IN THE SUPREME COURT OF TEXAS

NO. 05-0832

LAMAR HOMES, INC., PETITIONER,

v.

MID CONTINENT CASUALTY COMPANY, RESPONDENT

ON CERTIFIED QUESTIONS FROM THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

Argued February 14, 2006

JUSTICE BRISTER, joined by JUSTICE HECHT and JUSTICE WILLETT, dissenting.

Selling damaged property is not the same as *damaging* property. Among other differences, only the latter begets a claim for property damage. When the homebuyers here sued their builder for construction defects, they did not claim the builder damaged their property; instead, they alleged broken promises and breached duties connected with the sale. Those were not property damage claims, and thus were not covered by the builder's CGL policy.

The Court's conclusion to the contrary turns the construction industry on its head. Instead of builders standing behind their subcontractors' work and making necessary repairs, the Court shifts that duty to insurance companies. Every crack, stain, dent, leak, scratch, and short-circuit arising from a subcontractor's work (which will be most of them) must be repaired by the builder's insurer,

who may have to pay the builder to repair its own home. Why should builders avoid unqualified subcontractors if their insurers (and other policyholders) will pay the consequences? No one really believes this is what the parties intended — that for a $12,005 annual premium the insurer agreed to repair all damage to every home Lamar Homes had ever sold (at the rate of almost $3 million annually). As that is precisely what the Court holds today, I respectfully dissent.

The CGL insurance policy provides coverage only for suits seeking "bodily injury" and "property damage," the latter being defined to include "physical injury to tangible property." The homebuyers here certainly alleged their home suffered physical injury — foundation deflection, cracks in sheetrock and stonework, and doors that no longer worked properly. But the contract, warranty, fraud, DTPA, and negligence claims they brought against Lamar Homes were for breaching its promises and legal duties as a seller.[1] Such claims are for economic loss rather than property damage, so the policy does not cover them.

Thirty years ago in *Nobility Homes of Texas, Inc. v. Shivers* (a case involving a mobile home warranty claim), we held that "economic loss is not 'physical harm' to the user or his property."[2] Ten years later in *Jim Walter Homes, Inc. v. Reed*, we applied the same rule to homebuyers suing a builder for an inadequate foundation (precisely the allegations here), holding that such claims were for economic loss rather than property damage:

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[1] Specifically, the homebuyers alleged that Lamar Homes breached express and implied warranties that their home would be designed and constructed in a good and workmanlike manner; breached the DTPA by breaching those warranties; breached the DTPA by misrepresenting the reinforcement in their slab; committed fraud by making the same misrepresentations; and (along with its subcontractors) negligently designed their foundation.

[2] 557 S.W.2d 77, 80 (Tex. 1977) ("The courts of civil appeals have correctly reasoned that economic loss is not 'physical harm' to the user or his property. . . . We agree and hold that strict liability does not apply to economic losses.").

> When the injury is only the economic loss to the subject of a contract itself, the action sounds in contract alone. The Reeds' injury was that the house they were promised and paid for was not the house they received. This can only be characterized as a breach of contract . . . .[3]

The distinction between claims for economic loss and property damage is by no means limited to Texas; federal law and most states draw the same sharp line between them.[4] As the Restatement (Third) of Torts states, "harm to persons or property includes economic loss if caused by harm to . . . the plaintiff's property *other than the defective product itself*."[5] As a tentative draft of the Restatement states the law:

> When a service provider is responsible for a latent physical defect in property, physical impairment of the property resulting from the defect is not physical harm to that property or to other property that is part of an integrated whole with that property.[6]

An illustration in the tentative draft specifically applies it to foundation defects like the one at issue here.[7]

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[3] 711 S.W.2d 617, 618 (Tex. 1986) (citations omitted). For a description of the defects the Reeds asserted, *see Jim Walters Homes, Inc. v. Reed*, 703 S.W.2d 701, 705 (Tex. App.—Corpus Christi 1985), *aff'd in part and rev'd in part*, 711 S.W.2d 617 (Tex. 1986).

[4] *See Saratoga Fishing Co. v. J.M. Martinac & Co.*, 520 U.S. 875, 884–85 (1997) (applying federal maritime law); Robert A. Sachs, *Product Liability Reform and Seller Liability: A Proposal for Change*, 55 BAYLOR L. REV. 1031, 1115 n.372 (2003) ("Property damage to the product itself and consequential economic losses to the owner of the product are considered in most states to be recoverable under the law governing commercial transactions and the Uniform Commercial Code, not under tort law.") (citing cases).

[5] RESTATEMENT (THIRD) OF TORTS § 21 (1998) (emphasis added).

[6] RESTATEMENT (THIRD) OF ECONOMIC TORTS AND RELATED WRONGS § 8 cmt. c(2) (Council Draft No. 1, 2006).

[7] *Id*. § 8 cmt. C(3), illus. 12:

> Contractor negligently compacts fill dirt upon which it builds a house. Contractor sells the house to A who later sells the house to B. Noticing a crack in the house's slab, B's Broker asks Engineer to inspect the foundation on behalf of B before B contracts to buy the house. Engineer gives the house

Granted, the CGL policy does not distinguish between contract and tort claims, or mention economic loss. But it does limit coverage to "property damage" suits. Given the extensive jurisprudence separating property damage from economic loss, we cannot presume this policy was drafted without knowing or recognizing the difference.

Nor is the difference between property damage and economic loss claims merely a technical rule of pleading. While warranty claims generally pass to new buyers,[8] property damage claims do not, remaining with the party that owned the property when the tort occurred.[9] Here, the homebuyers alleged Lamar Homes failed to design, construct, and market their foundation properly, actions that all took place before the sale. Thus, they brought warranty claims because they *had* to, having no standing to assert a property damage claim.

Lamar Homes points out that the CGL policy doesn't define "property damage" as physical injury to the tangible property *of others*, and thus argues it should cover property that was defective when Lamar Homes sold it. But like all liability policies, this policy covers only third-party claims, not first-party claims. By limiting coverage to property damage claims asserted against Lamar

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> a clean bill. When the crack worsens and other problems develop B discovers the fill was improperly compacted. B sues Contractor and Engineer. The house, foundation, and fill are considered to be part of an integrated whole so the harm to the house resulting from the defect in the fill is a pure economic loss. There is no negligence action for the harm . . . .

[8] *See PPG Indus., Inc. v. JMB/Houston Ctrs. Partners Ltd. P'ship*, 146 S.W.3d 79, 88 (Tex. 2004).

[9] *See Vann v. Bowie Sewerage Co.*, 90 S.W.2d 561, 562 (Tex. 1936); *Cook v. Exxon Corp.*, 145 S.W.3d 776, 781 (Tex. App.—Texarkana 2004, no pet.); *Denman v. Citgo Pipeline Co.*, 123 S.W.3d 728, 732 (Tex. App.—Texarkana 2003, no pet.); *Exxon Corp. v. Pluff*, 94 S.W.3d 22, 27 (Tex. App.—Tyler 2002, pet. denied); *Senn v. Texaco, Inc.*, 55 S.W.3d 222, 225 (Tex. App.—Eastland 2001, pet. denied); *Abbott v. City of Princeton*, 721 S.W.2d 872, 875 (Tex. App.—Dallas 1986, writ ref'd n.r.e.); *Lay v. Aetna Ins. Co.*, 599 S.W.2d 684, 686 (Tex. Civ. App.—Austin 1980, writ ref'd n.r.e.).

Homes, the policy necessarily covered only property owned by a third party at the time it was damaged.

The Court relies on the subcontractor exception to the your-work exclusion to find coverage. This is a mistake for a simple reason: exclusions cannot create coverage. While an exception to an exclusion preserves any coverage that may exist, it cannot create coverage on its own.[10] Lamar Homes errs in asserting that this exception to an exclusion "represents a major extension of coverage"; extensions of coverage must be found in the policy's coverage provisions, not its exclusions. By finding coverage based on an exception to an exclusion, the Court now has the policy's tail wagging the dog.

I agree the subcontractor exception creates something of an anomaly when used in the construction industry. For several policy reasons, it has long been understood that CGL insurance does not cover damage to an insured's own work.[11] But because construction today is often entirely

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[10] *See Harken Exploration Co. v. Sphere Drake Ins. P.L.C.*, 261 F.3d 466, 471 (5th Cir. 2001) ("The insured bears the initial burden of showing that the claim against her is potentially within the insurance policy's scope of coverage.") (citations omitted); *see also Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899-900 (Pa. 2006) (finding it unnecessary to consider policy exclusions when there was no "occurrence" under the CGL); *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 576 (Neb. 2004) ("[T]he exception contained within exclusion '1' is irrelevant until . . . [t]here is an initial grant of coverage . . . ."); *Corder v. William W. Smith Excavating Co.*, 556 S.E.2d 77, 81 (W. Va. 2001) ("Before any coverage can be found to exist under . . . any other portion of the commercial general liability policy, an 'occurrence,' within the policy definition of that term, must be determined to have occurred.") (footnote omitted).

[11] *See, e.g.*, Stewart Macaulay, *Justice Traynor and the Law of Contracts*, 13 STAN. L. REV. 812, 825-26 (1961):

> Replacement and repair costs are to some degree within the control of the insured. They can be minimized by careful purchasing, inspection of material, quality control and hiring policies. If replacement and repair costs were covered, the incentive to exercise care or to make repairs at the least possible cost would be lessened since the insurance company would be footing the bill for all scrap. Replacement and repair losses tend to be more frequent than losses through injury to other property, but replacement and repair losses are limited in amount since the greatest loss cannot exceed the cost of total replacement. If the insured will stand these losses, insurance can be provided more cheaply since the company will be freed from administering many small claims for repairs, and it can set a rate

the work of subcontractors,[12] the subcontractor exception has effectively rendered the CGL policy's your-work exclusion meaningless when issued to a general contractor. I would not compound the confusion by allowing it to render the policy's coverage provisions meaningless as well.

It is true that if the subcontractor exception preserves only claims that no homebuyer could ever bring, it is hard to see why it was added. But that is not the case here. The insurer concedes the exception preserves coverage for damages by or to work done by subcontractors that the insured causes *after* the sale, such as during a repair call or while working on a neighboring property. Once title to the home has passed, any damage a builder causes thereafter would give the buyers a claim for property damage rather than economic loss. Lamar Homes complains that such accidents are not very likely, and thus its CGL policy would not cover very much. But of course the policy did not cost very much, and still covers all bodily injuries and property damage (other than the house itself) that might occur after the sale. Had these same construction defects cracked a grand piano or someone's head (rather than the home's own walls), Lamar Homes would undoubtedly feel differently about its value.

> for the more unusual risk of injury to property other than the contractor's work or product. This risk can be the hazardous one since there are no natural limitations on the damage the contractor might do to a homeowner's or a neighbor's property.

[12] *See* Ronald J. Mann, *The First Shall be Last: A Contextual Argument for Abandoning Temporal Rules of Lien Priority*, 75 TEX. L. REV. 11, 25 (1996) ("Usually much of the work of actual construction will be provided by a general contractor through one or more tiers of subcontractors."); *see, e.g.*, *Lennar Corp. v. Auto-Owners Ins. Co.*, 151 P.3d 538, 541 (Ariz. Ct. App. 2007) (noting that builder of 105 homes subcontracted all actual construction work); *see also* BLACK'S LAW DICTIONARY 351 (8th ed. 2004) ("general contractor. One who contracts for the completion of an entire project, including purchasing all materials, hiring and paying subcontractors, and coordinating all the work.").

Finally, the Court's opinion obscures the fact that we are adopting a minority view. The high courts of only 5 states have taken the same view as the Court,[13] a number the Court inflates by including cases in which "property damage" was not contested on appeal,[14] coverage was limited to property *other than* the builder's work,[15] or that have nothing to do with home builders.[16] By contrast, the courts of 11 states have held the CGL policy does not cover property damage to the home the insured built;[17] while the policies in some of these cases did not contain a subcontractor's exception, that is relevant only if exclusions can create coverage. Given the ubiquity of this policy nationwide, uniform treatment in the courts is important; while it is too late for complete uniformity, we should try not to make matters worse. The current lack of uniformity does not, of course, render

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[13] *See Travelers Indem. Co. of Am. v. Moore & Assocs., Inc.,* 216 S.W.3d 302 (Tenn. 2007); *Am. Family Mut. Ins. Co. v. Am. Girl*, 673 N.W.2d 65 (Wis. 2004); *Corner Constr. Co. v. U.S. Fed. & Guar. Co.*, 638 N.W.2d 887 (S.D. 2002); *Fejes v. Alaska Ins. Co., Inc*. 984 P.2d 519 (Alaska 1999); *High Country Assoc. v. New Hampshire Ins. Co.*, 648 A.2d 474 (N.H. 1994).

[14] *See Lee Builders, Inc. v. Farm Bureau Mut. Ins. Co.*, 137 P.3d 486, 495 (Kan. 2006) (noting insurer "only petitioned for review on the occurrence issue"); *Wanzek Constr., Inc. v. Employers. Ins*., 679 N.W.2d 322, 327 (Minn. 2004) (noting insurer did not contest that claim was an "occurrence" resulting in "property damage"); *McKellar Dev. v. N. Ins. Co*., 837 P.2d 858 (Nev. 1992) (failing to address whether claim involved an "accident" or "property damage").

[15] *See French v. Assurance Co. of Am*., 448 F.3d 693, 706 (4th Cir. 2006) (predicting Maryland courts would find no coverage for repairing defective work, but would find coverage for damage to other parts of home).

[16] *See Ferrell v. West Bend Mut. Ins. Co.*, 393 F.3d 786 (8th Cir. 2005); *Transportes Ferreos De Venezuela II CA v. NKK Corp*., 239 F.3d 555 (3d Cir. 2001) (predicting New Jersey courts would find coverage for claim against supplier of boom installed on cargo vessel).

[17] *See Burlington Ins. Co. v. Oceanic Design & Constr. Inc.*, 383 F.3d 940, 948–49 (9th Cir. 2004) (predicting Hawaii courts would find no coverage); *Travelers Indem. Co. v. Miller Bldg. Corp*., 97 FED. APPX. 431, 434 (4th Cir. 2004) (predicting North Carolina courts would find coverage only to extent defects damage carpet supplied by owner, not builder); *Acuity v. Burd & Smith*, 721 N.W.2d 33, 39 (N.D. 2006); *Kvaerner Metals Div. of Kvaerner U.S., Inc. v. Commercial Union Ins. Co.*, 908 A.2d 888, 899–900 (Pa. 2006); *L-J, Inc. v. Bituminous Fire & Marine Ins. Co*., 621 S.E.2d 33, 36–37 (S.C. 2005); *Auto-Owners Ins. Co. v. Home Pride Cos.*, 684 N.W.2d 571, 577 (Neb. 2004); *Corder v. William W. Smith Excavating Co*., 556 S.E.2d 77, 82 (W. Va. 2001); *Pursell Constr. Inc. v. Hawkeye-Security Ins. Co.*, 596 N.W.2d 67, 70 (Iowa 1999); *Commerce Ins. Co. v. Betty Caplette Builders, Inc*., 647 N.E.2d 1211, 1214 (Mass. 1995); *Dodson v. St. Paul Ins. Co.*, 812 P.2d 372, 378 (Okla. 1991); *Peerless Ins. Co. v. Brennon*, 564 A.2d 383, 386 (Me. 1989).

the policy ambiguous; a policy does not have two reasonable interpretations just because the courts cannot agree on one.[18]

Lamar Homes was sued for breaking promises, not for breaking property. Indeed, under Texas law that is the only claim the homebuyers could possibly bring. Because their injuries occurred when the sale took place (though the cracks appeared five years later), they did not have a property damage claim under Texas law. Because that is all this CGL policy covered, I would answer the second certified question "No." As this question disposes of the pending claim, I would decline to decide the others.[19]

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Scott Brister
Justice

OPINION DELIVERED: August 31, 2007

[18] *See City of Keller v. Wilson*, 168 S.W.3d 802, 828 (Tex. 2005) ("It is inevitable in human affairs that reasonable people sometimes disagree; thus, it is also inevitable that they will sometimes disagree about what reasonable people can disagree about.").

[19] *See, e.g.*, *Flores v. Millennium Interests, Ltd.,* 185 S.W.3d 427, 434 (Tex. 2005).