August 2013

Insurer Must Cover Total Amount Of Settlement Even Absent Consent

On August 23, 2013, the Texas Supreme Court in *Lennar Corp. v. Markel Am. Ins. Co.*, No. 11-0394 (Tex. Aug 23, 2013), held that the costs incurred by a builder to locate and repair damage caused by the builder's defective product are covered under its general liability insurance policy. The court also held that the insurer is responsible for those costs, even where the insurer refused to participate in the proactive inspection and remediation program through which the costs were incurred. Finally, the court held that the insurer would be responsible for all costs — including those incurred before and after its effective policy period because the policy's language makes insurers jointly and severally liable for all damages.

BACKGROUND

The insured, Lennar Corporation ("Lennar"), had constructed about 800 homes using the exterior insulation and finishing system known as EIFS, an artificial stucco cladding. Within months of its installation, EIFS had trapped water, resulting in rot, structural damage, mold, mildew and termite infestations at the constructed homes. Many of the problems were not apparent to Lennar's customers, but following a report by NBC News, homeowners began to submit complaints to Lennar. Lennar investigated each of the claims and proactively entered into agreements with the affected customers, under which Lennar agreed to repair the resulting damage and replace the defective EIFS systems. Lennar's prompt and proactive approach avoided litigation in all but three instances, and the three that went to suit eventually settled.

Lennar notified its insurers of the defects and invited its insurers to participate in the proactive remediation program. The insurers declined, preferring instead to address each homeowner's claim individually as it arose. In pursuit of coverage monies, Lennar brought suit against its insurers in 2000. The insurers obtained summary judgment and Lennar appealed. Summary judgment was affirmed for all but two of the insurers. Lennar then settled with one of the remaining insurers, and continued to litigate against Markel American Ins. Co. ("Markel").

On appeal, the intermediate appellate court held that losses sustained by Lennar were not "caused by property damage." The court also held that Lennar violated the policy by making voluntary payments without Markel's consent. The court further held, however, that Markel would be excused from indemnifying the voluntary payments only if Markel was prejudiced by Lennar's failure to secure its consent before making the payments. Following remand, further appeal was taken by Markel. From that, the Texas Supreme Court granted review.

THE TEXAS SUPREME COURT FINDS COVERAGE

The Texas Supreme Court considered: 1) whether to reinstate the jury's verdict despite Lennar's failure to secure written consent to the settlements from Markel; 2) whether the claimed loss occurred "because of" property damage, a condition for coverage; and 3) whether Markel was responsible for all sums even though other insurers covering other policy periods might owe indemnity to Lennar, or whether Texas should adopt a pro rata approach to allocation, which would make Markel responsible for only a portion of the loss.

© 2013 Hunton & Williams LLP

First, the court rejected Markel's argument that it was excused from paying the loss, regardless of prejudice because of the definition of "ultimate net loss" as "the total amount of [property] damages for which Lennar is legally liable," which "may be established by adjudication, arbitration, or a compromise settlement to which [Markel has] previously agreed in writing." The court found that Markel was required to show prejudice to enforce a consent to settlement requirement and that "[t]he jury was entitled to credit evidence that, had Lennar not proceeded as it did, the damages would have worsened and the remediation costs increased." Accordingly, there was no prejudice and Markel was bound to pay for the settlement whether or not the insured had obtained Markel's consent.

Second, the court affirmed the jury's finding that damages included the costs of removing the EIFS. Lennar could determine the extent of water damage only after removing the EIFS, and Lennar included the costs of removal in its damages claim, even for homes that had not actually been damaged at all. The costs expended by Lennar in finding EIFS property damage so that it could be repaired could only be reasonably interpreted as costs incurred "because of" property damage and hence were covered under the policy.

Third, the court held that there was coverage for all "damage [resulting] from a continuous exposure to the same harmful conditions" and that if any damage occurred during the Markel policy period, then the "total amount" of loss that resulted — "not just the loss incurred during the policy period" — was covered by the policy. Because there was some property damage to Lennar's homes during the policy period, Markel owed indemnity for the "total remediation costs" without any pro rata reduction.

The court noted that *Am. Physicians' Exchange v. Garcia*, 876 S.W.2d 842 (Tex. 1994), held that an occurrence that triggers multiple policies spanning different periods of coverage, the insured is at liberty to pursue optimal coverage, and insurers may then pursue each other for contribution. The court was not persuaded by Markel's argument that the relevant language from *Garcia* was mere dicta; nor was the court persuaded by the argument that it should "abandon *Garcia*" and adopt Markel's "pro rata" approach to allocation. Markel was therefore liable to Lennar for all sums expended on remediation of the EIFS damage.

IMPLICATIONS

Lennar confirms that all insurers with policy in effect at the time of property damage are responsible for all sums for which the policyholder is liable. By rejecting Markel's proposed "pro rata" approach, the court recognized that policyholders have a right to pursue the maximum coverage available. The court also held that insurers must cover reasonable settlements that do not prejudice them, regardless of whether the carrier consents.

The ruling that costs of remediation were covered in *Markel* makes clear that all costs of remediation — including the costs of discovering damage, and repairing that which was not yet damaged — are covered. The ruling establishes that there is coverage not only for the actual repair of damage, but also for the costs of discovering that damage so that it can be repaired.

Contacts

Walter J. Andrews
wandrews@hunton.com

Lon A. Berk
lberk@hunton.com

Lawrence J. Bracken, II
lbracken@hunton.com

Syed S. Ahmad
sahmad@hunton.com

Michael S. Levine
mlevine@hunton.com

Sergio F. Oehninger
soehniger@hunton.com

© 2013 Hunton & Williams LLP

John C. Eichman
jeichman@hunton.com

Robert J. Morrow
rmorrow@hunton.com

Curtis D. Porterfield
cporterfield@hunton.com

William T. Um
wum@hunton.com

Christine Terrell
cterrell@hunton.com

© 2013 Hunton & Williams LLP. Attorney advertising materials. These materials have been prepared for informational purposes only and are not legal advice. This information is not intended to create an attorney-client or similar relationship. Please do not send us confidential information. Past successes cannot be an assurance of future success. Whether you need legal services and which lawyer you select are important decisions that should not be based solely upon these materials.