The Monday Claims Report

Words of Policy Do Not Apply Unless Insurer is Prejudiced

June 23, 2014 *Barry Zalma*

The Supreme Court of Texas was asked to resolve an insurance coverage dispute arising from the fact that homes built with an exterior insulation and finish system ("EIFS") suffer serious water damage that worsens over time in *Lennar Corp. v. Markel American Insurance Co.*, 11-0394 (Tex. 2013). Lennar Corp., a homebuilder, facing potentially hundreds of expensive suits, undertook to remove the product from all the homes it had built and replace it with conventional stucco. The homebuilder's insurers refused to pay for the remediation program, because there was no claim and no evidence of actual property damage. The insurers preferred to rely on the policy language and do nothing until homeowners claimed damages or sued which is what it agreed to do by the wording of the policy. As a result the insurers denied coverage of the costs.

The litigation lasted more than twelve years between the builder and its insurers. The case before the Supreme Court of Texas, after twelve years, left only one insurer and the issues were winnowed to two: Not having consented to the homebuilder's remediation program, is the insurer nevertheless responsible for the costs if it suffered no prejudice as a result? Is the insurer responsible for (i) costs incurred to determine property damage as well as to repair it, and (ii) costs to remediate damage that began before and continued after the policy period?

Lennar decided not merely to address complaints as it received them but to contact all its homeowners and offer to remove the EIFS and replace it with conventional stucco. Lennar began its remediation program in 1999 and finished in 2003. Almost all the homeowners accepted Lennar's offer of remediation. A few were paid cash. Only three ever sued. All settled.

Early in the process, Lennar notified its insurers that it would seek indemnification for the costs. The insurers refused to participate in Lennar's proactive, comprehensive efforts, preferring instead to wait and respond to homeowners' claims one by one.

Lennar and Markel also disputed whether coverage was precluded by Lennar's failure to comply with Condition E of the policy, which states in part: "it is a requirement of this policy that . . . no insured, except at their own cost, voluntarily make any payment, assume any obligation, or incur any expense . . . without [Markel's] consent". Markel had not consented to Lennar's remediation settlements.

After hearing evidence for eight days, the jury found that Lennar's defective use of EIFS in home construction "create[d] an imminent threat to the health or safety of the inhabitants of the homes", and that Lennar took "reasonable steps to cure the construction defect as soon as practicable and within a reasonable time". The jury failed to find that Markel was prejudiced by Lennar's "failure to obtain Markel's consent (a) to enter into any compromise settlement agreement, or (b) to voluntarily make any payment, assume any obligation, or incur any expense". The trial court rendered judgment awarding Lennar $2,965,114.16, the damages found by the jury less a $425,000 credit for settlements with other insurers, $2,421,825.89, the attorney fees found by the jury, and $1,227,476.03 in prejudgment interest. The court of appeals reversed and rendered judgment for Markel on two grounds: Condition E of Markel's policy forbade Lennar, "except at [its] own cost, [from] voluntarily mak[ing] any payment, assum[ing] any obligation, or incur[ring] any expense . . . without [Markel's] consent". Though Markel did not consent to Lennar's settlements with homeowners, it conceded, as Lennar

I held, that Texas precedent required that the provision does not excuse its liability under the policy unless it was prejudiced by the settlements, words that do not exist in the policy.

At trial, Markel vigorously contended that Lennar's settlements were prejudicial, largely because Lennar offered remediation to homeowners with damaged houses who would never have sought redress had Lennar left them alone. Markel argued: "When an insurer is not asked to adjust a claim, provide a defense, or be involved in negotiating a settlement, but is simply told it has to pay for a voluntary payment, the insurer has suffered prejudice as a matter of law. That prejudice is even more stark in this case, in which the insured actively solicited claims which might otherwise never have been brought and made payments which were not covered under the Policy."

Assuming Markel is right, that an insurer need not show prejudice from an insured's failure to comply with a policy requirement that is "considered essential to coverage", the Supreme Court found that the Loss Establishment Provision does not qualify, certainly not for the reasons Markel argues. The Loss Establishment Provision is no more central to the policy than Condition E, and the requirement that Markel show prejudice from Lennar's non-compliance with either operates identically. Markel failed to prove that it was prejudiced in any way by Lennar's settlements.

The jury's failure to find prejudice leaves but one conclusion: that Lennar's loss as shown by the settlements is the amount Markel is obligated to pay under the policy. Absent prejudice to Markel, Lennar's settlements with homeowners establish both its legal liability for the property damages and the basis for determining the amount of loss.

The policy obligated Markel to pay "the total amount" of Lennar's loss "because of" property damage that "occurred during the policy period", including "continuous or repeated exposure to the same general harmful condition". Focusing on "because of", the court of appeals held that the policy covers only the cost of repairing home damage, not the cost of locating it, and because Lennar's evidence did not segregate the two, it was entitled to recover nothing. Additionally, Markel argued that Lennar's evidence improperly included the cost of repairing home damage that occurred outside the policy period. The court of appeals did not reach this argument.

For damage that occurs during the policy period, coverage extends to the "total amount" of loss suffered as a result, not just the loss incurred during the policy period. No question remains that all 465 houses at issue suffered property damage during the policy period, which began before or during the policy period and continued until it was repaired, all because of water trapped in home walls by EIFS applied to wood-frame construction. Thus, the policy covered Lennar's total remediation costs.

The Supreme Court concluded that Markel's policy covered Lennar's entire remediation costs for damaged homes. Lennar's responsible efforts to correct defects in its home construction did not absolve Markel of responsibility for the costs under its liability policy.

Zalma Opinion

The insured, Lennar, and Markel, entered into a written contract that clearly and unambiguously stated that Markel would owe nothing if the insured entered into a settlement without the consent of Markel. There is no question that Markel did not agree to the various settlements reached by Lennar. Regardless of the clear and unambiguous language of the policy the Texas Supreme Court required Markel to pay multi-millions of dollars it did not agree to pay. Insurance is a contract that should be given meaning. If the parties wanted a prejudice requirement in the policy they could have negotiated such a requirement. They did not and the Supreme Court put it in and changed the agreed to wording of the contract.

About the Author

Barry Zalma, Esq., CFE, has practiced law in California for more than 40 years as an insurance coverage and claims handling lawyer. He now limits his practice to service as an insurance consultant and expert witness specializing in insurance coverage, insurance claims handling, insurance bad faith and insurance fraud almost equally, for insurers and policyholders. He also serves as an arbitrator or mediator for insurance related disputes.

He founded Zalma Insurance Consultants in 2001 and serves as its only consultant. Mr. Zalma recently published the e-books, "Zalma on Insurance Fraud – 2013"; "Zalma on California Claims Regulations – 2013"; "Rescission of Insurance in California – 2013"; "Random Thoughts on Insurance" a collection of posts on this blog; "Zalma on Insurance Fraud – 2012"; "Zalma on Diminution in Value Damages – 2012," "Zalma on Insurance," "Heads I Win, Tails You Lose – 2011," "Arson for Profit" and more. Contact Barry Zalma at: http://www.zalma.com.