LLB&L Client Alert

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A Texas Two-Step: The Duty to Indemnify May Exist Even Where There is No Duty to Defend

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While Texas courts have recognized that a general liability insurer's duty to defend is distinct from its duty to indemnify, *see Farmers Tex. County Mut. Ins. Co. vs. Griffin*, 955 S.W.2d 81 (Tex. 1997), the Texas Supreme Court recently underscored the "two-step" nature of these independent inquiries. In *D.R. Horton-Texas v. Markel International Insurance Co*. (Tex., December 11, 2009, No. 06-1018), the Texas Supreme Court held that an insurer's duty to indemnify is not dependent on the duty to defend its insured in the underlying litigation and that an insurer may have a duty to indemnify the insured even if the duty to defend never arises. The *D.R. Horton* court did not disturb Texas' "eight corners" rule prohibiting the introduction of extrinsic evidence to determine the defense obligation, a rule that was reaffirmed in *Guideone Elite Ins. Co. vs. Fielder Road Baptist Church*, 197 S.W.3d 305 (Tex. 2006). The *D.R. Horton* court expressly recognized, however, that extrinsic evidence would be necessary to decide the indemnity obligation in this particular case. The Court thus upheld the lower court ruling that no duty to defend existed, while remanding the case for a determination on the duty to indemnify.

Background

The underlying plaintiffs, James and Cicely Holmes, found mold infestation in their home which was built by D.R. Horton-Texas Ltd. The Holmeses filed suit against D.R. Horton for remedial costs and alleged that latent defects in the chimney, roof, vent pipes, windows, window frames, and flashing around the roof and chimney allowed water to enter the house, eventually causing mold damage. D.R. Horton's masonry subcontractor, Rosendo Ramirez, was not sued or mentioned in the plaintiffs' pleadings. Ramirez, however, was insured through a CGL policy from Markel International Insurance Company, Ltd., and this policy listed D.R. Horton as an additional insured for claims against it involving Ramirez's work.

After D.R. Horton was sued, it sought coverage from Markel. Markel refused to defend D.R. Horton because the underlying plaintiffs' petition did not plead facts indicating that Ramirez's work was defective in order to invoke coverage under Markel's CGL policy. D.R. Horton defended itself in the litigation but settled with the Holmeses just before trial. D.R. Horton then sued Markel for reimbursement of defense costs and indemnity. Markel moved for summary judgment arguing there was no duty to defend D.R. Horton since the underlying petition did not contain allegations sufficient to trigger the CGL policy. D.R. Horton attacked the summary judgment motion with evidence that Ramirez's conduct was at issue including affidavits, inspection reports, the contract with Ramirez, and mold investigation reports.

The trial court granted Markel's summary judgment but overruled Markel's objections to the extrinsic evidence submitted by D.R. Horton. The court of appeals affirmed the findings that there was no duty to defend or indemnify D.R. Horton in the claims asserted by the Holmeses. The court of appeals reasoned that the "eight-corners" doctrine precluded the claim that Markel owed a duty to defend because there were no allegations on the face of the petition that implicated Ramirez's work. The court of appeals also reasoned that because there was no duty to defend, Markel also had no duty to indemnify.

Holding

With respect to the duty to defend, the Supreme Court of Texas found that D.R. Horton had waived its argument on appeal. It was not until D.R. Horton's second motion for rehearing in the court of appeals and after the Texas Supreme Court's decision in *Guideone*, *supra*, that D.R. Horton first advanced the position that an exception to the "eight corners" doctrine should apply. This was just too late, said the Court.

On the duty to indemnify, the Court specifically noted that the duties of defense and indemnity

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are "distinct and separate duties" but "the existence of one does not necessarily depend on the existence or proof of the other." In so doing, the Court expressly disapproved of Markel's broad reading of *Griffin*, *supra*, that a finding of no duty to defend would dispense with any duty to indemnify. Instead, the Court explained that *Griffin* – a case in which the issue was whether a drive-by shooting could form the basis for coverage under an automobile policy – was "grounded on the impossibility that the drive-by shooting in that case could be transformed by proof of any conceivable set of facts into an auto accident covered by the insurance policy." The *D.R. Horton* court made clear that *Griffin* "was not based on a rationale that if a duty to defend does not arise from the pleadings, no duty to indemnify could arise from proof of the allegations in the petition." Thus, the Court found that D.R. Horton's evidence that: (a) Ramirez was a subcontractor for building the home; (b) Ramirez performed masonry work and repairs allegedly contributing to the defects; and (c) Markel's CGL policy named D.R. Horton as an additional insured raised fact questions that defeated summary judgment on the duty to indemnify.

The Court remanded the duty to indemnify determination to the trial court for the introduction of other evidence to establish or refute such a duty. The court commented that other policy terms or other proof "may establish or refute the existence of coverage under the CGL policy and the insurer and insured may introduce evidence in the coverage litigation to establish or refute the duty to indemnify." The "circumstances of the case and other legal and equitable principles" will determine whether the material coverage facts will have been established in that underlying suit.

Commentary

Since the duty to defend is broader than the duty to indemnify, it may seem inconsistent to find that a duty to indemnify can exist where there is no duty to defend. However, through its discussion and limitation of the prior holding in *Griffin*, the *D.R. Horton* court makes clear that the duty to defend and the duty to indemnify are two distinct inquiries, and one duty does not depend on the other. All liability insurers should be mindful of this form of a "Texas two-step:" even where there is no duty to defend, a policyholder may still be permitted to pursue, litigate and present evidence that the insurer owes a duty to indemnify.

About the Authors

Jill Schaar is a partner at LLB&L. She draws from 20 years of experience litigating a wide variety of commercial, tort, maritime, and insurance disputes. Ms. Schaar's clients include national and international energy companies, construction interests, environmental service companies, international manufacturers, and domestic, foreign, and international insurers. Her practice in risk management goes beyond the courtroom, as Ms. Schaar regularly counsels clients in creating contractual arrangements and risk management programs that are tailored to the particular business sector involved.

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