



Insurance & Construction Defects: 'Lamar Homes' impact on liability

by Tom Stauch and Jacob D. Thomas

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For years, insurance carriers in Texas have denied homebuilders' claims for defense and indemnity under their commercial general liability (CGL) policies when the homebuilder has been sued for damages arising from construction defects. That trend will likely reverse now, at least in the short run.

The Supreme Court of Texas recently held that a lawsuit brought by a home buyer against its homebuilder asserting claims arising from construction defects can trigger an insurer's duty to defend under the homebuilder's CGL policy. In short, this means that a homebuilder sued by a home buyer for damages arising from construction defects should submit a claim for defense and indemnity to its CGL carrier as soon as the suit is initiated, and the carrier should, in most cases, tender a defense.

On Aug. 31, 2007, the Supreme Court of Texas handed down its long-awaited opinion in *Lamar Homes Inc. v. Mid-Continent Casualty Company*. Two of the major points the court was asked to address are:

1) When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege an "accident" or "occurrence" sufficient to trigger the duty to defend or indemnify under a CGL policy?

2) When a home buyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege "property damage" sufficient to trigger the duty to defend or indemnify under a CGL policy?

The Supreme Court of Texas answered each of these questions in the affirmative, delivering homebuilders in Texas a major victory and giving insurance companies something to think about before denying claims for coverage in construction defect cases.

The court's opinion set forth the facts of the underlying case, which may sound all too familiar to Texas homebuilders:

Vincent and Janice DiMare purchased a new home from Lamar Homes Inc. and several years later encountered problems that they attributed to defects in their foundation. The DiMares sued Lamar and its subcontractor complaining about these defects. Lamar forwarded the lawsuit to Mid-Continent Casualty Company seeking a defense and indemnification under a commercial general liability or CGL insurance policy. Mid-Continent refused to defend, prompting Lamar to seek a declaration of its rights under the CGL policy.

Mid-Continent refused to provide a defense to Lamar based on its contention that there was no "occurrence" under the terms of the policy because the homebuilder "should expect that faulty workmanship will result in damage to the project itself, and that if any injury is expected, it is not accidental." The company also contended the CGL policy only covered "property damage" when property other than the house itself was damaged as a result of an accident.

Mid-Continent further argued that "a CGL policy's purpose is to protect the insured from tort liability, not claims of defective performance under a contract." The Texas Supreme Court correctly rejected Mid-Continent's arguments.

Accidental Acts

The court focused on the clear wording of the CGL policy, which was the standard form developed by the Insurance Services Office Inc. (ISO). As set forth in the court's opinion:

The CGL policy provides that the insurance carrier "will pay those sums that the insured becomes legally obligated to pay as damages because of 'bodily injury' or 'property damage' to which this insurance applies" and will "defend the insured against any 'suit' seeking those damages." The policy further provides that the "insurance applies to 'bodily injury' and 'property damage' only if: (1) the 'bodily injury' or 'property damage' is caused by an 'occurrence' that takes place in the 'coverage territory.'" Consequently, the carrier's duty to defend is triggered by a claim for "property damage" or "bodily injury" caused by an "occurrence."

In rejecting Mid-Continent's argument that there was no occurrence, the court held that "a deliberate act, performed negligently, is an accident if the effect is not the intended or expected result; that is, the result would have been different had the deliberate act been performed correctly."

In other words, the court recognized that a homebuilder does not go about deliberately causing defects in its construction, but acknowledged that defects are often the result of undiscovered accidents during the course of construction.

Having decided that a construction defect can be an occurrence or accident under the terms of a CGL policy, the court then addressed whether the "occurrence" or "accident" resulted in property damage. "The policy defines 'property damage' as 'physical injury to tangible property, including all resulting loss of use of that property.'"

Once again rejecting Mid-Continent's arguments to the contrary, the Texas Supreme Court held that the definition of property damage does not eliminate the homebuilder's own work, and that the home, and its component parts, are clearly "tangible property" afforded coverage. Therefore, faulty workmanship is an accident and the resulting damage is damage to tangible property; thus the CGL policy can provide a homebuilder with coverage for damages arising from construction defects.

Here's the Catch

As with most issues related to insurance and certainly insurance law, there is a catch. The Standard CGL policy is often modified by exclusions and exceptions to them. In *Lamar Homes*, the CGL policy at issue excluded coverage for property damage to "your work." However, there was an exception to the exclusion that provided coverage if the property damage to "your work" was caused by work performed by a subcontractor.

This exclusion and exception are referred to as "Exclusion L." The standard Exclusion L includes the subcontractor exception, but the ISO has promulgated an endorsement (CG 22 94) that eliminates the subcontractor exception to Exclusion L. Therefore, if a homebuilder's CGL policy includes the CG 22 94 endorsement, the *Lamar Homes* opinion will likely not apply, and the carrier may still legally deny the homebuilder's claim for defense and indemnity.

While the *Lamar Homes* opinion is certainly a victory for homebuilders, it may be short lived. The insurance industry will certainly respond with greater efforts to exclude coverage for construction defects or increase premiums to cover the additional exposure, or both. Now, perhaps more than ever, it will be critical for the homebuilder to fully understand what risks are being covered through its CGL insurance policy. In light of these issues, a regular review of coverage from your insurance professional or lawyer is important. Truly understanding your risks is the first step to reducing them. **IB**

Thomas R. Stauch is a partner in the Dallas law firm of Nowak & Stauch LLP. He can be reached at tstauch@ns-law.net. Jacob B. Thomas is an associate with the firm, and can be reached at jthomas@ns-law.net. Their practice is focused on commercial, real estate and residential construction litigation.

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Nowak & Stauch LLP
214.823.2006