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## **Broad CGL Ruling May Leave Texas Contractors In Lurch**

By **Jesse Greenspan**

Law360, New York (April 8, 2011) -- A recent Texas Supreme Court decision that broadly interprets a contractual liability exclusion commonly found in commercial general liability policies has caused some insurers to start refusing to indemnify construction companies against underlying breach of contract claims, experts say.

Prior to 2010, when the Texas Supreme Court issued its decision in *Gilbert Texas Construction LP v. Underwriters at Lloyd's London*, most case law and insurance treatises said contractual liability exclusions only applied to indemnity contracts, according to experts who represent both insurers and policyholders.

But the Texas high court ruled in *Gilbert* that an insurance policy's intended coverage is determined by its plain language, and that legal precedent and treatises cannot be rewritten judicially to narrow the policy's scope.

"This whole decision was a complete shock, because every decision in Texas had come out saying that this was not what the exclusion was designed to exclude," said Lee H. Shidlofsky, a partner at the Shidlofsky Law Firm PLLC who represented *Gilbert* before the state Supreme Court.

"There are only a few cases in the country that have come out the way our Supreme Court has come out on this," he added.

Shidlofsky said he believed the *Gilbert* decision conflicts with a 2007 decision, *Lamar Homes Inc. v. Mid-Continent Cas. Co.*, in which the Texas Supreme Court found that breach of contract can constitute an occurrence that causes property damage and can therefore be covered by the duty to defend clause in a commercial general liability policy.

At that time, the court did not explicitly address the contractual liability exclusion. But insurers had been interpreting the exclusion the same way as policyholders, according to Shidlofsky.

"This is really one of the first cases that have said that a liability defense — not a coverage defense, but a liability defense — can affect whether you have coverage or not," he said. "And that's one way the [*Gilbert* decision] got it wrong."

This decision could be construed to render any breach of contract claim excluded, added David Taubenfeld, a partner at [Haynes and Boone LLP](#) who represents policyholders.

"It's definitely one of those opinions that is going to have to be undone or explained or interpreted to the specific facts of the case," Taubenfeld said.

The dispute dates back to 1993, when the Dallas Area Rapid Transit Authority contracted with Gilbert Texas Construction to build a light rail system through the middle of the downtown.

A portion of the contract required Gilbert to protect the work site and surrounding property. But at one point, a large rainstorm flooded a building adjacent to the construction area.

The building's owner, RT Realty, responded by suing DART and Gilbert for property damage. On summary judgment, a trial court knocked out all of the negligence tort claims on the basis of governmental immunity, but it allowed a breach of contract claim to proceed.

Gilbert then settled with RT Realty for about \$6.2 million.

Although its primary insurer, Argonaut Insurance Co., agreed to assume Gilbert's defense, its excess insurer, Lloyd's of London, denied coverage, citing the contractual liability exclusion.

Gilbert promptly sued, and a trial court granted its motion for coverage while rejecting its request for punitive damages. Both sides appealed, and the Court of Appeals for the Fifth District of Texas ended up handing a total victory to the underwriters.

The state Supreme Court affirmed that decision first in June, and again in December in a follow-up opinion that changed some wording about an estoppel argument but left intact the contractual liability exclusion logic.

“There's an exclusion that, if you read plainly, says coverage does not exist for liabilities assumed under a contract,” said Glenn R. Legge, a partner at Legge Farrow Kimmitt McGrath & Brown LLP who represented the Lloyd's underwriters in the case.

This exclusion should not be read narrowly, nor should its scope be confined to indemnity agreements, he added.

Legge said his client was facing a singular cause of action for breach of contract, with no accompanying negligence claim, thereby distinguishing this case from others asserting similar claims that had been litigated in Texas.

What's not clear, however, is how far the Gilbert decision was intended to go, according to Shidlofsky.

He asked, for example, whether it will apply only when there is a third-party beneficiary such as RT Realty, or if it also will apply when a contractor is directly sued by a contractee.

A negligence tort claim can easily be bumped on statute of limitations grounds, on the basis of governmental immunity, or through the state's economic loss rule, Shidlofsky pointed out.

“Let's say that an owner wants to sue a general contractor and does have a viable negligence claim and they have a viable breach of contract claim, but for whatever reason they wait three years to bring their claim,” Shidlofsky said.

The negligence claim, but not the breach of contract claim, would be barred by the statute of limitations. This means that the exact same property damage that would have been covered by the insurance policy is now denied by the contractual liability exclusion, he added.

“It doesn't make a whole lot of sense,” he said.

Since the Gilbert decision, insurers have raised the contractual liability exclusion in many more reservation of rights letters than they ever did before, and have also begun bringing up this issue in court, he said.

The two lower courts to look at the Gilbert decision have ruled in completely disparate ways, according to Shidlofsky.

“I don't think the [Supreme] Court fully appreciated what they were doing,” he said. “I believe [Gilbert] is having an effect they did not contemplate, but one that we warned them about.”

The matter will eventually make its way back up to the Texas Supreme Court, albeit with a new set of facts, Shidlofsky predicted.

Legge, meanwhile, took home different lessons from the Gilbert decision.

“We all carry around presumptions with us, about what we believe certain insurance clauses provide coverage for, because that's what we've always been told,” he said.

In fact, many domestic insurers were skeptical about filing amicus briefs because they thought Lloyd's would lose the case, according to Legge.

“In light of the Texas Supreme Court's plain reading approach in Gilbert ... it makes all of us realize that maybe we should sit down with cold eyes and without presumptions and reread the insurance terms,” he said.

The case is Gilbert Texas Construction LP v. Underwriters at Lloyd's London, case number 08-0246, in the Supreme Court of Texas.

--Editing by Pamela Wilkinson and Greg Ryan.

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