

**ALLOCATION AMONG MULTIPLE CARRIERS IN
CONSTRUCTION DEFECT LITIGATION**

**FRED L. SHUCHART
COOPER & SCULLY, P.C.
700 Louisiana Street, Suite 3850
Houston, Texas 77002**

**7th Annual Construction Law Symposium
January 27, 2012
Dallas, Texas**

TABLE OF CONTENTS

I. INTRODUCTION 1

 A. DUTY TO DEFEND 1

 1. Property Damage Within Policy Period..... 1

 2. Can You Use Extrinsic Evidence?..... 2

 B. ALLOCATION..... 3

 1. *Liberty v. Mid-Continent*..... 3

 2. *Lexington v. Chicago* 5

 3. *Nautilus v. Pacific Employers’* 5

 4. *Trinity Universal Insurance Co. v. Employers Mutual Casualty Co.* 6

 5. *Maryland Casualty Co. v. Acceptance Indemnity Insurance Co.* 6

 6. *Millis Development & Construction, Inc. v. America First Lloyd’s Insurance Co.*..... 7

TABLE OF AUTHORITIES

CASES

Amerisure Mut. Ins. Co. v. Travelers Lloyds Ins. Co., 2010 WL 1068087 (S.D. Tex 2010).....2

Don’s Building Supply, inc. v. OneBeacon Insurance Co., 267 S.W.3d 20 (Tex. 2008).....1

Gehan Homes, Ltd. v. Employers Mut. Cas. Co., 146 S.W.3d 833 (Tex.App.-Dallas 2004, pet. denied).....1

Geico General Insurance Company F/K/A Houston Fire and Cas Co. v. Austin Power, Inc, No. 14-11-00049-CV(Tex. App.-Houston [14th Dist.] January 5, 2012)1

Lexington Ins. Co. v. Chicago Ins. Co., 2008 WL 3538200 (S.D. Tex. August 8, 2008).....5

Maryland Casualty Co. v. Acceptance Indemnity Insurance Co., 639 F.3d 701 (5th Cir. 2011).....6

Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co., 236 S.W.3d 765 (Tex. 2007).....3, 5

Millis Development & Construction, Inc. v. America First Lloyd’s Insurance Co., 2011 WL 3567331 (S.D. Tex. 2011)2, 7

Nautilus Ins. Co v. Pac. Emplrs. Ins. Co, 2008 WL 5272222 (5th Cir. Dec. 16, 2008)5

Trinity Universal Insurance Co. v. Employers Mutual Casualty Co., 592 F.3d 687 (5th Cir. 2010)6

Weingarten Realty Management Co. v. Liberty Mutual Fire Insurance Co., 343 S.W.3d 859 (Tex.App.-Houston [14 Dist.] 2011, rev. denied)2

Williams Consolidated j, Ltd. v. TIG Insurance so., 230 S.W.3d 895 (Tex. App.- Houston [14th Dist.1 2007, no pet.).....1

I. INTRODUCTION

Recently, both Federal and State Courts in Texas muddied the water regarding which of multiple insurance companies may be responsible for providing an insured a defense and what they may do to allocate defense and indemnity payments. As a result of the several recent opinions, insurance carriers are left perplexed in determining if they should provide a defense, if they should settle underlying cases, whether they can get some or all of their defense and indemnity expenses reimbursed, and if they can seek reimbursement, and what formula may they utilize.

DUTY TO DEFEND

1. Property Damage Within Policy Period

Every policy of insurance requires that the “property damage” occur within the policy period in order to trigger coverage and the duty to defend. The question is, what allegations are necessary to allege property damage within a policy period in the construction defect context.

In *Don’s Building Supply, inc. v. OneBeacon Insurance Co.*, 267 S.W.3d 20 (Tex. 2008), the Texas Supreme Court adopted an “injury-in-fact” theory to determine when coverage is triggered for property damage. According to the Court, the policy language is clear and unambiguous and the policy is triggered when an actual injury occurs. *Id.* at 29-30.

The Texas Supreme Court's decision in *Don’s Building* does not provide real guidance in situations where the time the injury occurred has not been pled.

In *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833 (Tex.App.-Dallas 2004, pet. denied), the carrier provided coverage from June 1997 through June 1998. The only allegation regarding timing in the underlying lawsuit was that the plaintiffs had suffered past bodily injury and property damage but did not identify when in the past it occurred. *Id.* at 846. The Dallas Court of Appeals concluded that the carrier failed to establish that the property damage did not occur during the policy period.

Id. In doing so, the court noted that, with respect to the duty to defend, the pleadings are strictly construed against the insurer and any doubt must be resolved in favor of the duty to defend. *Id.* at 838.

In *Williams Consolidated, Ltd. v. TIG Insurance Co.*, 230 S.W.3d 895 (Tex. App.-Houston [14th Dist.1 2007, no pet.), the insured was a subcontractor for a residential homebuilder. The insured was sued as a result of installation of a vapor barrier which allegedly resulted in the accumulation of moisture in the home and mold. In the underlying lawsuit, the plaintiff alleged that he entered into the construction contract in June 1991, took possession of the home in August 1991 and discovered mold in 2000. The underlying lawsuit contained no other allegations with respect to dates. The carrier, TIG, issued coverage from August 1, 1999 to May 1, 2001 and excluded from coverage any damage which occurred prior to the policy period. The Houston Fourteenth Court of Appeals determined that TIG had a duty to defend, reasoning that because there was no specific allegation that the property damage first occurred prior to August 1, 1999, there was a potential that there was no injury prior to the initial policy period.

In *Geico General Insurance Company F/K/A Houston Fire and Cas Co. v. Austin Power, Inc.*, No. 14-11-00049-CV(Tex. App.-Houston [14th Dist.] January 5, 2012, n.p.h.), the underlying Plaintiff sued the insured as a result of exposure to asbestos containing products. The Petition did not allege an actual date of injury but alleged that the Plaintiff was exposed in the past, exposed on numerous occasions and each exposure contributed to his injuries. The carrier declined the defense on the grounds that the allegations did not allege an injury within the policy period. The Court rejected the carrier’s position and concluded that the carrier had a duty to defend. The Court, relying on *Gehan*, reasoned that when liberally construed, the allegations stated a potential for coverage.

The Texas Southern District Court reached an opposite conclusion in *Amerisure Mut. Ins. Co. v. Travelers Lloyds Ins. Co.*, 2010

WL 1068087 (S.D. Tex 2010). In *Amerisure*, the pleadings set forth the date that construction started, the date of substantial completion and the date the injury was discovered. The carriers on the risk between the start of the work and prior to discovery declined to provide a defense on the basis of no property damage within their policy periods. The Court accepted the carriers' arguments and concluded that they had no duty to defend. In essence, the Court concluded that because there was no allegation of the date of actual injury, the policies were not triggered.

2. Can You Use Extrinsic Evidence?

Under Texas law, an insurance company determines whether it has a duty to defend by the "Eight Corners Doctrine" or "Complaint-Allegation Rule." In general, you must rely upon only the allegations contained in the live pleading and the terms and conditions of the policy of insurance to determine whether there is a duty to defend. Texas law is clear that when evidence outside those two documents contradicts a direct pleading, neither the carrier nor insured can rely upon the evidence to determine the duty to defend. Texas law is further clear that when evidence outside those documents touches upon both liability and coverage, that evidence cannot be considered by either the insured or the carrier to determine the duty to defend.

Although the Texas Supreme Court has never expressly adopted any exception to the "Eight Corners Doctrine" or "Complaint Allegation Rule," lower state courts and federal courts have concluded that there may be a limited exception where it is impossible to determine if coverage is originally implicated and the extrinsic evidence goes solely to fundamental issue of coverage which does not overlap with the merits of or engaged the truth or falsity of any facts alleged.

In the construction defect litigation context, the issue most frequently arises with respect to a party's status as an additional insured.

In *Weingarten Realty Management Co. v. Liberty Mutual Fire Insurance Co.*, 343 S.W.3d 859 (Tex.App.-Houston [14 Dist.] 2011, rev.

denied), a property manager was sued as a result of an injury which occurred on the property. The lease between the tenant and the property owner required that the property owner be named as an additional insured under the tenant's policy. In the petition, the plaintiffs specifically alleged that the property manager was actually the owner of the property. The carrier declined coverage on the basis that the property manager was not an additional insured because the lease did not require that the property manager be named as an additional insured. The property manager argued that, because the pleadings specifically stated that it was the property owner, the carrier could not rely upon extrinsic evidence to determine that the property manager was not an additional insured. The Court rejected the property manager's position and concluded that the carrier could rely upon the actual lease to determine that the property manager was not required to be an additional insured. Although the extrinsic evidence challenged the truth of an actual pleading, the Court stated that the Eight Corners Doctrine did not apply because it was designed to protect an insured, not a stranger to the policy. The Court adopted a limited exception where the extrinsic evidence shows that the party seeking coverage is a stranger to the policy.

In *Millis Development & Construction, Inc. v. America First Lloyd's Insurance Co.*, 2011 WL 3567331 (S.D. Tex. 2011), a construction worker was injured on the job. The worker was employed by a sub-subcontractor and sued a variety of parties including the owner. The owner sought coverage under the subcontractor's policy as an additional insured. The pleadings contained no mention of the sub-subcontractor relationship. The carrier declined the tender because there was no allegation that the subcontractor's work was involved and therefore the additional insured endorsement was not potentially triggered. The Court concluded that the insurer was allowed to rely upon all the construction contracts to require the carrier to provide a defense. The Court adopted a limited exception to the general rule because the allegations did not allow for initial determination of potential coverage and the

relationship between the parties had no relevance to liability.

B. ALLOCATION

1. *Liberty v. Mid-Continent*

In *Mid-Continent Ins. Co. v. Liberty Mutual Ins. Co.*, 236 S.W.3d 765 (Tex. 2007), Kinsel, a contractor, was sued pursuant to its involvement in a car accident on a highway on which it was the general contractor. Liberty Mutual was Kinsel's primary CGL carrier, with a \$1M policy. Kinsel also was listed as additional insured on the Mid-Continent primary CGL \$1M policy issued to Crabtree Barricades, Kinsel's subcontractor. The policies both contained identical "other insurance" clauses, requiring pro rata apportionment up to each policy's respective limits. Both Liberty Mutual and Mid-Continent agreed that Kinsel was liable and that both insurers owed some portion of defense and indemnity. Liberty Mutual eventually agreed at a mediation with the claimants to settle on behalf of Kinsel for \$1.5 M, but since Mid-Continent claimed they valued the case at \$300,000, they paid only \$150,000, with Liberty Mutual funding the remaining \$1.35M. Liberty Mutual then sued Mid-Continent to recover its pro-rata share of the sum paid to settle the suit, and after removal to the Northern District of Texas, the court found that Liberty Mutual was entitled, through subrogation, to \$550,000 from Mid-Continent, concluding that each insurer owed a duty to act reasonably in exercising rights under the CGL policy, that Mid-Continent was objectively unreasonable in its assessment of \$300,000, and that whether apportioned in pro-rata or equal shares, Mid-Continent was liable for one-half of the \$1.5M settlement, and based on amounts already paid by Mid-Continent, it was liable for \$550,000. On appeal, the following certified question from the Fifth Circuit was sent to the Texas Supreme Court (while there were three questions certified by the Fifth Circuit, the only certified question the Texas Supreme Court addressed was the following):

1. Two insurers, providing the same insured applicable primary insurance liability

coverage under policies with \$1 million limits and standard provisions (one insurer also providing the insured coverage under a \$10 million excess policy), cooperatively assume defense of the suit against their common insured, admitting coverage. The insurer also issuing the excess policy procures an offer to settle for the reasonable amount of \$1.5 million and demands that the other insurer contribute its proportionate part of that settlement, but the other insurer, unreasonably valuing the case at no more than \$300,000, contributes only \$150,000, although it could contribute as much as \$700,000 without exceeding its remaining available policy limits. As a result, the case settles (without an actual trial) for \$1.5 million funded \$ 1.35 million by the insurer which also issued the excess policy and \$150,000 by the other insurer.

In that situation, is any actionable duty owed (directly or by subrogation to the insured's rights) to the insurer paying the \$1.35 million by the underpaying insurer to reimburse the former respecting its payment of more than its proportionate part of the settlement?

At the Texas Supreme Court, Liberty Mutual argued that upon payment of the settlement amount, it was subrogated to its insured's contractual right to enforce language in the Mid-Continent policy, under which it was an additional insured, to pay an equal or pro-rata share of settlement. Mid-Continent argued that it owed no direct duty to Liberty Mutual as a co-primary insurer upon which reimbursement may be based, as well as that its insured has no

enforceable contractual right to which Liberty Mutual may be subrogated, as Mid-Continent fulfilled any duties to Kinsel as insured by assuming defense and acknowledging policy coverage. The Court examined two possible scenarios argued by Liberty Mutual: one involving any ability of a co-primary insurer to compel another co-primary insurer to proportionately participate in the settlement of a third-party claim, and a second involving an insured's ability to compel an insurer's proportionate participation in settlement of a third-party claim.

The Court held that in the first scenario, Liberty Mutual essentially raised a claim for contribution, which the Court had previously held does exist between co-insurers, but that such a direct claim does not exist when the policies contain the other insurance clauses, which would operate to make the insurers liable only for a pro-rata share of a covered loss. The court noted that each co-insurer is contractually bound to the insured to pay a pro-rata share of covered loss, and did not contractually agree to pay any other insurer's pro rata share. The effect of the pro rata clause precludes a direct claim for contribution among insurers because the clause makes the insurer's obligations several and independent of each other. With independent contractual obligations, the co-insurers do not meet the common obligation requirement of a contribution claim.

In addition, the Mid-Continent Court stated that if a co-insurer under these circumstances pays more than its pro-rata share, it does so voluntarily, without legal obligation to do so. "Thus, a co-insurer paying more than its proportionate share cannot recover the excess from the other co-insurers." Therefore, the Court held that no contractual obligations existed between the insurers to apportion between themselves the payments on the insured's behalf.

Because a right of contribution did not exist, Liberty Mutual sought reimbursement through contractual or equitable subrogation to the rights of Kinsel. In either case, Liberty Mutual must step into Kinsel's shoes to assert

only those rights held by Kinsel against Mid-Continent. Liberty argued that it was subrogated to the contractual right of Kinsel to enforce Mid-Continent's policy language which imposed a duty on Mid-Continent to defend and indemnify Kinsel and to pay a pro rata share of settlement. The Court held that the duty of both insurers to pay a pro rata share of covered losses up to their policy limits could not be viewed apart from the actual purpose of the pro rata clause or of the rule that once the insured has been fully indemnified, an insurer's duty to pay pro-rata shares of a loss is unenforceable. The Court pointed out that the insured's right of indemnity under a policy is limited to actual amount of loss, and that when two policies provide coverage for losses, "the pro rata clause does not create an exception to the principle of indemnity, but rather implements that principle by eliminating the potential for double recovery by the insured." The Court went on to hold that equity does not demand a different result here. The Court held, therefore, that a fully indemnified insured has no right to recover an additional pro rata portion of settlement from an insurer regardless of that insurer's contribution to the settlement. Having fully recovered its loss, Kinsel had no contractual rights that a co-insurer could have asserted against another co-insurer in subrogation.

Liberty also argued that it was subrogated to the common law right of Kinsel to enforce Mid-Continent's duty to act reasonably when handling an insured's defense-including reasonable negotiation and participation in settlement. An insurer's common law duty in this third party context is limited to the *Stowers* duty to protect the insured by accepting a reasonable settlement offer within policy limits. The court stated that Mid-Continent did not breach a *Stowers* duty to Kinsel because a settlement demand was never made within Mid-Continent's policy limits. Finally, the Court held that Liberty's dual status in the case as a primary and excess carrier negated the fundamental requirement of subrogation that a subrogee must have paid a debt for which another is primarily liable.

2. *Lexington v. Chicago*

The Southern District Court explored *Mid-Continent's* holding in *Lexington Ins. Co. v. Chicago Ins. Co.*, 2008 WL 3538200 (S.D. Tex. August 8, 2008) where coverage was contested by one of two insurers that issued consecutive professional liability policies to a health care agency and each contributed half to settle claims against the insured. The Court distinguished *Mid-Continent* because it did not address whether an insurer that contributes to a settlement fund but denies coverage for the underlying lawsuit, and that reserves the right to dispute coverage and seek reimbursement for the entire amount paid, may recover that amount from the other insurer, particularly when the other insurer also denies coverage. In this case, although the settlement fully indemnified the insured, both insurers denied coverage for the underlying lawsuit. Chicago and Lexington each paid fifty percent of the amount needed to settle the underlying lawsuit under a non-waiver agreement that allowed them to fund the settlement while continuing to deny coverage and reserving any available right to seek reimbursement from the other. Both insurers disputed coverage.

The Court reasoned that the rulings in *Mid-Continent* only apply where both policies provide coverage for the underlying lawsuit. As a result, the Court addressed the coverage issues: late notice by Chicago and reformation by Lexington. Having found coverage under both policies, the Court then held that Lexington and Chicago had no contractual right to contribution between them based on *Mid-Continent*.

Furthermore, the Court held that Lexington had no right of subrogation against Chicago because the insured was fully indemnified in the underlying lawsuit, otherwise, such a cause of action would allow the insured an opportunity for double recovery. In reaching its conclusion, the Court rejected the argument that *Mid-Continent* was limited to concurrent policies. The Court also rejected the argument that the non-waiver agreement created a contractual subrogation right.

3. *Nautilus v. Pacific Employers'*

The Fifth Circuit addressed the issue in *Nautilus Ins. Co v. Pac. Empls. Ins. Co.*, 2008 WL 5272222 (5th Cir. Dec. 16, 2008). In *Nautilus*, EOG was an additional insured under a liability policy issued by Nautilus Insurance Company and a policy issued by Pacific Employers Insurance Company. Both policies contained identical pro rata ("other insurance") provisions that required the insurers to pay a pro rata portion of any judgment or settlement if the coverages overlapped with other primary insurance. Several homeowners sued EOG alleging that EOG's seismic activity caused foundation defects to their homes. EOG sought protection under its own insurance, as well as the coverage afforded by Nautilus and Pacific. Nautilus and the other insurers settled some of the lawsuits for \$3.5 million with Nautilus paying \$1.5 million of the settlement. Pacific refused to contribute to the settlement and allowed the remaining cases to proceed to trial. The jury ruled against most of the homeowners' claims and the court granted summary judgment on the remaining claims. Thus, Pacific paid nothing towards settlement and nothing in the underlying state court cases on behalf of EOG.

Nautilus and EOG sued Pacific under theories of contractual and equitable subrogation. Both the district court and Fifth Circuit followed *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765 (Tex. 2007) and ruled in favor of Pacific. Nautilus argued that *Mid-Continent* was distinguishable on the fact that the decision applies narrowly and only when an insurer settles a case to "protect its own coffers," which Nautilus asserts is missing. Nautilus pointed out that Liberty Mutual covered the insured for \$1 million primary and \$10 million excess and under those circumstances, Liberty Mutual had a self-serving motive to settle the entire case because it did not want to risk liability for a large judgment under its excess policy. Thus, Nautilus argued that the import of *Mid-Continent* is that an insurer cannot recover from an co-insurer based upon a right of subrogation when the insurer pays a claim to protect its own financial interest. Nautilus claims it paid the claims against EOG

solely based upon the duty to indemnify EOG as additional insured.

Nautilus made the policy argument that an insurer will be less likely to settle a suit if it cannot recover the money its pays to settle. Also, Nautilus argued that a broad reading of *Mid-Continent* will lead to the elimination of the right of subrogation, which in turn will lead to an unfair distribution of losses among insurers.

The Fifth Circuit held that even if the Supreme Court's *Mid-Continent* decision will have these policy effects, the Texas Supreme Court is the final arbiter of Texas law. However, according to the Fifth Circuit, *Mid-Continent* is unlikely to have such drastic effects because subrogation remains viable for an excess insurer against a primary insurer. Furthermore, it would be inequitable to force Pacific to contribute to settlement when it chose not to settle, bore the risk of trial that it could be liable for more than it would pay in a settlement and prevailed at trial. The Fifth Circuit concluded that the Texas Supreme Court made the policy decision against an insurer that voluntarily pays more than its pro rata share of settlement.

4. *Trinity Universal Insurance Co. v. Employers Mutual Casualty Co.*

The Fifth Circuit addressed the issue again in 2010 in *Trinity Universal Insurance Co. v. Employers Mutual Casualty Co.*, 592 F.3d 687 (5th Cir. 2010). The underlying lawsuit dealt with defective construction claims involving Trinity Memorial Hospital in New Braunfels, Texas. The masonry contractor was covered by four consecutive policies of insurance which were arguably triggered by the underlying claims. Three of the carriers agreed to provide a defense while one denied coverage. The three participating carriers brought suit against the other carrier seeking a declaration that the carrier had a duty to defend and reimbursement for their pro rata share of the previous defense cost. In addition to contesting coverage under its policy, the holdout carrier also argued that even if there was coverage, any claim for reimbursement was barred by *Mid-Continent*. The Fifth Circuit noted that *Mid-Continent*

barred a contribution claim on the basis that, with respect to the duty to indemnify, the "other insurance" provision made the obligations independent and discreet and therefore contribution could not apply. The Court noted that the duty to defend is separate and distinct from the duty to indemnify and then concluded that the express terms of the "other insurance" provision only applied to the duty to indemnify because it used the term "loss." The Court then acknowledged previous case law which held that the duty to defend creates a debt which is equally and concurrently due by all the carriers. As a result, the Court concluded that the other carriers, in fact, had a contribution claim for a pro rata share of the previous defense cost.

5. *Maryland Casualty Co. v. Acceptance Indemnity Insurance Co.*

Mid-Continent was discussed again by the Fifth Circuit in *Maryland Casualty Co. v. Acceptance Indemnity Insurance Co.*, 639 F.3d 701 (5th Cir. 2011). In *Maryland*, the insured contracted to build a "negative edge" swimming pool for the underlying plaintiff's home. The insured was covered by consecutive policies issued by two carriers. Maryland Casualty agreed to provide the insured a defense but Acceptance denied any obligation to defend and/or indemnify. Maryland subsequently settled the claims against the insured and brought a lawsuit against Acceptance seeking to recover a pro rata portion of the defense and indemnity cost under theories of contribution and subrogation. Acceptance moved for summary judgment on the basis of *Mid-Continent*. The trial court granted the motion with respect to the contribution claim but denied the motion with respect to the subrogation claim. The subrogation issue went to trial and was subsequently appealed. The appeal did not include the contribution claim. The Fifth Circuit rejected Acceptance's argument that *Mid-Continent* controlled and barred the claims. In reaching its decision, the Fifth Circuit noted a previous decision which rejected an overly broad view of *Mid-Continent's* subrogation conclusion and held that, although the language in the opinion specifically states to the contrary, *Mid-Continent* does not bar contractual subrogation simply because the insured has been

fully indemnified. The Court then concluded that because Acceptance declined coverage, Maryland would be entitled to pursue a subrogation claim for both defense and indemnity.

6. *Millis Development & Construction, Inc. v. America First Lloyd's Insurance Co.*

The most recent decision addressing *Mid-Continent* is *Millis Development & Construction, Inc. v. America First Lloyd's Insurance Co.*, 2011 WL 3567331 (S.D. Tex. 2011). In *Millis*, a worker was injured on a job site and brought suit against the general contractor and owner of the property. Mt. Hawley provided coverage to both entities and settled the matter. It then brought suit to recover a pro rata share of the defense costs and indemnity payments from America First who denied coverage to the owner and initially denied coverage to the general contractor. America First argued that *Mid-Continent* barred the claims. Without much discussion, the Fifth Circuit concluded that *Mid-Continent* did not apply because America First totally denied coverage to the owner and originally denied coverage to the general contractor. As a result, the Fifth Circuit concluded that the theory of contractual subrogation applied.