



Texas Supreme Court Ruling on Contractual Liability Exclusion Prompts Federal District Court to Deny Coverage for Construction Defect Claims

On the heels of the Texas Supreme Court's recent interpretation of the contractual liability exclusion in *Gilbert Tex. Constr. L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010), a federal court has ruled against a contractor seeking general liability coverage for claims of faulty construction.

In *Ewing Constr. Co. v. Amerisure Ins. Co.*, No. C-10-256 (S.D. Tex. Apr. 28, 2011), the Hon. Janis Graham Jack found that the insurer had no duty to defend and indemnify the insured construction company for breach of contract and tort claims related to the construction of a tennis court. The insurer moved for summary judgment based on the *Gilbert* opinion, in which the Texas Supreme Court departed from the majority of U.S. jurisdictions that limit Exclusion 2(b) in the standard form comprehensive general liability policy to indemnity and hold-harmless agreements.

Both *Ewing Constr.* and *Gilbert* involved Exclusion 2(b) in the standard ISO CGL form, which states:

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. This exclusion does not apply to liability for damages:*

- (1) *Assumed in a contract or agreement that is an "insured contract;" or*
- (2) *That the insured would have in the absence of the contract or agreement.¹*

¹ The standard ISO CGL policy defines "insured contract" in part as:
That part of any other contract or agreement pertaining to your business under which you assume the tort liability of another to pay damages because of bodily injury" or "property damage" to a third person or organization . . .
Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.



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The Texas Supreme Court held in *Gilbert* that the plain terms of the exclusion extended beyond indemnity and hold-harmless agreements and excluded coverage for any liability assumed in contracts. Specifically, the Court found:

the exclusion's language applies without qualification to liability assumed by contract except for two situations: (1) specified types of contracts referred to as "insured contracts," including indemnity agreements by which the insured assumes another's tort liability, and (2) situations in which the insured's liability for damages would exist absent the contract—in other words, situations in which the insured's liability for damages does not depend solely on obligations assumed in the contract.

To determine if the second exception applies, one must ascertain whether the insured proved it would have had liability for damages absent its contractual undertaking.

In *Ewing Constr.*, Judge Jack concluded that *Gilbert*

"stands for the proposition that the contractual liability exclusion applies when an insured has entered into a contract and, by doing so, has assumed liability for its own performance under that contract."

The court in the *Ewing* opinion then found that the insured had assumed liability for its own defective work when it entered into the contract to build the tennis court.

Judge Jack then examined the applicability of the second exception to Exclusion 2(b). Here, the plaintiffs in the underlying suit alleged damage to the tennis courts, which were the subject matter of the contract between the insured and underlying plaintiffs. Significantly, the claims against the insured were restricted to the faulty construction of the tennis courts and did not allege damage to any other property not covered by the contract. Because the negligence claims were based on the same conduct as the breach of contract claims, the court found that, under the economic loss rule, the claims in the underlying suit sounded only in contract. Absent the contract to construct the tennis courts, the insured would have faced no liability for damages in the underlying suit. Based on this reasoning, the Court found that the insured faced no liability in absence of the contract, therefore, the second exception to Exclusion 2(b) did not apply.

The Texas Supreme Court's "plain language" interpretation of Exclusion 2(b) in the *Gilbert* opinion eviscerated the traditional "assumptions" about the scope of this policy exclusion. It will be interesting to witness the



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extent to which other jurisdictions embrace this logical, “plain language” approach as they interpret, or reconsider, Exclusion 2(b), as well as other exclusions, in liability and property policies.

Legge Farrow had the privilege of representing Underwriters in the *Gilbert* matter through the trial court, the Fifth Court of Appeals and the Texas Supreme Court.

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