No. 11-0394

In the Supreme Court of Texas
Austin, Texas

LENNAR CORPORATION, *ET AL*.,

Petitioners,

vs.

MARKEL AMERICAN INSURANCE COMPANY

Respondent.

BRIEF OF CERTAIN TEXAS INSURANCE COVERAGE LAWYERS AS *AMICI CURIAE* IN SUPPORT OF PETITION FOR REVIEW

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STATEMENT OF INTEREST OF AMICI CURIAE

This amicus curiae brief is submitted by a group of private practitioners in Texas that concentrate on representing insureds in coverage disputes with their insurers.

The members of this group have been recognized in various peer-based rankings such as Chambers USA, The Best Lawyers in America, and Texas Super Lawyers. They have a history of volunteer service to both the bar and the public through numerous activities. For example, several signatories to this brief helped to create the Insurance Law Section of the State Bar of Texas and serve on its Council. These lawyers routinely help to educate the bar through planning and speaking at CLE seminars. They have published articles, treatises and practice guides on the subject of insurance law. When their assistance is sought by those with great need but an inability to pay, they have donated their time by providing pro bono services, such as helping to prepare the State Bar's Hurricane Ike Disaster Legal Resources Manual.

A short description of each member of this group is provided below:

- Erika L. Blomquist: Ms. Blomquist is a partner in the Dallas office of Haynes and Boone, LLP. She lectures frequently on Texas insurance coverage issues and serves as an author and speaker on insurance-related matters for the American Bar Association.

- David H. Brown: Mr. Brown is a founding partner of Brown & Kornegay LLP. He was a partner in Vinson & Elkins' Houston office for 24 years and served as chair of the Vinson & Elkins' insurance coverage group. Mr. Brown is an advisor to the American Law Institute on "Principles of Insurance Law." He is a member of the State Bar of Texas Insurance Law Council.

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- Marc E. Gravely Mr. Gravely is a founding partner of Gravely & Pearson, LLP. He is a contributing author to the Texas Insurance Law Digest. He served as amicus counsel to several public and private Texas trade groups on issues concerning commercial insurance coverage. Mr. Gravely is a member of the Insurance Section of the State Bar of Texas and the Tort Trial and Insurance Practice Section of the American Bar Association.

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- Lee H. Shidlofsky: Mr. Shidlofsky is the founding shareholder of Shidlofsky Law Firm PLLC. He is the immediate past chair of the Insurance Law Section of the State Bar of Texas and also is a past council member of the Construction Law Section of the State Bar of Texas. Mr. Shidlofsky has been named a "Super Lawyer" by Texas Monthly Magazine since 2004, including a ranking as a Top 50 attorney in the Central and West Texas Region for 2007, 2008, 2009, and 2010.

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These amici curiae are not being compensated for this brief in any way by any party. Because they find the decision of the Court of Appeals troubling in numerous respects, they felt compelled to submit this brief in the interest of expressing their views for the benefit of the Court and their clients who are facing these issues or will face them in the future.

ARGUMENT

I. COSTS INCURRED BY AN INSURED TO LOCATE HIDDEN PROPERTY DAMAGE ARE COVERED WHETHER OR NOT THEY ARE "PREVENTATIVE" (LENNAR'S THIRD ISSUE PRESENTED)

The Court of Appeals held that the costs Lennar incurred to locate hidden property damage so it could be accessed and repaired are not recoverable under Markel's commercial excess liability policy. The Court of Appeals labeled those damages as "preventative" except for the limited costs incurred by Lennar to locate damage where the damage "was actually found." See Markel American Ins. Co. v. Lennar Corp., No. 14-10-8-CV, ___ S.W.3d ___ , 2011 WL 1466494, *5 (Tex. App.—Houston [14th Dist.] Apr. 19, 2011, pet. filed) (Lennar II). While Lennar disputes that any of those costs were in fact "preventative,"[1] that is beside the point. The appropriate analysis is whether the amounts were incurred "because of property damage." According to the evidence presented and clear Texas case law, they were.

A. The Costs to Find Property Damage are Unquestionably Damages Because of Property Damage

Lennar's Petition for Review directed this Court to key pieces of evidence and concessions by Markel and its experts. For example, Markel conceded in the Court of Appeals that property damage did in fact exist on every single home that was submitted to the jury. See Petition for Review at 13 (citing Brief of

[1] Petition for Review at 14.

Appellant at 16, 18-19, Lennar II). Testimony was also presented at trial that Lennar's method of repair was reasonable, and that the only sensible way to locate all of the property damage was to remove all of the exterior coating. See Amended Brief of Appellees at 33, Lennar II (citing 7 RR 170); Petition for Review at 3-4 (citing 2 RR 122-23, 132-33, 138-40; 6 RR 204-07). Although Markel presented the jury with an alternative method of repair, its experts agreed that all of the property damage — some found in unexpected places and all hidden from plain sight — could not be located and repaired unless all of the exterior coating was removed. See Petition for Review at 12 (citing 8 RR 66-68, 133; 9 RR 147-50). The jury weighed this evidence on a home by home basis and decided in favor of the insured, and the trial court rendered judgment on that verdict. See Petition for Review at App. Tabs 3 & 4.

Despite this evidence, Markel's concessions and the broad scope of coverage provided by Lennar's insurance policy, the Court of Appeals reversed. Respectfully, we disagree with that result. Steps taken by an insured to determine the location and scope of property damage, where some amount of damage is in fact suspected and found, are not preventative measures. The costs associated with this undertaking are consequential damages "because of property damage" and fall within the coverage of the policy. See, e.g., Zurich Am. Ins. Co. v. Nokia, Inc., 268 S.W.3d 487, 499 (Tex. 2008) (stating that the "damages

because of" language in a general liability policy "is susceptible to a broad definition"). Stated differently, if all of the claimants had filed suit over the defective EFIS materials, they would have been entitled to recover these costs as consequential damages.[2] Accordingly, they would have been insurable under Lennar's policy. The fact that these steps also prevent further damage is an additional benefit to the claimants, the insureds and the insurer, but this preventative benefit does not destroy coverage.[3]

We are not alone in believing that damages "because of property damage" should broadly include the type of investigative costs incurred by Lennar. Allan Windt, in his treatise on Insurance Claims and Disputes, states that:

> [l]iability policies cover not only damages for property damage, but damages because of, on account of or by reason of property damage. Accordingly, once covered property damage exists, all consequential damages are covered. . . . In short, even though an item of damage is not covered as property damage, it can be covered if it constitutes a consequential damage flowing from covered property damage.

3 Allan D. Windt, INSURANCE CLAIMS & DISPUTES § 11:1 (5th ed. 2007 & Supp. 2011). Another commentator agrees: "'Because of' can, and should, be read to mean: as a consequence of, on account of, or arising from. Certainly, this is the

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[2] See, e.g., Tex. Prop. Code, section 27.004(m) (If a contractor fails to cure a defect in a reasonable time, the owner of the residence may recover "the reasonable cost of the repairs" plus "any other damages recoverable under any law not inconsistent with the provisions of this chapter").

[3] Indeed, as discussed in section I(B), infra pp. 4-5, some courts in other jurisdictions have specifically held that preventative measures are covered.

ordinary and usual meaning of 'because of.'" 1 Scott C. Turner, INSURANCE COVERAGE OF CONSTRUCTION DISPUTES § 6:20 (2d ed. 2007 & Supp. 2011).

This is the most sensible and plain meaning reading of the policy. See Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co., 267 S.W.3d 20, 23 (Tex. 2008) ("Policy terms are given their ordinary and commonly understood meaning unless the policy itself shows the parties intended a different, technical meaning."). Moreover, to extent that "damages because of property damage" is susceptible to two reasonable interpretations, then that language should be interpreted most favorably to the insured. Id. ("If, however, a contract is susceptible to more than one reasonable interpretation, we will resolve any ambiguity in favor of coverage.").

B. Some Courts Even Hold that Measures Aimed Solely at Preventing Property Damage are Covered

Although the steps in this case were done to locate covered property damage and repair the damage that was found, courts in other jurisdictions have gone even further and held that the costs to prevent a present injury from getting worse are covered damages under a general liability policy. See, e.g., lntel Corp. v. Hartford Acc. & Indem. Co., 952 F.2d 1551, 1565 (9th Cir. 1991) (cost of preventing further contamination covered absent application of owned-property exclusion); AIU Ins. Co. v. Superior Court, 51 Cal. 3d 807, 819 (Cal. 1990) (collecting cases holding that cost of mitigating future consequences of existing harm are

"'damages' that an insured is 'legally obligated' to pay as a result of 'property damage.'"); Diamond Shamrock Co. v. Aetna Cas. & Sur. Co., 554 A.2d 1342, 1348 (N.J. App. 1989) ("[O]nce some present injury has been proved, the plaintiff's damages may include the cost of measures intended to prevent future injury.").

In sum, this group supports Lennar's petition for review and urges the Court to request briefing on the merits because costs incurred by an insured to find property damage are covered damages "because of property damage."

II. ALTHOUGH IT IS DICTA, THE COURT OF APPEALS' ALTERNATIVE HOLDING REGARDING SETTLEMENT-WITHOUT-CONSENT IS AT ODDS WITH TEXAS LAW AND PUBLIC POLICY (LENNAR'S FIRST AND SECOND ISSUES PRESENTED)

Because the Court of Appeals disposed of the case through its ruling on the property damage issue, its discussion of the settlement-without-consent issue was unnecessary to its decision. Accordingly, that aspect of the opinion is dicta. Nevertheless, because of the content of this portion of the opinion coupled with the chance that some courts and litigants might overlook the fact it is dicta and give weight to it, this group feels compelled to address it.

Provisions of this sort have long been written and treated as conditions concerning the handling of a claim, not a substantive part of a policy's insuring agreement. In this case, the clause was located in two places – one in the insuring agreement and one in the conditions. See Petition for Review at 8, n. 1 (citing Appendix Tab 5). The Court of Appeals erred in giving different meaning

to these two provisions (one being subject to prejudice and waiver, while the other was not). In departing from established precedent and charting new ground, the Court of Appeals did not cite to any cases addressing the prejudice requirement or the insured's fundamental right (and, on occasion, need) to settle when it is abandoned by its insurer. Lennar II, 2011 WL 1466494 at *8. Precedents from this Court and others as well as principles of judicial economy and sound public policy are contrary to the ruling from the Court of Appeals on this issue.

Consequently, this group of amici curiae respectfully requests that this Court accept review to address this situation.

A. A Brief Discussion of the Long History of Settlement-Without-Consent Provisions

For decades, settlement-without-consent provisions have been policy conditions. For example, the "no action" clause in the 1943 Insurance Services Office[4] general liability form stated:

[4] As this Court previously noted, "[t]he CGL policy is a standard form developed by the Insurance Services Office, Inc. ("ISO") and is used throughout the United States. See 2 Jeffrey W. Stempel, STEMPEL ON INSURANCE CONTRACTS § 14.01 (3d ed. 2006). . . . The ISO is the industry organization responsible for drafting the industry-wide standard forms used by insurers." Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W.3d 1, 5 & n. 1 (Tex. 2007).

> No action shall lie against the company unless, as a condition precedent thereto, the insured shall have fully complied with all the terms of this policy, nor until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured after actual trial or by written agreement of the insured, the claimant and the company.

Because it operates as a condition and has historically been written as one, insurers that want to use an insured's breach of a settlement-without-consent provision to defeat coverage have long been required to show that they were prejudiced by that breach. This is just an example of the material breach rule in basic contract law. See Hernandez v. Gulf Group Lloyds, 875 S.W.2d 691, 692 (Tex. 1994) ("A fundamental principle of contract law is that when one party to a contract commits a material breach of that contract, the other party is discharged or excused from any obligation to perform.").

The prejudice rule in Hernandez has been applied to a settlement-without-consent clause in a commercial general liability policy. See Coastal Ref. & Mktg., Inc. v. U.S. Fidelity & Guar. Co., 218 S.W.3d 279, 294-96 (Tex. App.—Houston [14th Dist.] 2007, pet. denied) (Guzman, J.). This Court has even chosen to expand this rule. See PAJ v. Hanover Ins. Co., 243 S.W.3d 630, 631 (Tex. 2008) (applying the Hernandez prejudice rule to a notice provision); Prodigy Commc'ns Corp. v. Agric. Excess & Surplus Ins. Co., 288 S.W.3d 374, 380 (Tex. 2009) (same).

No Texas court has retreated from this rule, particularly in the manner suggested by the Lennar court. Importantly, this rule applied in Hernandez even

though it was part of the insuring agreement in that case. Id. at 694. The location of this clause did not make a difference to this Court in Hernandez. It has never made a difference, until now. The Lennar opinion focuses on whether the clause is one of "coverage" versus "condition." However, a similar analysis was rejected by this Court in PAJ, 243 S.W.3d at 633-34 (prejudice rule applies whether clause is characterized as a "condition precedent" or "covenant.").

Through the use of definitions and clever drafting, the entire policy could be incorporated into the insuring agreement. Coupled with the Court of Appeals' conclusion that even a wrongful denial of coverage will not waive enforcement of a strategically-placed settlement-without-consent clause, the Lennar court strikes an unprecedented and unnecessary blow against Texas insureds. If an insurer moves a typical policy "condition" into the insuring agreement, its insured is worse off than a party to any other type of contract. A contract provision is not any more or less material based on its location in the contract. If the Court of Appeals' decision is left intact, it will stand alone in rejecting a fundamental protection for Texas insureds.

Texas has a strong public policy of protecting Texas insureds, not impairing them. And if the Lennar decision emboldens excess insurers to further restructure their policies to take advantage of this new rule, then insureds like

Lennar could be deprived of insurance protection at the highest levels of coverage — when they need it most.

Finally, because the policy in this case had two consent provisions, with the Court of Appeals holding that one required prejudice[5] and the other one did not,[6] a structural ambiguity exists in the policy. Clauses with similar wording in the same policy should not have two completely opposite effects. For this reason as well, the issue should be resolved in the insured's favor. If not, then form becomes greater than substance.

This group respectfully submits that the prior rule requiring prejudice, which is the rule announced by this Court and followed by others, is the correct one.

B. This Decision Creates a Dilemma that Harms Insureds, Claimants, Courts and Other Litigants While Benefitting Only Recalcitrant Carriers

The approach set forth by the Court of Appeals forces insureds to choose between one of two bad options: either they settle with their own money at the risk of destroying their insurance, or they put the case to trial and run the risk of potentially far worse outcomes. Dilemmas like these are not what Texas insureds plan on getting when they purchase insurance. In fact, they are the

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[5] See Lennar Corp. v. Great Am. Ins. Co., 200 S.W.3d 651, 695 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (Lennar I).

[6] See Lennar II, 2011 WL 1466494 at *8-9.

opposite result of that calculus. For this reason, we do not believe the Lennar court's decision is the right outcome under the law.

Aside from putting insureds to a fundamentally unfair choice, this decision raises a host of other practical problems. What if the insured cannot afford to settle, and likewise cannot risk taking the case through trial? What if the carrier is not Stowerized and an excess judgment is rendered? How would this work in multiple-carrier situations in light of Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co., 236 S.W.3d 765 (Tex. 2007)? Space does not permit us to answer these and other questions today, but we respectfully request that this Court accept review so it can study these important issues.

The decision from the Court of Appeals also harms claimants, courts and other litigants while giving a benefit only to recalcitrant carriers with clauses identical to the one in Markel's policy. If insurance is not available for settlements, then settlement offers will be lower in many cases. If insureds or claimants must then take more cases to trial due to insufficient settlement offers, then courts will get even larger backlogs, impairing their work and harming other litigants in the process. The approach set forth by the Court of Appeals will likely foster more litigation rather than less, either through additional

coverage disputes or taking underlying cases to trial. This is contrary to this Court's pronouncements favoring settlements.[7]

This new rule could also result in a windfall for recalcitrant insurers with the same clause as Markel's policy. In light of the premiums that are paid for protection against settlements or judgments, such a windfall would constitute unjust enrichment. Applying the same prejudice rule for conditions—regardless of where they are placed in the policy—protects all interested parties, including insureds, insurers and claimants.

For these reasons, we support Lennar's petition for review of this issue and urge the Court to request briefing on the merits.

III. THE COURT OF APPEALS ALTERED THE POLICY LANGUAGE BY HOLDING THAT LENNAR MAY ONLY ESTABLISH ITS LEGAL LIABILITY THROUGH ADJUDICATION, ARBITRATION AND A SETTLEMENT WITH MARKEL'S CONSENT (LENNAR'S FOURTH AND FIFTH UNBRIEFED ISSUES).

Finally, the Court of Appeals modified Markel's policy by concluding that Lennar could only establish its legal liability through adjudication, arbitration or a settlement with the insurer's consent. Here is the policy provision at issue:

> "Ultimate net loss" means the total amount of damages for which the insured is legally liable in payment of "bodily injury," "property damage," "personal injury," or "advertising injury." "Ultimate net loss" may be established by adjudication, arbitration, or a compromise settlement to which we have previously agreed in writing.

[7] See, e.g., Stewart Title Guarantee Co. v. Sterling, 822 S.W.2d 1, 9 (Tex. 1991) ("This Court seeks to promote a public policy that encourages settlements.").

See Petition for Review at 8, n. 1 (citing Appendix Tab 5). This was erroneous in two key respects.

First, the Court of Appeals changed the actual language of the policy — "Ultimate net loss may be established" (emphasis added) through adjudication, arbitration, or a settlement with the insurer's consent — rewriting it by adding in the word "only" so it now reads "Ultimate net loss may only be established . . . ." The most reasonable construction of this provision is that the language is permissive and not mandatory.[8] By doing so the Court of Appeals failed to follow established rules of contract construction and ignored several decisions from this Court, including:

- Fortis Benefits v. Cantu, 234 S.W.3d 642, 649 (Tex. 2007) (Court is "loathe to judicially rewrite the parties' contract . . .");
- Fiess v. State Farm Lloyds, 202 S.W.3d 744, 746 (Tex. 2006) ("As with any other contract, the parties' intent is governed by what they said, not by what they intended to say but did not.");
and
- Dallas Cnty. Cmty. Coll. Dist. v. Bolton, 185 S.W.3d 868, 874 (Tex. 2005) (the word "may" should be given its permissive meaning).

Second, the Court of Appeals also departed from established Texas insurance law on how an insured may establish its legal obligation to pay. See, e.g., Lennar I, 200 S.W.3d at 680 ("legally obligated to pay" means "an obligation

[8] Even if there is an alternative interpretation of this provision, this Court must adopt the construction favoring coverage. See Don's Bldg. Supply, 267 S.W.3d at 23.

imposed by law, such as an obligation to pay pursuant to a judgment, settlement, contract, or statute"); Venture Encoding Serv., Inc. v. Atlantic Mut. Ins. Co., 107 S.W.3d 729, 737 (Tex. App.—Ft. Worth 2003, pet. denied) (legal obligation under contract); Acceptance Ins. Co. v. S&S Telecom, Inc., 2001 WL 844749, at *2 (Tex. App.—San Antonio July 25, 2001, no pet.) (unpub. op.) (insured legally obligated under general tort law); Tex. Prop. & Cas. Ins. Guar. Ass'n v. Boy Scouts of Am., 947 S.W.2d 682, 691 (Tex. App.—Austin 1997, no writ) (stating that the insurer becomes legally obligated to pay claims once the obligation is fixed by judgment or settlement contract); Ins. Co. of N. Am. v. Aberdeen Ins. Servs., Inc., 253 F.3d 878, 885-86 (5th Cir. 2001) (applying Texas law) (insured legally obligated by contract). The language of Markel's policy does not support such a shift in Texas law.

For these reasons as well, we support Lennar's petition for review and urge the Court to request briefing on the merits.

CONCLUSION

If the decision from the Court of Appeals is left untouched, the far-reaching impacts of this case will detrimentally affect policyholders, tort claimants, courts and other litigants. Therefore, this Court should request briefing on the merits so that it can study these important issues and determine whether it should accept review.

Respectfully submitted,

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I certify that a copy of this document has been served by sending it by first class mail or email to the following counsel on July 13, 2011:

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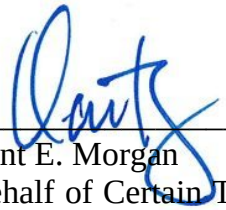

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