

CGL Contractual Liability Exclusion in Flux: Insurer and Policyholder Perspectives

Grappling with the Expanding Exclusion for Construction and Commercial Contracts

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Today's faculty features:

Rodrigo (Diego) Garcia, Jr., Partner, Thompson Coe, Houston

David Taubenfeld, Partner, Haynes and Boone, Dallas

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CGL CONTRACTUAL LIABILITY EXCLUSION IN FLUX: INSURER AND POLICYHOLDER PERSPECTIVES

Rodrigo (Diego) Garcia, Jr.

Thompson Coe

One Riverway

Suite 1400

Houston, TX 77056

dgarcia@thompsoncoe.com

David Taubenfeld

Haynes and Boone LLP

2323 Victory Avenue

Suite 700

Dallas, TX 75219

david.taubenfeld@haynesboone.com

History of the Contractual Liability Exclusion 1966 and 1973 CGL Forms

- This insurance does not apply . . . (a) to liability assumed by the insured under any contract or agreement except an incidental contract; but this exclusion does not apply to a warranty of fitness or quality of the named insured's products or warranty that work performed by or on behalf of the named insured will be done in a workmanlike manner.

History of the Contractual Liability Exclusion 1966 and 1973 CGL Forms

“Incidental Contract” Definition:

“Incidental Contract” means any written (1) lease of premises; (2) easement agreement, except in connection with construction or demolition operations on or adjacent to a railroad, (3) undertaking to indemnify a municipality required by municipal ordinance, except in connection with work for the municipality, (4) sidetrack agreement, or (5) elevator maintenance agreement.

History of the Contractual Liability Exclusion

1966 and 1973 CGL Forms

- Because contractual liability coverage under the CGL policy was narrow, insureds either purchased a separate policy providing contractual liability coverage or broad form endorsements

History of the Contractual Liability Exclusion 1986 CGL Form

- When ISO amended the standard CGL form introduced in 1986, the contractual liability exclusion was substantially amended to approximate the coverage provided by the broad form endorsements previously available.
- The term “incidental contract” became “insured contract” and the definition of “insured contract” was broadened.

History of the Contractual Liability Exclusion

Current Definition

- The contractual liability exclusion currently states in relevant part:

This insurance does not apply to . . . (b) “Bodily injury” or “property damage” for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.

History of the Contractual Liability Exclusion Current CGL Form

- Key part of “insured contract” definition:
“Insured contract” means . . . (f) that part of any other contract or agreement pertaining to your business . . . under which you assume the tort liability of another party to pay for “bodily injury” or “property damage” to a third person or organization. Tort liability means liability that would be imposed by law in the absence of any contract or agreement.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- Facts: Gilbert was hired by the Dallas Area Rapid Transit Authority (DART) as a general contractor to construct a light rail system.
- Gilbert agreed in its contract with DART to protect from damage all existing improvements and utilities (1) at or near the work site and (2) on adjacent property of a third party . . . [and] repair any damage to those facilities, including those that are the property of a third party, resulting from the failure to comply with the requirements of this contract or failure to exercise reasonable care in performing the work.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- Facts: During construction, Dallas suffered an unusually heavy rain event, and a building adjacent to the construction area was flooded. The building owner (RTR) sued DART, Gilbert and other entities involved in construction. RTR alleged that it was an intended third-party beneficiary of the DART – Gilbert contract.
- A trial court granted summary judgment in favor of Gilbert on grounds of governmental immunity on all claims except for RTR's breach of contract claim based upon its contention that it was a third-party beneficiary.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- After the summary judgment was granted on all claims except breach of contract, Lloyds informed Gilbert that the breach of contract claim was not covered because of the contractual liability exclusion. Gilbert settled RTR's breach of contract claim for \$6.175 million. Lloyds denied coverage.
- Gilbert then sued Lloyds for breach of contract and extra-contractual damages. On cross-motions for summary judgment, the trial court held that the claim was covered but denied Gilbert's other claims. Both parties appealed.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- The appeals court reversed the trial court in part, holding that the contractual liability exclusion barred coverage for Gilbert's settlement with RTR. The appeals court affirmed those parts of the judgment in Lloyds' favor. 245 S.W.3d 29 (Tex. App. – Dallas 2007, pet. granted). Gilbert appealed.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- The Texas Supreme Court reviewed the contractual liability exclusion and held that the exclusion “means what it says. It applies when the insured assumes liability for bodily injury or property damage by means of contract, unless an exception to the exclusion brings a claim back into coverage or unless the insured would have liability in the absence of the contract or agreement.” 327 S.W.3d at 132.
- The Court distinguished cases from other jurisdictions that limited the exclusion to the insured’s assumption of another party’s liability for bodily injury or property damage by means of contract.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- The Court also held that RTR's claim against Gilbert did not fall within the "insured contract" exception to the exclusion. The Court explained that Gilbert's only potential liability to RTR when the case was settled was for breach of contract, not tort, and the "insured contract" definition only refers to tort liabilities assumed by the insured. *Id.* at 134.

Gilbert Texas Construction, L.P. v. Underwriters at Lloyds' London, 327 S.W.3d 118 (Tex. 2010)

- The question after *Gilbert* was whether *Gilbert* would be limited to its facts, because *Gilbert* assumed liability in its contract with DART for damages for which it otherwise would have been immune as a result of governmental immunity.

Ewing Construction Co. v. Amerisure Mut. Ins. Co.

- Facts: Tuloso-Midway ISD hired Ewing to construct a tennis facility in Corpus Christi, Texas. After construction, the tennis courts began to crack and flake, with chunks of the course surfaces coming loose, making the courts unusable for competitive events.
- In February 2010, Tuloso-Midway ISD sued Ewing for breach of contract and negligence. Ewing tendered the defense of the lawsuit to Amerisure, which denied coverage. Ewing then sued Amerisure.
- On cross-motions for summary judgment, U.S. District Judge Janis Jack found for Amerisure. 814 F.Supp.2d 739 (S.D. Tex. 2011).

Ewing Construction Co. v. Amerisure Mut. Ins. Co.

- Judge Jack relied upon *Gilbert* in finding that the contractual liability exclusion in the Amerisure policy barred coverage for Tulosso-Midway ISD's claims:
- “[T]he Court concludes that the allegations in the underlying petitions sufficiently demonstrate that Ewing assumed liability for its own construction work pursuant to the parties’ contract. . . . [B]y entering into the contract with Tulosso-Midway, Ewing is liable if the work it agreed to perform under that contract is defective.”

Ewing Construction Co. v. Amerisure Mut. Ins. Co.

- Judge Jack also held that the exceptions to the exclusion did not apply.
- Specifically, the Court concluded that as the claims against Ewing sounded in contract (even though there was a claim for negligence), the exception for liability that the insured would have in the absence of the contract or agreement was inapplicable.
- Ewing appealed.

Ewing Construction Co. v. Amerisure Mut. Ins. Co.

- The U.S. Fifth Circuit Court of Appeals originally affirmed the district court's decision in June 2012. 684 F.3d 512.
- In August 2012, the Fifth Circuit vacated its decision and certified two questions for the Texas Supreme Court. 690 F.3d 628. The Texas Supreme Court agreed to hear the case.
- In February 2013, the Texas Supreme Court heard oral argument on the case.
- These questions are:
 - (1) Whether a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike manner, without more specific provisions enlarging this obligation, "assumes liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion; and
 - (2) If the answer is "Yes," whether the allegations in the underlying suit alleging that the contractor violated its common law duty to perform the contract in a careful, workmanlike, and non-negligent manner fall within the exception to the exclusion for "liability that would exist in the absence of contract."

Extreme Minority Review

- As the Court in *Gilbert* acknowledged, virtually every court to analyze the exclusion and all commentators have determined or opined that the Exclusion is meant to apply only to third-party agreements, like indemnification and hold-harmless agreements.
- Some courts have applied the exclusion to any claim based on a contract, however.

Most Recent Examination of a “*Gilbert* situation”

- *Mid-Continent Cas. Co. v. Castagna*, 2013 WL 4432353 (Dallas Aug. 20, 2013).
- Construction Contract – Contract of Sales for residence in Frisco.
 - Owner sued for foundation problems.
 - Suit subject of binding arbitration.
 - Final arbitration award in Plaintiff’s favor.
 - Castagna sued Mid-Continent as judgment creditor.
 - Moved for summary judgment that arbitral award covered.
 - Trial court granted summary judgment.
 - Mid-Continent appealed to the Dallas Court of Appeals.
 - Mid-Continent, *inter alia*, that contractual liability exclusion precluded coverage.
 - This particular CLE exactly like one in *Gilbert* and *Ewing*.

CGL Contractual Liability Exclusion

- CT looked at Arbitrator's Findings:
 - There was no written warranty attached to the contract, nor was there any discussion of any implied warranty.
 - The implied warrant of good workmanship was no excluded.
 - The contractor breached the implied warranty.
 - Court discusses and distinguishes *Gilbert* at length.
 - "Here, unlike *Gilbert*, (the contractor) did not assume any contractual obligation in addition to, or that extended beyond, the 'general law' of implied warranty of good workmanship."
 - Thus, the Contractual Liability Exclusion did not apply!

Impact on Construction Industry if Texas Supreme Court Interprets Exclusion Broadly

- Return to pre-*Lamar Homes*.
- No coverage for construction defect litigation.
- *Brokers* can have a powerful influence on insurers and the resolution of important claims.
- Subject to the resolution of the pending *Ewing* case, brokers and insureds may seek to modify the “contractual liability” exclusion to apply only to damages resulting from the “assumption of liability of another.”
- Policies will evolve and coverage will obtain.
- If carriers won’t change wording, cash or other bonds may substitute in.
- Many fewer contractors will be able to afford to accept construction contracts.

Potential Effects of Ewing Decision Outside Construction Context

- Energy industry contracts commonly contain indemnity agreements; many of those indemnity agreements are also subject to the Texas Oilfield Anti-Indemnity Act (Tex. Civ. Prac. & Rem. Code Chapter 127) that limit the scope of indemnity.
- ISO forms will adapt. There will be a version limiting the CLE to “third party liability.”
- Other Contractual Liability coverages will evolve.