period.[24] Importantly, the district court found that Pennzoil's timely notice of the related suit involving the same plaintiffs was insufficient to satisfy its obligation to provide notice in the *Shepard* suit.[25] The district court also noted that "[t]he administrative consolidation of the cases [did] not affect Pennzoil's notice obligation, particularly because the consolidation did not occur until 2003," which was after the expiration of the extended reporting period.[26] *Pennzoil* follows the rule established in *Prodigy Communications Corp. v Agricultural Excess & Surplus Insurance Co.*, where the Supreme Court of Texas noted that because the purpose of the "notice" condition is to allow the insurer to "close its books" on a policy, an insurer may only deny coverage for a material breach of that condition.[27]

III. INSURER'S RIGHT OF REIMBURSEMENT

In its 2007 opinion in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, the Texas Supreme Court held that any "direct claim for contribution between co-insurers disappears when the insurance policies contain other insurance or pro rata clauses."[28] Additionally, the Texas Supreme Court held that because the right of subrogation is based upon a situation where the insurer "stands in the shoes" of its insured, if the insured is fully indemnified it will have no right to pass to the insurer for the insurer to enforce.[29] *Mid-Continent* created confusion among policyholders and insurers regarding the intended scope of its holdings and the relative obligations it created among co-insurers. In particular, worries centered on whether restricting a co-insurer from seeking reimbursement or contribution from another co-insurer for payments made on behalf of a mutual insured would hamper settlement negotiations. The concern regarding the scope of *Mid-Continent* was amplified by a 2008 opinion issued by the United States District Court for the Southern District of Texas. In *Trinity Universal Ins. Co. v. Employers Mutual Casualty Co.*, the federal district court extended *Mid-Continent* to the duty to defend, holding that an insurer could not seek reimbursement of defense costs, through contribution or subrogation, from a co-insurer that wrongfully

23. *Id.*
24. *Id.*
25. *Id.*
26. *Id.*
27. Prodigy Commc'ns Corp. v. Agric. Excess & Surplus Ins. Co., 288 S.W.3d 374, 382 (Tex. 2009).
28. 236 S.W.3d 765, 772–73 (Tex. 2007).
29. *Id.* at 775–76.

refused to contribute to the defense of their common insured.[30] During this Survey period, however, the Fifth Circuit reversed the district court, finding that the district court had "mischaracterized" the Texas Supreme Court's holding in *Mid-Continent*.[31] In its opinion, the Fifth Circuit noted that *Mid-Continent* addressed only whether a co-insurer may seek reimbursement under its "other insurance" clause through contribution or subrogation from a non-paying co-insurer for amounts paid to *indemnify* their common insured.[32]

The Fifth Circuit specifically noted that "*Mid-Continent* left open the separate question of whether a co-insurer that pays more than its share *of defense costs* may recover such costs from a co-insurer who violates its duty to defend a common insured."[33] In its analysis, the Fifth Circuit reiterated the long-standing principle that although an insurer may owe only a portion of the costs associated with the defense of its insured, the insurer nevertheless has a complete duty to defend that is "equally and concurrently due" by all insurers.[34] The Fifth Circuit then focused on the fact that the "other insurance" clause addresses only an insured's "loss" but does not implicate a similar proration of defense costs.[35] Based on this, the Fifth Circuit held that the insurer seeking contribution established that it made a compulsory payment of more than its proportionate share of defense costs and was therefore entitled to contribution from the non-participating insurer.[36]

Nevertheless, shortly after the Fifth Circuit issued its opinion in *Trinity*, the Third Court of Appeals in Austin criticized the Fifth Circuit's analysis in *Trinity* and held that the Fifth Circuit misapplied the holding in *Mid-Continent*.[37] Specifically, in *Truck Insurance Exchange v. Mid-Continent Casualty Co.*, Truck Insurance Exchange (Truck) and Mid-Continent Casualty Company (MCCC)[38] shared a common insured that sought coverage from both carriers in an underlying suit.[39] Truck agreed to defend, and spent substantial sums in defending the insured through jury trial.[40]

30. Trinity Universal Ins. Co. v. Employers Mut. Cas. Co., 586 F. Supp. 2d 718, 728–30 (S.D. Tex. 2008), *aff'd in part and rev'd in part*, 592 F.3d 687 (5th Cir. 2010). For a detailed discussion, please refer to the 2008 Insurance Law Survey. J. Price Collins, Ashley E. Frizzell & Blake H. Crawford, *Family Law Insurance Law*, 62 SMU L. REV. 1267, 1289 (2009).

31. *Trinity*, 592 F.3d at 694.

32. *Id.*

33. *Id.*

34. *Id.* at 695 (quoting *Mid-Continent*, 236 S.W.3d at 772). *See also* Indian Harbor Ins. Co. v. Valley Forge Ins. Group, 535 F.3d 359, 363 (5th Cir. 2008) (recognizing that insurers must provide a complete defense under Texas law); Tex. Prop. & Cas. Ins. Guar. Ass'n v. Sw. Aggregates, Inc., 982 S.W.2d 600, 606 (Tex. App.—Austin 1998, no pet.) (noting if one claim potentially falls within coverage, the insurer must defend the entire suit).

35. *Trinity*, 592 F.3d at 695.

36. *Id.*

37. *See* Truck Ins. Exch. v. Mid-Continent Cas. Co., 320 S.W.3d 613, 622–23 (Tex. App.—Austin 2010, no pet.).

38. This acronym is used to avoid confusion regarding references to the party involved in this particular case as opposed to the supreme court's opinion in *Mid-Continent*.

39. *Truck Ins. Exch.*, 320 S.W.3d at 616.

40. *Id.*

MCCC, however, refused to defend, and instead filed a declaratory judgment action against the insured in federal court on the coverage issues after the jury rendered its verdict.[41] Truck eventually funded a $2,000,000 judgment against the insured.[42] While the federal declaratory judgment action was pending, Truck sought declaratory relief in state court that MCCC owed a duty to defend and a duty to indemnify the insured in the underlying case and that MCCC was required to reimburse Truck through contribution, subrogation, and breach of contract for the defense and settlement costs it paid on behalf of their common insured.[43] After the federal court declaratory action ended in favor of MCCC, the parties to the state court declaratory action filed cross-motions for summary judgment.[44]

The first issue before the Third Court of Appeals of Texas was whether the federal court decision in favor of MCCC on the coverage issues precluded Truck's claims in the state court declaratory action.[45] Noting that all of Truck's claims depended upon a finding that MCCC owed the common insured a duty to defend or a duty to indemnify in connection with the underlying case, the court of appeals determined that all the Texas res judicata factors were present, thus precluding relitgation of the issues that were resolved in the federal court action.[46] The court of appeals recognized that because Truck was precluded from relitigating the coverage issues in state court, MCCC was entitled to summary judgment.[47]

Even though MCCC was entitled to summary judgment based on the preclusion issue and MCCC had won its own declaratory judgment that it had no duty to defend the insured, the court of appeals nevertheless chose to address Truck's second issue regarding whether the supreme court's holding in *Mid-Continent* would apply if MCCC had breached its duty to defend.[48] Truck first argued that *Mid-Continent* should be distinguished because it does not bar a contribution claim by a co-insurer against another co-insurer that breaches the duty to defend.[49] In rejecting this argument, the court of appeals noted that "the supreme court's holding was that, in the absence of a contractual agreement between the insurers to be obligated for the proportional amount, the presence of 'other insurance' clauses in the policies precludes an equitable contribution claim."[50] The court of appeals also noted that in reaching its opinion in *Mid-Continent*, the supreme court had relied on cases in which

41. *Id.*
42. *Id.*
43. *Id.*
44. *Id.* at 615–16.
45. *Id.* at 617.
46. *Id.* at 620–21.
47. *Id.* at 618–21.
48. *Id.* at 621.
49. *Id.* at 622.
50. *Id.* (citing *Mid-Continent*, 236 S.W.3d at 773).

a co-insurer had breached its duty to defend.[51] The court of appeals then turned to Truck's argument that under the Fifth Circuit's *Trinity* opinion, "*Mid-Continent* does not apply to claims for contribution of defense costs."[52] Although the co-insurer in *Mid-Continent* sought reimbursement for settlement costs, the court of appeals noted that the supreme court had nevertheless relied on cases where a co-insurer was in fact seeking defense costs.[53] Accordingly, the court of appeals stated that it disagreed with the Fifth Circuit's view that the supreme court had left unresolved the question of whether a co-insurer may recover when it pays more than its proportionate share of defense costs, and found that Truck's contribution claim against MCCC was barred as a matter of law.[54]

During the Survey period, the Fifth Circuit also held in *Amerisure Insurance Co. v. Navigators Insurance Co.* that the Texas Supreme Court's holding in *Mid-Continent* did not bar a primary auto insurer's contractual subrogation claim against an excess insurer, even though their common insured had been fully indemnified.[55] In that case, the underlying plaintiffs sued the insureds for damages resulting from an auto accident.[56] All parties agreed that prompt settlement was in their best interests.[57] However, during settlement negotiations, the primary auto insurer insisted that coverage did not apply due to various exclusions under its policy, while the excess insurer refused to fund its portion of the settlement until the primary auto insurer had tendered its $1 million policy limit.[58] Ultimately, the primary auto insurer paid $1 million and the excess insurer paid $1.35 million to settle the case, but the primary auto insurer reserved the right to seek subrogation from the excess insurer.[59] After the district court denied the primary auto carrier's motion for summary judgment on that issue, the primary auto insurer appealed.[60]

The first issue before the Fifth Circuit was one of first impression: "whether *Mid-Continent* precludes contractual subrogation simply because the insured has been fully indemnified."[61] In holding that *Mid-Continent* does not, the Fifth Circuit stated that it agreed "with [a] majority of courts that" subrogation still exists when an insured has been fully indemnified, rejecting "the overly broad view of *Mid-Continent*'s subrogation exclusion."[62] According to the Fifth Circuit, extending the rationale from

51. *Id.* (citing Employers Cas. Co. v. Trans. Ins. Co., 444 S.W.2d 606, 607 (Tex. 1969) and Gen. Ins. Co. v. Hicks Rubber Co., 169 S.W.2d 142, 145 (Tex. 1943)).
52. *Id.*
53. *Id.* (citing *Employers*, 444 S.W.2d at 607; *Hicks Rubber*, 169 S.W.2d at 148).
54. *Id.* at 623.
55. 611 F.3d 299, 307 (5th Cir. 2010).
56. *Id.* at 302.
57. *Id.*
58. *Id.*
59. *Id.*
60. *Id.*
61. *Id.* at 305.
62. *Id.* at 307. *See also* Employers Ins. Co. of Wausau v. Penn-America Ins. Co., 705 F. Supp. 2d 646, 708 (S.D. Tex. 2010) (finding that the holding from *Mid-Continent* is limited); Arrowood Indem. Co. v. Gulf Underwriters Ins. Co., No. EP-08-CV-285-DB, 2008 U.S.

Mid-Continent beyond its application to the specific facts of that case "would effectively end contractual subrogation in Texas."[63] Finding that this was not the intent, the Fifth Circuit held "that *Mid-Continent* does not bar contractual subrogation simply because the insured is fully indemnified."[64]

Moving on to the issue of whether *Mid-Continent* precluded subrogation in this case, the Fifth Circuit likewise held that it did not.[65] Specifically, the Fifth Circuit noted that the insured in *Mid-Continent* "was fully protected because both insurers acknowledged their duties to defend and indemnify."[66] There was no dispute that both carriers owed duties to their common insured.[67] By contrast, in this case, the primary auto insurer claimed its policy did not apply, while the excess insurer refused to indemnify until the primary auto insurer paid its $1 million policy limit.[68] Noting "that dueling coinsurers must place the interests of their insureds before their own[,]"[69] the Fifth Circuit found that applying the *Mid-Continent* exclusion to a situation where the carriers disagreed regarding which one should pay would place the interests of the insured at risk.[70] The Fifth Circuit therefore held that *Mid-Continent* does not bar contractual subrogation when an insurer denies or otherwise challenges coverage under its policy.[71] The Fifth Circuit specifically explained that a contrary holding would deviate "from settled principles of Texas insurance law by discouraging insurers from first defending and indemnifying and then seeking reimbursement for the costs that a coinsurer should have paid."[72]

Dist. LEXIS 107779, at *15–16 (W.D. Tex. 2008) (finding that *Mid-Continent* was dependent on the pro rata clauses and its holding should not extend beyond the specific facts); Duininck Bros., Inc. v. Howe Precast, Inc., No. 4:06-CV-441, 2008 U.S. Dist. LEXIS 70938, at *24 (E.D. Tex. 2008) (explaining that *Mid-Continent* is a "narrow case"); Lexington Ins. Co. v. Chi. Ins. Co., No. H-06-1741, 2008 U.S. Dist. LEXIS 60629, at *38, 62–63 (S.D. Tex. 2008).

63. *Amerisource*, 611 P.3d at 307. The Fifth Circuit also recognized that the Texas Supreme Court recently issued a contractual subrogation case where it allowed a health insurer to subrogate to the rights of a patient for whom it had paid substantial medical expenses. *Id.* (citing Tex. Health Ins. Risk Pool v. Sigmundik, 315 S.W.3d 12, 14–15 (Tex. 2010)). Thus, according to the Fifth Circuit, the supreme court did not intend on ending contractual subrogation with *Mid-Continent*.

64. *Id.*

65. *Id.*

66. *Id.*

67. *Id.*

68. *Id.* at 308.

69. *Id.* (quoting Hardware Dealers Mut. Fire Ins. Co. v. Farmers Ins. Exchange, 444 S.W.2d 583, 588–89 (Tex. 1969)).

70. *Id.*

71. *See id.*

72. *Id.* (citing Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 20 S.W.3d 692, 703 (Tex. 2000) and *Hardware Dealers*, 444 S.W.2d at 588–89). *See also* Employers Ins. Co. v. Penn-Am. Ins. Co., 705 F. Supp. 2d 696, 708 (S.D. Tex. 2010). In *Employers*, the district court noted that "[c]ourts applying *Mid-Continent* have stressed that it is limited to its facts." *Id.* The district court also noted that *Mid-Continent* was never intended to preclude statutory or contractual subrogation for an "insurer of a seller asserting that its acts or omissions did not cause the underlying plaintiff's injury if the seller's insurer assumed the insured's defense and paid to settle the claim." *Id.* at 709.

Based on the opinions issued since *Mid-Continent*, it appears the federal courts are attempting to limit the holding in that case to its particular facts, whereas at least one state court has found that the decision is meant to have a broader application. Because the scope of the *Mid-Continent* holding on both the contribution and subrogation issues is still relatively uncertain, we anticipate that litigation will continue on this topic.

IV. CONTRACTUAL LIABILITY

A. THE DUTY TO DEFEND AND THE DUTY TO INDEMNIFY

It is well established that under Texas law an insurer's duty to defend is both distinct from and independent of its duty to indemnify.[73] Based on these premises, it was not uncommon for insurers to argue that if their broader duty to defend was not implicated, their narrower duty to indemnify could never be implicated.[74] During this Survey period, the Texas Supreme Court held in *D.R. Horton-Texas, Ltd. v. Markel International Insurance Company, Ltd.* that an insurer may have a duty to indemnify in certain circumstances even though it has no duty to defend.[75] In the case, homeowners sued their general contractor, D.R. Horton, for various alleged construction defects related to the construction of their home.[76] D.R. Horton sought coverage for the suit as an additional insured under a policy Markel International Insurance Company, Limited (Markel) had issued to one of D.R. Horton's subcontractors. Noting that the homeowners did not allege that the subcontractor's work was defective or caused the alleged damage, Markel denied D.R. Horton's request for coverage.[77] D.R. Horton subsequently settled the lawsuit with the homeowners and sued Markel for reimbursement of its defense costs and the amount it paid to settle the suit.[78]

After Markel filed a motion for summary judgment, D.R. Horton filed a response arguing that the pleading should be broadly construed to favor

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73. *See, e.g.*, Zurich Am. Ins. Co. v. Nokia, Inc., 268 S.W.3d 487, 490 (Tex. 2008); GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church, 197 S.W.3d 305, 310 (Tex. 2006); Utica Nat'l Ins. Co. v. Am. Indem. Co., 141 S.W.3d 198, 203 (Tex. 2004); Farmers Tex. County Mut. Ins. Co. v. Griffin, 955 S.W.2d 81, 82 (Tex. 1997); Mid-Continent Cas. Co. v. JHP Dev., Inc., 557 F.3d 207, 213 (5th Cir. 2009).

74. *See, e.g.*, Grimes Constr., Inc. v. Great Am. Lloyds Ins. Co., 188 S.W.3d 805, 818 (Tex. App.—Fort Worth 2006), *rev'd*, 248 S.W.3d 171 (Tex. 2008) ("The duty to defend is thus broader than the duty to indemnify; if an insurer has no duty to defend, it has no duty to indemnify."); Reser v. State Farm Fire & Cas. Co., 981 S.W.2d 260, 263 (Tex. App.—San Antonio 1998, no pet.) ("If the underlying petition does not raise factual allegations sufficient to invoke the duty to defend, then even proof of all of those allegations could not invoke the insurer's duty to indemnify."); Lay v. Aetna Ins. Co., 599 S.W.2d 684, 687 (Tex. App.—Austin 1980, writ ref'd n.r.e.) (finding that no indemnity existed when the duty to defend did not apply); Great Am. Ins. Co. v. Calli Homes, 236 F. Supp. 2d 693, 698 (S.D. Tex. 2002) ("If the insurer has no duty to defend the insured, no duty to indemnify is present.").

75. 300 S.W.3d 740, 741, 745 (Tex. 2010).

76. *Id.* at 742.

77. *Id.*

78. *Id.*

a defense.[79] Moreover, D.R. Horton attached to this response evidence indicating that the subcontractor was actually responsible for the work that caused the damage to the home.[80] The trial court granted Markel's motion; the court of appeals affirmed, further noting that the "eight corners doctrine" precluded the examination of extrinsic evidence in determining whether D.R. Horton was entitled to a defense.[81] Finally, "[t]he court of appeals reasoned that because Markel had no duty to defend, it also had no duty to indemnify D.R. Horton."[82]

The question before the Texas Supreme Court was whether Markel had a duty to indemnify D.R. Horton despite having no duty to defend.[83] The supreme court held that the duty to indemnify is independent of the duty to defend, and therefore an insurer may have a duty to indemnify its insured even if the duty to defend never arises.[84] The supreme court specifically noted that although Markel's duty to defend D.R. Horton was never triggered by the allegations in the homeowners' underlying petition, it is not the "eight corners doctrine," but rather the facts actually established in the underlying suit or evidence introduced in coverage litigation that determine the duty to indemnify.[85] Thus, the evidence D.R. Horton presented in its response to Markel's summary judgment motion raised sufficient fact questions to defeat Markel's motion for summary judgment on the duty to indemnify.[86] The supreme court also expressly rejected Markel's reliance on *Farmers Texas County Mutual Insurance Co. v. Griffin*, noting that under the facts presented in that case, there was no possibility that any facts outside the pleadings could have transformed the drive-by shooting at issue into an auto accident.[87] The supreme court further held that it had previously recognized that it may be necessary to wait to resolve indemnity issues until after the third-party litigation is resolved, as coverage could turn on facts developed through that litigation.[88]

What appears to be unresolved by *D.R. Horton* is whether an insurer that has no duty to defend based on the eight corners of the policy and the pleadings must nevertheless continue to monitor the underlying litigation for evidence that may implicate the duty to indemnify. Moreover, it is not clear whether *D.R. Horton* only applies in situations where additional information has been provided to the insurer, or if the insurer is

79. *Id.*
80. *Id.*
81. *See id.*
82. *Id.*
83. *Id.*
84. *Id.* at 745.
85. *Id.* at 744–45.
86. *Id.* at 745.
87. *Id.* The Texas Supreme Court also mentioned that "[s]everal authorities have mistakenly cited *Griffin*" to support the proposition that if no duty to defend exists, there can be no duty to indemnify. *Id.* at 745 n.4.
88. *Id.*

under some duty to investigate the actual facts surrounding every claim submitted for coverage.

V. EXTRA-CONTRACTUAL LIABILITY

A. THE STOWERS DOCTRINE

In *AFTCO Enterprises, Inc. v. Acceptance Indemnity Insurance Co.*, the issue was "whether a settlement offer triggers an insurer's duty to settle when the plaintiffs' settlement terms require funding from multiple insurers, and no single insurer can fund the settlement within the limits that apply under its particular policy."[89] Noting that the supreme court had previously left this question unanswered, the First District Court of Appeals of Texas found that the plaintiffs' settlement demand triggered neither insurer's *Stowers* duties.[90] The underlying personal injury lawsuits arose out of a major traffic accident that occurred in 2003 involving a tractor-trailer driven by an employee of ETSI, Inc. (ETSI) who was transporting a trailer provided by AFTCO Enterprises, Inc. (AFTCO).[91] ETSI and AFTCO were insureds under various insurance policies, including a $1 million primary policy issued by Southern County Mutual Insurance Company (Southern) and a $1 million excess policy issued by Acceptance Indemnity Insurance Company (Acceptance).[92] The underlying plaintiffs offered to settle for approximately $2.6 million.[93] Southern never responded to this initial demand; Acceptance indicated that it had no obligation unless and until the limits of all the primary policies were exhausted.[94] The plaintiffs made a subsequent offer of settlement, demanding the limits of all the insurance policies.[95] After failing to settle, the case went to trial resulting in a verdict in excess of $20 million.[96] The insurers then settled all outstanding claims with the available policy limits, thereby relieving AFTCO and ETSI of liability.[97] Thereafter, AFTCO and ETSI filed suit in state court, alleging that the insurers negligently breached their *Stowers* duties thereby causing AFTCO and ETSI to incur attorneys' fees and expenses they would not have had to incur if the insurers had settled the case before trial.[98] After Acceptance and Southern won summary judgments at the trial court, AFTCO and ETSI appealed.[99]

To determine if Acceptance and Southern breached their *Stowers* duties, the court of appeals first outlined the general principles of the *Stow-*

89. 321 S.W.3d 65, 69 (Tex. App.—Houston [1st Dist.] 2010, pet. denied).
90. *Id.* at 69, 72.
91. *Id.* at 62.
92. *Id.* at 66–67.
93. *Id.* at 67.
94. *Id.*
95. *Id.*
96. *Id.*
97. *Id.*
98. *Id.*
99. *Id.* at 68.

ers doctrine, noting first that its purpose is to "[shift] the risk of an excess judgment from the insured to the insurer by subjecting an insurer to liability for the wrongful refusal to settle a claim against the insured within policy limits."[100] Next, the court of appeals recognized that under *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, "in a claim involving multiple policies, a settlement demand does not activate one primary insurer's *Stowers* duty unless the demand falls within the applicable limits available under that single policy."[101] The court of appeals then explained that an excess insurer's *Stowers* duty is not implicated unless and until the primary insurers have tendered their limits.[102]

The court of appeals then turned to whether Southern had breached its *Stowers* duty. In holding that it had not, the court of appeals found that (1) the settlement demand was "directed toward multiple policies and all of the insurers together, in exchange for a release from multiple plaintiffs[;]" (2) the "plaintiffs did not offer to release their claims against those insured under a particular policy in exchange for the limits available under that policy[;]" and (3) "[t]he settlement demand also referred to [an amount that] was an aggregate of multiple policies and . . . exceeded the Southern policy's limits."[103] The court of appeals also held that Acceptance's *Stowers* duty was never implicated because the primary insurer neither received a demand within its limits nor tendered its limits pursuant to that demand.[104]

VI. COMMON GENERAL LIABILITY POLICIES

A. THE CONTRACTUAL LIABILITY EXCLUSION

In *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, the Texas Supreme Court adopted a broad reading of the "contractual liability" exclusion found in the standard Commercial General Liability (CGL) policy form.[105] Specifically, the supreme court held in *Gilbert* that this exclusion applies broadly to exclude coverage for claims where the insured assumes liability for damages in a contract, unless an exception to the exclusion is implicated.[106]

At issue in *Gilbert* was a claim for breach of contract asserted by an

100. *Id.* at 69 (citing Phillips v. Bramlett, 288 S.W.3d 876, 879 (Tex. 2009); Westchester Fire Ins. Co. v. Am. Contractors Ins. Co. Risk Retention Group, 1 S.W.3d 872, 874 (Tex. App.—Houston [1st Dist.] 1999, no pet.)).

101. *Id.* at 70 (citing Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765, 776 (Tex. 2007)).

102. *Id.* (citing Keck, Mahin & Cate v. Nat'l Union Fire Ins. Co. of Pittsburgh, Pa., 20 S.W.3d 692, 701 (Tex. 2000)).

103. *Id.* at 71.

104. *Id.* (citing *Keck*, 20 S.W.3d at 701 and Emscor Mfg., Inc. v. Alliance Ins. Group, 879 S.W.2d 894, 903 (Tex. App.—Houston [14th Dist.] 1994, writ denied)).

105. *See* 327 S.W.3d 118, 131–32 (Tex. 2010). The supreme court initially issued its opinion on June 4, 2010, but later withdrew that opinion after the insured filed a motion for rehearing. After denying that motion, the supreme court issued its December 17, 2010 opinion, which is discussed in this Article.

106. *Id.* at 132.

alleged third-party beneficiary of the contract.[107] The contract at issue was executed in 1993 by Dallas Area Rapid Transit Authority (DART) and Gilbert Texas Construction, L.P. (Gilbert).[108] DART contracted for Gilbert's services as general contractor in constructing a light rail system in the City of Dallas. In relevant part, the contract provided that Gilbert would "preserve and protect all structures . . . on or adjacent to the work site" and:

> [P]rotect from damage all existing improvements and utilities (1) at or near the work site and (2) on adjacent property of a third party . . . [and] repair any damage to those facilities, including those that are the property of a third party, resulting from failure to comply with the requirements of this contract or failure to exercise reasonable care in performing the work.[109]

During the course of the DART project, the Dallas area experienced heavy rains, resulting in the flooding of a building adjacent to the construction site.[110] The owner of the flooded building, RT Realty (RTR), filed suit against DART, its contractors, and various other entities involved in the project, alleging the water damage to the building was the result of the nearby construction activities.[111] RTR sued Gilbert, both in tort and for breach of contract, arguing that Gilbert had assumed liability for such damages in its contract with DART.[112] Claiming to be a third-party beneficiary of that contract, RTR asserted that Gilbert was liable to RTR for the breach.[113] In addition to its primary CGL policy, Gilbert had several layered excess coverage policies through Underwriters at Lloyd's of London (Underwriters).[114] While Gilbert's primary insurer, Argonaut Insurance Company, assumed Gilbert's defense, Underwriters sent several reservation of rights letters to Gilbert, noting that its policy did not include a duty to defend Gilbert, and that coverage for the damages sought by RTR could not yet be determined but depended upon the judgment rendered and facts found in the suit.[115]

The defendants in RTR's suit moved for summary judgment based on DART's governmental immunity as a subdivision of the state, and Gilbert's immunity as DART's contractor.[116] The trial court granted the summary judgment motions with respect to all claims in the suit except RTR's breach of contract claim against Gilbert.[117] Shortly thereafter, in another reservation of rights letter to Gilbert, Underwriters adopted the position that damages sought in RTR's breach of contract claim were not

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107. *Id.* at 121.
108. *Id.* at 121–22
109. *Id.* at 122.
110. *Id.*
111. *Id.*
112. *Id.* at 121.
113. *Id.*
114. *Id.* at 122.
115. *Id.* at 122–23.
116. *Id.* at 123.
117. *Id.*

covered under the policy due to the policy's contractual liability exclusion, which bars coverage for "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.[118] However, the "exclusion does not apply to liability for damages: (1) [a]ssumed in a contract or agreement that is an 'insured contract;' or (2) [t]hat the insured would have in the absence of the contract or agreement."[119]

Gilbert settled the breach of contract claim with RTR for $6.175 million; Underwriters denied coverage.[120] Following settlement with RTR, Gilbert brought a suit against Underwriters, alleging breach of contract for its denial of coverage.[121] The trial court granted Gilbert's motion for summary judgment with respect to coverage under the policy.[122] However, the court of appeals reversed finding for Underwriters.[123] The court of appeals held that the contractual liability exclusion barred coverage for RTR's breach of contract claim, and that the second exception to the exclusion, allowing coverage for liability the insured would have even in the absence of the contract, was inapplicable.[124]

At the supreme court, Underwriters conceded that RTR's claim fell within the broad, general terms of the policy; however, it asserted that because Gilbert's only basis for liability was Gilbert's contractual obligations assumed in the DART contract, the contractual liability exclusion applied to bar coverage.[125] Gilbert advanced a "narrow" reading of the contractual liability exclusion, arguing that the "assumption" in the exclusion referred only to the assumption of "liability *of another* such as in hold-harmless or indemnity agreements."[126] Gilbert asserted that the supreme court's opinion in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.* supported its position.[127] Gilbert also argued that, "at the very least, the [contractual liability] exclusion [was] ambiguous," and thus should "be interpreted in favor of finding coverage."[128] In the alternative, Gilbert argued that, even if the court found the exclusion to be applicable, its liability to RTR fell within the second exception to the exclusion.[129] Under this exception, coverage is restored for the insured's liability for damages that it would bear even in the absence of the contract or agreement.[130]

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118. *Id.*
119. *Id.* at 124.
120. *Id.* at 123.
121. *Id.*
122. *Id.*
123. *Id.*
124. *Id.*
125. *Id.* at 125.
126. *Id.*
127. *Id.* (*see* Lamar Homes Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1 (Tex. 2007)).
128. *Id.*
129. *Id.* at 133.
130. *Id.*

The supreme court rejected Gilbert's reading of the contractual liability exclusion, finding that the exclusion barred coverage for the liability in question and that the instant case did not fall within one of the exceptions to the exclusion.[131] Specifically, the supreme court noted that "Gilbert agreed under its contract with DART to 'repair any damage to . . . facilities, including those that are the property of a third party, resulting from failure to comply with the requirements of this contract or failure to exercise reasonable care in performing the work.'"[132] Because Gilbert had defeated all potential tort liability through summary judgment, the only remaining theory of liability arose from Gilbert's contract with DART, or in other words, "an obligation or liability contractually assumed by Gilbert."[133]

While Gilbert argued that a broader reading of the exclusion renders the term "assumption" superfluous, the supreme court characterized Gilbert's suggested interpretation as a "judicial rewrit[ing] of the insurance policy"—effectively, inserting an additional word so as to exclude only assumption of "*another's* liability."[134] The supreme court found the language of the exclusion to be plain and unambiguous and, had the parties intended the narrow exclusion for which Gilbert advocates, they easily could have drafted a policy to that effect.[135] The supreme court noted that the parties did, in fact, use such specific language in the "insured contract" definition, which references the assumption of "the tort liability *of another*."[136] Thus, the supreme court's interpretation of the exclusion is consistent with the general objective of contract interpretation in reading each provision so as to harmonize the agreement as a whole and to give meaning and effect to each provision.

Discounting the proposition that "assumption" referred only to the assumption of another's liability, the supreme court held that the exclusion applies in those situations in which the insured is obligated to pay damages by reason of the contractual assumption of liability beyond its obligations under general law.[137] Because Gilbert already owed a duty to RTR under general law principles to exercise reasonable care in performing its work, the supreme court concluded that the obligation to pay for damages "resulting from a failure to comply with the requirements of this contract" represented an additional liability Gilbert assumed by contract.[138] Having found that the exclusion applied, the supreme court also rejected Gilbert's assertion that the exclusion was ambiguous; rather, the supreme court found the language of the exclusion to be straightforward and subject to only one "reasonable interpretation."[139]

131. *Id.* at 121.
132. *Id.* at 126.
133. *Id.* at 127.
134. *Id.* at 126.
135. *Id.* at 134.
136. *Id.* at 127–28 (emphasis added).
137. *Id.* at 127.
138. *Id.*
139. *Id.* at 134.

The supreme court recognized that other jurisdictions, including the Fifth Circuit, have adopted more narrow interpretations of the exclusion.[140] However, the supreme court noted that one of the leading cases on which these courts relied had interpreted an earlier and more limited version of the standard CGL form at issue.[141] In distinguishing those cases, the supreme court found that principles of insurance policy interpretation and the plain language of the contract before them dictate a broader reading of the exclusion.[142] The court specifically explained that:

> The exclusion means what it says. It applies when the insured assumes liability for bodily injury or property damages by means of contract, unless an exception to the exclusion brings a claim back into coverage or unless the insured would have liability in the absence of the contract or agreement.[143]

The supreme court also rejected Gilbert's argument that its holding "effectively eviscerates" the *Lamar Homes* opinion, pointing out that the contractual liability exclusion was not at issue in that case.[144] The supreme court also noted that it did not address the duty to indemnify in *Lamar Homes*, whereas here Gilbert had already settled its contractual claims with RTR.[145] Finally, the supreme court considered Gilbert's alternative argument that the second exception to the exclusion restored coverage.[146] Under the second exception, the contractual liability exclusion "does not apply to liability for damages . . . that the insured would have in the absence of the contract or agreement."[147] According to Gilbert, in the absence of its contract with DART, it would not have had governmental immunity, and therefore would have been liable in tort on RTR's negligence claim. Such a basis for liability, Gilbert argued, would be independent of any contractual assumption of liability in the DART contract.[148] However, the supreme court rejected this argument,[149] saying that because Gilbert asserted no other basis for its settlement than RTR's breach of contract claim, Gilbert's settlement payment for which it sought indemnity simply was not a liability for damages it had apart from its contract with DART.[150] Thus, the supreme court affirmed the court of appeals' judgment in favor of Underwriters.[151]

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140. *Id.* at 129.
141. *Id.* at 130 (citing Olympic, Inc. v. Providence Wash. Ins. Co., 648 P.2d 1008 (Alaska 1982)).
142. *Id.* at 131–32.
143. *Id.* at 132.
144. *Id.*
145. *Id.* at 133.
146. *Id.*
147. *Id.*
148. *Id.*
149. *Id.* at 134.
150. *Id.*
151. *Id.* at 137. The supreme court also rejected Gilbert's argument that Underwriters was estopped from denying coverage. *Id.* Noting its opinion from Ulico Casualty Co. v. Allied Pilots Assoc., 262 S.W.3d 773, 782 (Tex. 2008), that estoppel cannot be used to create coverage where none existed, the supreme court held that because Gilbert would

B. "PROPERTY DAMAGE"

In *Building Specialties, Inc. v. Liberty Mutual Fire Insurance Co.*, the issue was whether a claimant had asserted claims of "property damage" against an insured.[152] In the underlying case, Building Specialties, Inc. contracted to install heating and air conditioning insulation at a home in Houston, Texas.[153] After completing its work, water began leaking from an air conditioning grill located in the home's ballroom.[154] The general contractor made repeated demands that Building Specialties pay for the costs associated with tearing down the ceiling, fixing the problem, and replacing the ceiling in the ballroom.[155] After these requests were ignored, the general contractor sued Building Specialties, alleging, in part, that it had "designed and installed the heating and air conditioning duct work" and that "defects in the installation of the duct work were discovered."[156] Building Specialties tendered the lawsuit for coverage to its CGL insurer Liberty Mutual Fire Insurance Company (Liberty).[157] Liberty denied coverage for many reasons, including the lack of "property damage," due to "no allegation[s] of damage to tangible property or loss of use of tangible property."[158] Building Specialties subsequently settled and sued Liberty, asserting breach of the insurance contract.[159] Both parties moved for summary judgment.[160]

The district court focused its discussion on the "property damage" requirement of the Coverage A insuring agreement.[161] The district court recognized that in *Lamar Homes*, the Texas Supreme Court held that for purposes of the duty to defend, allegations of unintended construction defects might constitute "property damage" caused by an "occurrence," sufficient to trigger an insurer's defense obligation.[162] However, the district court found that this holding was inapplicable to the case at bar because in *Lamar Homes*, the underlying claimants specifically alleged that the insured's work caused physical damage to other property.[163] In finding for Liberty, the district court stated:

> In this case . . . the amended petition in the underlying litigation alleged only that the duct work was defective and had to be replaced. There were no allegations of any resulting physical damage to the

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not have had coverage for the contract claims regardless of whether Underwriters assumed control of its defense, Gilbert could not show that it was prejudiced by an action of Underwriters. *See Gilbert*, 327 S.W.3d at 136–37.

152. *See* 712 F. Supp. 2d 628, 639–40 (S.D. Tex. 2010).
153. *Id.* at 631.
154. *Id.* at 632.
155. *Id.*
156. *Id.* at 632–33.
157. *Id.* at 632.
158. *Id.*
159. *Id.* at 633.
160. *Id.*
161. *Id.* at 637.
162. *Id.* at 640 (citing Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 16 (Tex. 2007)).
163. *Id.*

> duct work itself or to other parts of the house or to the loss of use. The petition sought damages only for the cost of repairing the defective duct work. The petition alleged defective work by the insured but did not allege that the defective work caused physical injury or loss of use.[164]

Accordingly, the district court held as a matter of law there was no duty to defend because the underlying lawsuit did not claim covered property damage.[165]

The holding in *Building Specialties* follows the already established principle that there is simply no "property damage" if the work done by an insured is immediately unsatisfactory as soon as completed or otherwise unsatisfactory while being performed.[166] As the Fifth Court of Appeals of Texas has stated, where the term "physical injury" is not defined, "the plain meaning connotes an alteration in appearance, shape, color, or in other material dimension."[167] Accordingly, there is no "property damage" if the property was not changed from a satisfactory state into an unsatisfactory state, or otherwise physically altered.[168] This opinion and the cases cited by the district court suggest, if the insured's defective work itself was not damaged and caused no damage to other property, there can be no "property damage" under a CGL policy.

C. THE "BUSINESS RISK" EXCLUSIONS

During this Survey period, several courts issued opinions analyzing the scope of the various "business risk" exclusions.[169] In particular, in *Essex Insurance Co. v. Hines*, the Fifth Circuit again examined the scope of exclusion j(5), which bars coverage for "property damage to 'that particular

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164. *Id.* at 645 (citing 3 ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATION OF INSURANCE COMPANIES AND INSUREDS § 11:1 (5th ed. 2010) ("[I]t is not enough that the party suing the insured has incurred property damage; the damages being sought must be because of that property damage. And the issue is not whether the insured could be sued for such damages, but whether it is being sued for such damages")).

165. Bldg. Specialties, Inc. v. Liberty Mut. Fire Ins. Co., 712 F. Supp. 2d 628, 645 (S.D. Tex. 2010).

166. *Id.* at 642; *see* Summit Custom Homes, Inc. v. Great Am. Lloyds Ins. Co., 202 S.W.3d 823, 828 (Tex. App.—Dallas 2006, pet. withdrawn); Lennar Corp. v. Great Am. Ins. Co., 200 S.W.3d 651, 678–79 (Tex. App.—Houston [14th Dist.] 2006, pet. filed) (holding that products "already in an unsatisfactory state when applied" are inherently defective and thus do not constitute "property damage"); Fritz Indus., Inc. v. Wausau Underwriters Ins. Co., No. 3:02-CV-894-L, 2004 WL 396258, at *1 (N.D. Tex. 2004); *see generally* 3 ALLAN D. WINDT, INSURANCE CLAIMS & DISPUTES: REPRESENTATIONS OF INSURANCE COMPANIES & INSUREDS § 11:1 (5th ed. 2010) ("[T]he installation/incorporation of a defective product into a larger product can constitute property damage to the larger product. It has, however, been held that the mere incorporation of an insured's defective work/product into a larger product does not constitute property damage if the defective work/product did not cause physical damage to the larger product; that is, if the alleged harm is limited to the cost of replacing the insured's defective work/product.").

167. *Summit Custom Homes*, 202 S.W.3d at 828 (citing *Lennar Corp.*, 200 S.W.3d at 678–79).

168. *Lennar Corp.*, 200 S.W.3d at 678–79.

169. Under the standard form CGL policy, the "business risk" exclusions are exclusions j., k., l., m., and n.

part of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.'"[170] Relying on *Mid-Continent Casualty Co. v. JHP Development, Inc.*, the Fifth Circuit found that the "that particular part" language "limits the scope of the exclusion to damage to parts of the property that were actually worked on by the insured."[171] The Eastern District of Texas also examined the scope of exclusion j(4), which bars coverage for damage to "[p]ersonal property in the care, custody or control of the insured."[172] In the underlying case, the insured was responsible for "making welding repairs between deliveries of flammable condensate into a disposable trough."[173] The insured "allegedly failed to properly wash and rinse the salt water trough," and when the welding resumed, a fire broke out causing extensive damage.[174] The insurer argued that because the insured was performing welding work on the trough when the fire started, the equipment and pieces compromising the trough were in its "care, custody, or control."[175] The district court held that the exclusion "applies only to the particular object of the insured's work, usually personally, and to other property which [the insured] totally and physically manipulates."[176] Because there were no allegations that the insured had the right to exercise dominion or control over the trough, the district court found that this exclusion did not apply.[177]

In *American Home Assurance Co. v. Cat Tech, LLC*, the Southern District of Texas examined the scope of exclusion k., which bars coverage for "'property damage' to 'your product' arising out of or any part of it."[178] In the standard CGL form, the term "your product" is defined, in part, as "[a]ny goods or products, other than real property, manufactured, sold, handled, distributed, or disposed of by [the insured]."[179] The underlying dispute arose out of damage to a reactor that the insured was hired to service.[180] After arbitration resulted in an award of damages against the insured, litigation ensued regarding the coverage issues.[181] In that coverage action, one of the insurer's arguments was that exclusion k. barred coverage because the insured "handled" the damaged goods and products in the course of performing its work at the refinery.[182] In response, the insured argued that pursuant to *noscitur a sociis*, the term "handled"

170. 358 Fed. Appx. 596, 599 (5th Cir. 2010).
171. *Id.* (quoting Mid-Continent Casualty Co. v. JHP Dev., Inc., 557 F.3d 207, 214 (5th Cir. 2009)).
172. Essex Ins. Co. v. McFadden, No. 6:09-CV-193, 2010 WL 2246293, at *8 (E.D. Tex. 2010).
173. *Id.* at *1.
174. *Id.*
175. *Id.* at *7.
176. *Id.* (quoting Goswick v. Employers' Cas. Co., 440 S.W.2d 287, 289–90 (Tex. 1969)).
177. *Id.*
178. 717 F. Supp. 2d 672, 679 (S.D. Tex. 2010).
179. *Id.*
180. *Id.* at 674.
181. *Id.*
182. *Id.* at 687.

means something similar to manufactured, sold, distributed, or disposed of.[183] The insurer argued that interpreting "handled" this way would render that term meaningless under the policy, and that the "'everyday meaning" of the word, which is 'to try or examine with the hand,' should be applied."[184]

In addressing the issue, the district court noted that the Fifth Circuit has held that "handled" in the context of the "your product" exclusion means "'to deal or trade in' rather than 'to touch.'"[185] The district court also specifically found that the insurer's intent to restrict the word "handled" is apparent from its inclusion with "manufactured, sold, distributed, or disposed of."[186] Noting that other jurisdictions have agreed with the Fifth Circuit's interpretation of "handled," the court found that because there was no evidence that the insured "bought, sold, dealt, traded in, or supplied any of the materials it used in performing its work on the . . . reactor," the "your product" exclusion did not apply.[187]

VII. DIRECTORS' AND OFFICERS' LIABILITY POLICIES

The Fifth Circuit recently analyzed two significant issues with respect to exclusions in directors' and officers' liability policies (D&O policies). Specifically, in *Pendergest-Holt v. Certain Underwriters at Lloyd's of London*, the Fifth Circuit court analyzed the implications of the "determined in fact" language common in certain exclusions found in D&O policies and whether the "eight corners rule" restricts an insurer from examining extrinsic evidence to determine if it should pay defense costs under a policy that does not impose a duty to defend.[188] In *Pendergest*, Underwriters issued a D&O policy to certain companies founded by R. Allen Stanford.[189] After conducting an extensive investigation, the Securities Exchange Commission (SEC) sued three of these companies and numerous individual executives (the executives) in February 2009, alleging that the companies and executives had sold investors worthless certificates of deposit through a Ponzi scheme.[190] In June 2009, the government also filed a twenty-one count criminal indictment charging four of the executives "with conspiracy to commit mail, wire, and securities fraud, wire fraud, mail fraud, conspiracy to obstruct an SEC investigation, obstruction of an SEC investigation, and conspiracy to commit money laundering."[191]

The executives sought coverage for these actions under the D&O pol-

183. *Id.*
184. *Id.* at 688.
185. *Id.* The court also noted that the dictionary definition of the term "handled" is "to buy and sell; to deal, or trade in." *Id.* (quoting WEBSTER'S NINTH COLLEGIATE DICTIONARY 550 (1990)).
186. *Id.* at 687.
187. *Id.*
188. 600 F.3d 562, 565, 567 (5th Cir. 2010).
189. *Id.* at 565.
190. *Id.*
191. *Id.*

icy issued by Underwriters.[192] This policy provided that Underwriters would pay for "[l]oss resulting from any Claim first made during the Policy Period for a Wrongful Act."[193] The D&O policy imposed no duty to defend, instead obligating Underwriters to reimburse the executives for covered defense costs they incurred in defending themselves against claims, provided they notified Underwriters before these defense costs were incurred."[194] Underwriters agreed initially to advance the defense costs to the executives, but expressly reserved their rights with respect to the "fraud" and "money laundering" exclusions.[195]

The "money laundering" exclusion barred "coverage for loss (including defense costs) resulting from any claim 'arising directly or indirectly as a result of or in connection with any act or acts (or alleged act or acts) of Money Laundering [as defined in the D&O policy].'"[196] However, the exclusion did provide for the qualified reimbursement of defense costs in limited circumstances "*until such time that it is determined that the alleged act or alleged acts* [of Money Laundering] *did in fact occur.*"[197]

Underwriters subsequently informed the executives they would no longer provide coverage for the defense costs because the Underwriters had determined from the available evidence that "Money Laundering" had, in fact, occurred.[198] The executives sued Underwriters "seeking damages, a declaration that their defense costs must be reimbursed under the D&O policy, and a preliminary injunction ordering the Underwriters to pay their defense costs until a final judgment on the merits of the coverage dispute."[199] Underwriters sought an expedited appeal after determining that the "money laundering" exclusion likely would not apply, the district court granted the executives' injunction.[200] On appeal, the Fifth Circuit initially noted that two predicate issues required resolution: (1) *who* makes the "in fact" determination (i.e., whether Underwriters' duties end under the policy when they make an "in fact" determination, subject to judicial review, or whether a court alone can make this determination); and (2) *what* can be considered in making the "in fact" determination (i.e., whether a carrier or court can review extrinsic information or if they are constrained the pleadings and policy).

Although the dictionary definitions of the terms "determined" and "in fact" supported the conclusion that a judicial decision maker must make the "in fact" decision, the Fifth Circuit court found that these definitions provided no conclusive answer on the issue.[201] The Fifth Circuit court then noted that had Underwriters desired to fill the interpretive "void,"

192. *Id.* at 566.
193. *Id.*
194. *Id.*
195. *Id.*
196. *Id.* at 567.
197. *Id.*
198. *Id.* at 567–68.
199. *Id.* at 568.
200. *Id.*
201. *Id.* at 571.

they "could have unambiguously reserved a unilateral right to determine that the alleged acts in fact occurred."[202] Because the terms of the D&O policy provided no clear direction, the court then turned to the parties' respective arguments.

Underwriters argued that they make the "in fact" determination and that their decision is "subject only to judicial reversal after the fact."[203] Conversely, the executives argued that a court must first make the "in fact" determination, and "that the underwriters' duties continue until they have a court judgment in hand, decreeing that [the wrongful act] was 'in fact' committed."[204] The Fifth Circuit court found that, in the absence of the insurer's unambiguous reservation of the right to make a unilateral coverage decision, the use of the "determined" language in conjunction with "in fact" language requires a judicial determination on the issue.[205]

In reaching its holding, the Fifth Circuit court further explained that the true question is not whether a court makes the "in fact" determination, but during which part of the judicial proceeding this determination is made.[206] The Fifth Circuit court contrasted the language from the "final adjudication" requirement sometimes used in D&O policies, with that from the "in fact" requirement at issue.[207] Citing the fact that "courts have generally imbued 'in fact' language with a broader scope than 'final adjudication,' holding . . . that the term requires a final decision on the merits in either the underlying case or a separate coverage case, or an admission by the insured," the court found that by including the "in fact" language the insurer had effectively "reserve[d] the right to litigate the coverage question outside of the underlying action."[208] Accordingly, the Fifth Circuit court found that the terms of the D&O policy, in requiring Underwriters to advance defense costs until an "in fact" determination was made by the court, "require recourse to something more than mere allegations."[209]

Having found that a court—not the insurer—must decide whether the "determined in fact" language is satisfied, the Fifth Circuit court then turned to the question of what evidence may be considered in making that decision.[210] The executives argued that the "eight corners" rule applied, but the court rejected this contention, noting that the Texas Supreme Court has only used this rule in duty-to-defend cases and that no other Texas state courts have applied the rule to a case where a duty-to-advance defense-cost policy is at issue.[211] Moreover, according to the Fifth Circuit court, there was no need to reach the issue of whether the

202. *Id.*
203. *Id.* at 570.
204. *Id.*
205. *Id.* at 573–74.
206. *See id.* at 574.
207. *Id.*
208. *Id.* at 573.
209. *Id.* at 574.
210. *Id.*
211. *Id.*

eight corners rule applied, as the parties in this case contracted around the eight corners rule in plain language by clearly agreeing that extrinsic evidence would be used in making the "in fact" determination.[212]

VIII. HOMEOWNERS' POLICIES

In *State Farm Lloyds v. Page*, the Texas Supreme Court analyzed whether claims for mold damage resulting from plumbing leaks were covered by a standard homeowners' insurance policy.[213] The policy at issue was a Standardized Homeowners Policy—Form B (HO-B policy), which provided coverage for the dwelling and the contents of the dwelling.[214] The insured, after finding mold and water damage in her home, sought coverage for that damage under her HO-B policy.[215] An investigation of the plumbing revealed that leaks in the sanitary sewer lines were the cause of the mold and water damage.[216] After receiving payment for remediation and repair of the structure, remediation of her personal property, and her living expenses, the insured sought additional funds to remedy the damage to the carpet in the home.[217] When the insurer refused to pay, the insured filed a lawsuit alleging, among other things, breach of contract.[218] The trial court found for the insurer; the court of appeals reversed.[219]

The issue before the Texas Supreme Court was "the extent of coverage [the insured's] HO-B policy affords for mold contamination resulting from plumbing leaks."[220] The supreme court began its analysis by explaining that the HO-B policy provided two separate coverage forms: Coverage A for damage to the insured dwelling against "all risks," and Coverage B for damage to the insured's personal property against twelve enumerated perils, including "plumbing leaks." Both coverage forms were subject to various exclusions, including an exclusion that barred coverage for loss caused by mold.[221] Pursuant to an "exclusion repeal provision" found under Coverage B, however, the "mold" exclusion did not bar coverage for loss caused by "plumbing leaks."[222]

The insurer argued that under *Fiess v. State Farm Lloyds*,[223] the supreme court had "unequivocally construed the same policy there to exclude all mold damage to a dwelling irrespective of its cause."[224] The insured argued that *Fiess* was limited to circumstances involving leaks

212. *Id.* at 574–75.
213. 315 S.W.3d 525, 526 (Tex. 2010).
214. *Id.*
215. *Id.*
216. *Id.*
217. *Id.*
218. *Id.* at 526–27
219. *Id.* at 527.
220. *Id.*
221. *Id.*
222. *Id.* at 527–28.
223. 202 S.W.3d 744, 744 (Tex. 2006).
224. *Page*, 315 S.W.3d at 528.

from roofs and windows, and pointed to *Balandran v. Safeco Insurance Co. of America*[225] to support her position that when the "mold" exclusion and "exclusion repeal provision" are read together, the Coverage A insuring agreement under the HO-B policy "expressly cover[s] mold damage caused by plumbing leaks."[226] The insured argued in the alternative that an ambiguity existed, thereby affording coverage under the HO-B policy.[227]

The supreme court held that the policy did not provide coverage for mold damage to the dwelling, but that neither its opinion from *Fiess* nor from *Balandran* was "directly on point."[228] With respect to *Fiess*, the supreme court noted that while its decision "was unquestionably broad," that decision did not "unequivocally [vitiate] coverage for all mold damage no matter the cause."[229] Regarding *Balandran*, the supreme court noted that it had analyzed the "exclusion repeal provision" in conjunction with a "foundation movement" exclusion, not under a "mold" exclusion.[230] Rather, the supreme court explained that it agreed with *Carrizales v. State Farm Lloyds*,[231] where the Fifth Circuit had recently concluded that the "interaction between the mold exclusion and the 'exclusion repeal provision' under Coverage B did not create an ambiguity."[232] The supreme court explained that if it were to adopt the insured's argument that the "exclusion repeal provision" reinstated coverage for mold damage to the dwelling caused by plumbing leaks, it would make the mold exclusion "entirely nugatory."[233] Rather, according to the supreme court, reading the "exclusion repeal provision" to reinstate coverage only for mold damage to the insured's personal property caused by plumbing leaks gives the policy's provisions their full effect.[234] The Texas Supreme Court therefore held that mold damage to the insured dwelling resulting from plumbing leaks was not covered by the HO-B policy.[235]

The supreme court did state in dicta, however, that the "exclusion repeal provision" did in fact reinstate coverage for damages to the insured's personal property caused by mold from plumbing leaks.[236] This decision answered an important issue that affects many Texas insureds regarding the scope of coverage under the standard homeowners' policy for common claims arising from plumbing leaks. Now that the supreme court has expressly found that the "mold" exclusion applies to bar coverage for damage to an insured's dwelling, but does not apply to bar coverage for

225. 972 S.W.2d 738, 738 (Tex. 1998).
226. *Page*, 315 S.W.3d at 528.
227. *Id.*
228. *Id.* at 528–29.
229. *Id.* at 529.
230. *Id.* at 530.
231. 518 F.3d 343, 346 (5th Cir. 2008).
232. *Page*, 315 S.W.3d at 530–31 (citing *Carrizales*, 518 F.3d at 346).
233. *Id.* at 530.
234. *See id.*
235. *See id.* at 531.
236. *Id.*

damage to the insured's personal property, both policyholders and insured will have better guidance for both policyholders and insurers regarding the risks covered under these common policies.

IX. CONCLUSION

During this Survey period, Texas courts continued to examine important issues arising under various insurance policies and affecting both policyholders and insurers. Significantly, when the Texas Supreme Court issued *Gilbert*, the decision was controversial. In fact, the insured filed a motion for rehearing supported by briefing from those in the insurance industry in an effort to have the supreme court reconsider its decision. Nevertheless, the supreme court denied the insured's motion and re-issued an opinion nearly identical to its original. Whether this will quell litigation on issues created by that case remains to be seen.

We do expect that litigation will continue in the future, however, with respect to notice issues under claims-made policies and the relative rights of co-insurers through contribution and subrogation, as these areas of law continue to evolve in the wake of recent significant opinions. In particular, there have been some inconsistent holdings between the federal and state courts on the issue of a co-insurer's right of subrogation. We anticipate that the Texas Supreme Court will need to revisit the issues addressed in *Mid-Continent* in the near future to provide guidance on the intended scope of that opinion and to resolve the issues that have created the conflicting holdings in state and federal courts.