An Update on Recent Insurance Coverage Decisions and their Impact on the Construction Industry:

The Policyholders' Perspective

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I. *VRV Development L.P. v. Mid-Continent Casualty Co.*, 630 F.3d 451 (5th Cir. 2011)

In a quick start to the new year, the Fifth Circuit Court of Appeals issued an opinion in *VRV Development L.P. v. Mid-Continent Casualty Co.*, 630 F.3d 451 (5th Cir. Jan. 7, 2011). The court affirmed the district court's opinion but on an alternative ground, as the district court had held that VRV Development L.P. did not qualify as an insured on two CGL policies issued to VRV Inc. Instead, the Fifth Circuit ruled the underlying lawsuit did not allege a covered occurrence of property damage during the effective periods of the CGL policies. *Id.* at 453.

A. Background Facts

VRV Inc. contracted with Goodman Family of Builders, L.P. to develop residential lots in Dallas. Goodman's successor-in-interest, K. Hovnanian Homes – DFW, LLC ("Hovnanian"), built two homes on the lots and sold them to individual owners. *Id.* at 453–54. During the development process, in May 2004, VRV Inc. bought a CGL policy from Mid-Continent, which listed VRV Inc. as the named insured and identified the entity as a corporation. Kenny Marchant, VRV Inc.'s president, was covered as an executive officer. In development of the lots, VRV Inc. retained subcontractors to design and build the retaining walls on the lots.

As of January 1, 2005, VRV Inc. converted into a Texas limited partnership, VRV L.P., with Marken Management GP LLC serving as the general partner and Marchant as the sole limited partner of VRV L.P. VRV Inc.'s insurance policy was renewed for the period of May 2005 to May 2006 and still listed VRV Inc. as the named insured and the entity was identified as a corporation. No evidence existed that Mid-Continent knew of the conversion. VRV L.P. did not renew the policies after May 2006. *Id.* at 454.

Sometime between May and July 2006, a homeowner's inspection identified a crack in a retaining wall. Then in January and March 2007, following periods of heavy rainfall, the walls collapsed, damaging the four homeowners' backyards and undermining support for a public utility easement owned by the City of Dallas. *Id.* Thereafter, in April 2007, Hovnanian sued VRV for negligence and breach of contract, and the four homeowners intervened in the suit, suing VRV L.P. and Marken for negligence and breach of implied warranties. The City of Dallas also intervened against VRV. *Id.*

VRV demanded a defense and indemnity from Mid-Continent, who denied coverage. Accordingly, VRV filed suit. Mid-Continent contended VRV L.P. was not an insured under the policies issued to VRV Inc., no property damage occurred during the effective policy periods, and policy exclusions precluded coverage. The district court granted Mid-Continent's summary judgment on the ground that VRV was not an insured. *Id.*

B. The Duty to Defend (and the Duty to Indemnify)

At the outset, the court explained that the two policies at issue were the standard CGL policies used in the industry. Notably, though, the subcontractor exception to exclusion *l* had been removed by endorsement. *Id.* at 455 n.5

The court's first step was to evaluate the allegations in the pleadings against VRV. The court noted the plaintiffs alleged that VRV or its subcontractors negligently designed and built

the retaining walls during the two year period during which VRV Inc. held policies with Mid-Continent. The homeowners alleged a crack existed in one retaining wall and was discovered between May and July 2006, so the court assumed it existed during the policy period. The homeowners alleged the retaining walls collapsed in January and March 2007. Finally, the City alleged the collapse and failure of the retaining walls affected the City's use and enjoyment of a public utility easement. Thus, in sum, the retaining walls were damaged during the policy period whereas the backyards and easement were damaged in 2007 following the collapse of the walls.

Turning to the policies, the court found no coverage existed. Although acknowledging the walls were damaged during the policy period, the court found exclusion *l* precluded coverage for damage to work completed by VRV and its subcontractors. *Id.* at 457 (citing *Wilshire Ins. Co. v. RJT Constr., LLC*, 581 F.3d 222, 226 (5th Cir. 2009) (finding that the "your work" exclusion precluded coverage for damage to a foundation built by an insured)). In particular, the court noted that the policies in question had an endorsement (presumably CG 22 94) that removed the subcontractor exception to exclusion *l*. Additionally, the court found the damage to the backyards and to the easement were not covered because they were not damaged until the walls collapsed in 2007—well after the last policy expired, which was in May 2006.

"VRV points out that property damage that occurs during the policy period 'includes any continuation, change or resumption of that . . . 'property damage' after the end of the policy period." *Id.* at 458. That is, VRV requested the court find that the damage to backyards and to the easement occurred at the same time as the underlying damage to the retaining walls. Relying on *RJT Construction*, the court refused to conflate an allegedly defective retaining wall with the separate property damage that ultimately resulted. *Id.* The court explained that nearly all property damage is traceable back to an earlier event, but that is not the court's inquiry. Rather, the court is required to look at what happened at the time of the actual physical damage to the property. *Id.* (citing *Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20, 24, 29–30 (Tex. 2008)). Because the backyards and the City's easement actually were physically damaged by the collapse of the walls in 2007—and not by the negligent design and construction of the walls or their continuous exposure to the walls—the court held the damages were not covered. "In other words, this is not a case involving festering, undiscovered damage to covered property during the policy period." *Id.* (citing *Don's Bldg. Supply*, 267 S.W.3d at 23, 31). And, although the damage to the walls may have festered and changed over the years, coverage for that damage was excluded by the policy. *Id.*

The court acknowledged the duty to indemnify typically can be resolved only after the underlying lawsuit is adjudicated. Nevertheless, in the instant case, the same reasons that negated the duty to defend—the lack of evidence of property damage caused by an occurrence during the policy period—also negated any possibility of any duty to indemnify. VRV simply did not satisfy its burden of establishing facts supporting its claim that a duty to indemnify might be covered. Thus, the court granted summary judgment in favor of Mid-Continent. *Id.* at 459.

C. Commentary

The court's ruling sidestepped the issue of whether an insured's rights and obligations under an insurance policy can transfer to a new entity following a conversion of the insured's business. While the district court decided the case on that issue, the Fifth Circuit found that

discussion to be unnecessary. Rather, the court looked at the policies and the pleadings and found that, no matter who was the insured, no coverage existed. In particular, the court applied the specific policy language in question to preclude coverage for the only property damage that occurred during the policy period. The remainder of the damage, based on the facts of the case, did not occur until after the last policy expired and, therefore, was not covered.

II. *Crownover v. Mid-Continent Casualty Co.*, Civil Action No. 3:09-CV-2285 (N.D. Tex. Jan. 13, 2011)

On January 13, 2011, Judge Reed O'Connor issued an opinion addressing the "contractual liability" exclusion in a standard-form CGL policy. *See Crownover v. Mid-Continent Cas. Co.*, Civil Action No. 3:09-CV-2285 (N.D. Tex. Jan. 13, 2011) (unpublished opinion). In doing so, Judge O'Connor applied the holding in *Gilbert Texas Construction, LP v. Underwriters at Lloyds*, 327 S.W.3d 118 (Tex. 2010), finding that an arbitration award was not covered under a CGL policy because the award was based on a breach of contract claim.

A. Background Facts

The Crownovers contracted with Arrow Development, Inc. to construct a home for them in Sunnyvale, Texas. Arrow hired a number of different contractors to perform different aspects of the foundation design and construction. Mid-Continent insured Arrow under a number of CGL policies covering the period from August 2001 through August 2008. Ultimately, the Crownovers filed an arbitration proceeding against Arrow for damages to their home arising out of the HVAC system and foundation design defects. Under a reservation of rights, Mid-Continent defended Arrow in the arbitration in which the arbitrator awarded the Crownovers over $600,000 because the HVAC system was not "installed properly, did not perform as required, and exhibited numerous deficiencies" and "the foundation failed." *Crownover*, slip op. at 5. Arrow never paid the arbitration award and Mid-Continent refused to do so, contending that the "contractual liability" exclusion, the "your work" exclusion and exclusions j(5) and j(6) precluded coverage.

B. The Contractual Liability Exclusion

Although Mid-Continent raised other exclusions, the court focused entirely on application of the contractual liability exclusion. In relevant part, the contractual liability exclusion provides as follows:

> This insurance does not apply to:
>
> **b. Contractual Liability**
>
> "[B]odily injury" or "property damage" for which the insured is obligated to pay damages by reasons of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
>
> (1) That the insured would have in the absence of the contract or agreement; or
>
> (2) Assumed in a contract or agreement that is an "insured contract" . . . .

Id. at 9. Mid-Continent contended that the entire arbitration award was "based solely on liability Arrow assumed in its contract with Plaintiffs." *Id.* at 10. The Crownovers argued that the exclusion did not apply in the first place and, even if it did, the first exception applied to reinstate coverage. *Id.*

At the outset, Judge O'Connor reviewed the *Gilbert* decision at length, noting that the Supreme Court of Texas found in *Gilbert* that "the contractual liability exclusion and its two exceptions provide that the policy does not apply to . . . property damage for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement . . . except for instances in which the insured would have liability apart from the contract." *Id.* at 11 (quoting *Gilbert*, 327 S.W.3d at 126). Moreover, the Supreme Court had held that the liability assumed did not have to be that "of another," but the exclusion applied when the insured assumed liability independent of its non-contractual obligations. *Id.* (citing *Gilbert*, 327 S.W.3d at 126). Finding the exclusion applied, the Supreme Court addressed the exception for liability the insured would have in the absence of the contract or agreement and found that it did not apply. In doing so, "the court asked whether Gilbert proved that it would have had liability 'absent its contractual undertakings.'" *Id.* at 12 (quoting *Gilbert*, 327 S.W.3d at 134).[1]

Turning to the facts before it, the court in *Crownover* analyzed whether Arrow would have had liability to the Crownovers "absent its contractual undertakings." First, the court found that the arbitration award clearly was based on the Crownovers' breach of contract claim against Arrow. The court rejected the Crownovers' argument that the award was made for reasons other than the breach of contract claim and that Arrow was liable independent of the contractual liability. *Id.* at 13–14. In doing so, Judge O'Connor noted that even the Crownovers acknowledged that the arbitrator never reached their negligence and breach of implied warranty claims. Thus, Mid-Continent had satisfied its burden to prove the exclusion applied. *Id.* at 14.

Second, the court found that the Crownovers did not establish that the exception to the exclusion applied. That is, they did not prove that the award constituted "liability for damages . . . [t]hat the insured would have in the absence of the contract or agreement." *Id.* Ultimately, the Crownovers contended that the common law implied warranty of good workmanship—which mirrors the express warranty on which the arbitrator relied—constituted liability in the absence of the contract. *Id.* at 15. Judge O'Connor disagreed, however, noting that the Supreme Court specifically limited the exception by stating that "the existence of the contract . . . was merely an underlying fact that was to be considered in determining the [duty to indemnify]." *Id.* (quoting *Gilbert*, 327 S.W.3d at 134). Accordingly, the court refused to ignore the existence of the Crownovers' contract with Arrow, as the implied warranty of good workmanship only would exist in the absence of an express contractual warranty. *Id.* at 15–16. As such, the implied warranty did not "offer a non-contractual basis for Arrow's arbitration damage liability in this case" and the Crownovers failed to prove the exception applied. Thus, Mid-Continent prevailed.

[1] A more in-depth discussion of the *Gilbert* decision can be found below in connection with the *Ewing Construction* decision issued by the Southern District of Texas.

C. Commentary

The decision in *Crownover*, like the decision in *Ewing Construction* to be discussed below, suffers from a fundamental flaw. In particular, Judge O'Connor misread the decision in *Gilbert*, which did not hold that merely entering into a contract to perform construction work constituted an "assumption of liability" sufficient to trigger the contractual liability exclusion. In fact, the Supreme Court actually went to great lengths to explain the specific assumption that existed in Gilbert's contract—an analysis that was not addressed in any way in *Crownover*. Moreover, unlike in *Gilbert*, where the non-contractual claims had been dismissed by summary judgment, non-contractual claims against Arrow existed at the time the arbitration award was issued, which should have been sufficient under *Gilbert* to trigger the exception to the exclusion. Read literally, the *Crownover* opinion stands for the proposition that no coverage exists if liability is based on a breach of contract theory. That is a very expansive interpretation of *Gilbert* and, quite frankly, is wrong.

The Crownovers have appealed Judge O'Connor's decision to the Fifth Circuit Court of Appeals. Oral argument was heard on March 8, 2012.

III. *Admiral Insurance Co. v. H&W Industrial Services, Inc.*, 2011 WL 318277 (W.D. Tex. Feb. 1, 2011)

On February 1, 2011, Judge Cardone issued an opinion applying the "your products" and "impaired property" exclusions to negate coverage for damage to street signs manufactured by the insured. *See Admiral Ins. Co. v. H&W Indus. Servs., Inc.*, 2011 WL 318277 (W.D. Tex. Feb. 1, 2011).

A. Background Facts

H&W Industrial Services was sued in an underlying lawsuit arising out of a contract the company entered into with the Texas Department of Transportation in which H&W agreed to provide TXDOT with signs in addition to more than 10,000 street signs to be used by the City of El Paso (the "City"). According to TXDOT and the City, the street signs began deteriorating soon after they were installed, as the film on the signs—which was supplied by one of H&W's subcontractors—began to shrink and discolor. The signs allegedly were rendered unserviceable and created a traffic hazard. *Id.* at *2. TXDOT and the City, as a third-party beneficiary to TXDOT's contract with H&W, asserted claims for breach of contract and breach of express and implied warranties. *Id.* The damages sought were the costs incurred "in labor and materials to remove and replace the defective street signs" and also for "the expense of storage of the replaced street signs and other incidental damages." *Id.* H&W sought a defense and indemnity from Admiral Insurance Company, its CGL carrier, but Admiral denied coverage. *Id.* at *3. Admiral filed the instant declaratory judgment action, seeking a ruling that it did not have a duty to defend or indemnify H&W in the underlying lawsuit. Admiral moved for summary judgment that there was no "property damage" caused by an "occurrence," and, alternatively, the "your products" and "impaired property" exclusions precluded coverage. *Id.* at *4. H&W did not respond to the motion.

B. The Duty to Defend

Although H&W did not respond to the motion and did not satisfy its burden to prove the claims against it fell within the Admiral policy insuring agreement, the court addressed the exclusions raised by Admiral and found them to be dispositive. *Id.* at *5.

1. The "Your Products" Exclusion

First, the court determined the "your products" exclusion precluded coverage for the underlying plaintiffs' claims for costs "in labor and materials to remove and replace the defective street signs." *Id.* The exclusion bars coverage for "'property damage' to 'your product' arising out of it or any part of it" and "your product" was defined as goods manufactured, sold, handled, or distributed by the insured, including warranties for those goods. *Id.* TXDOT and the City alleged, among other things, that the signs were physically damaged as a result of the film on the signs shrinking and discoloring. *Id.* The court found that such damage qualified as "physical injury or loss of use" but that the signs and warranties of fitness, quality, durability and performance fell within the definition of "your product." Moreover, the damage to the signs arose from the products themselves. Thus, the exclusion precluded coverage. *Id.* (citing *Valmont Energy Steel, Inc. v. Commercial Union Ins. Co.*, 359 F.3d 770, 776 (5th Cir. 2004) (applying a "your product" exclusion to similar facts); *Sigma Marble & Granite-Houston, Inc. v. Amerisure Mut. Ins. Co.*, 2010 WL 5464257, at *11 (S.D. Tex. Dec. 28, 2010) (same)).

2. The "Impaired Property" Exclusion

Second, the court found the cost incurred in storing the signs after they were removed and replaced fell within the "impaired property" exclusion. *Id.* The "impaired property" exclusion precludes coverage for, among other things, claims based on "property damage" to property that is not physically injured arising from a "defect" or "deficiency" in "your product," of from a "failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms." *Id.* The court said that assuming the storage expenses evidence a loss of use of property that was not physically injured, that loss of use would necessarily arise from a defect in the signs sold by H&W or H&W's failure to provide acceptable signs as required by the contract. *Id.* The defect in the signs or H&W's failure to provide signs in accordance with the contract led to the removal and storage of the signs. *Id.* Thus, according to the court, the "impaired property" exclusion applied. *Id.* (citing *Mid-Continent Cas. Co. v. Camaley Energy Co., Inc.*, 364 F. Supp. 2d 600, 607–08 (N.D. Tex. 2005) (applying an "impaired property" exclusion to a suit against an insured that was based on a defect in the insured's product, which defect also constituted a failure by the insured to properly perform a contract); *Gibson & Assocs., Inc. v. Home Ins. Co.*, 966 F. Supp. 468, 474–75 (N.D. Tex. 1997) ("Courts in other jurisdictions have found [the impaired property] exclusion to remove from coverage claims arising at bottom solely from a breach of contractual duties.")).

C. The Duty to Indemnify

Because the exclusions applied, there was no duty to defend H&W in the underlying lawsuit. Admiral also sought a declaration as to the duty to indemnify, though, so the court addressed that issue as well. Under established Texas law, the two duties are "distinct and

separate." *Id.* (citing *D.R. Horton—Tex., Ltd. v. Markel Int'l Ins. Co., Ltd.*, 300 S.W.3d 740, 743 (Tex. 2009)). Typically, the insurer's duty to indemnify the insured cannot be determined until the facts of the underlying lawsuit are adjudicated *unless* the insurer does not have a duty to defend "*and the same reasons that negate the duty to defend likewise negate any possibility the insurer will ever have a duty to indemnify*." *Id.* (quoting *Farmers Tex. Cnty. Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997) (emphasis in original)). While that does not always mean a finding of no duty to defend means no duty to indemnify exists, determining the issue is a fact-specific inquiry. *Id.* (citing *D.R. Horton*, 300 S.W.3d at 744). More importantly, that finding only can be made if it is an "impossibility" that the claims could be "transformed by proof of any conceivable set of facts into [claims] covered by the insurance policy." *Id.* (quoting *D.R. Horton*, 300 S.W.3d at 745). Because H&W did not present any summary judgment evidence—or even respond to the motion for summary judgment at all—the court found the *Griffin* exception applied. Thus, Admiral had neither a duty to defend nor a duty to indemnify H&W.

D. Commentary

The court's opinion presumably could be considered dicta from the outset, as the insured, who has the burden to establish a claim falls within the CGL policy's insuring agreement, failed to even respond to Admiral's motion for summary judgment. Nevertheless, Judge Cardone's well-reasoned opinion properly applies the "your products" exclusion for the damages to the signs themselves, which were manufactured by H&W. That being said, one might be able to question the application of the "impaired property" exclusion after Judge Cardone found the damages to the signs "qualifies as physical injury or loss of use" as the exclusion should not apply if there was physical injury.

IV. *Evanston Insurance Co. v. D&L Masonry of Lubbock, Inc.*, 2011 WL 1465776 (Tex. App.—Amarillo Apr. 18, 2011, no pet.)

On April 18, 2011, the Amarillo Court of Appeals issued an opinion addressing exclusions j(5) and j(6), focusing on the all important "that particular part" language. *See Evanston Ins. Co. v. D&L Masonry of Lubbock, Inc.*, 2011 WL 1465776 (Tex. App.—Amarillo Apr. 18, 2011, no pet.). That language was interpreted very narrowly by the court and in favor of coverage.

A. Background Facts

D&L Masonry was retained by a general contractor to install masonry on renovations and improvements to an elementary school and junior high school in Muleshoe, Texas. Because of scheduling and weather delays, the masonry was not installed until after the window frames and windows had been installed—a scenario that was opposite of when the masonry typically would have been installed. Because the windows already were installed, D&L had to seal the area between the window frames and the brick with mortar. In doing so, D&L used making tape around the frames and soaped the windows with soap and water in an attempt to prevent mortar from damaging the windows and frames. The effort apparently fell short, as the school ultimately found mortar stains on the window frames. Additionally, some of the frames were scratched from D&L's attempts to remove excess mortar from the frames while they performed their work. As a result, the school ultimately decided to have the damaged window frames replaced at

D&L's cost. D&L tendered a claim to Evanston, its CGL insurer, but Evanston denied the claim based on exclusions j(5) and j(6), contending that "the window frame damage was damage to property upon which D&L performed its work." *Id.* at *1.

D&L filed suit against Evanston regarding its duty to indemnify the company for the cost of replacement of the window frames. On cross-motions for summary judgment, the trial court ruled in favor of D&L. Evanston filed a timely appeal.

B. Coverage Analysis

On appeal, as the court explained, the parties "main point of contention . . . is whether the actions taken by D&L in preparing to apply the mortar, and applying the mortar, to the space between the last brick and the window frame constitutes working on the window frames." *Id.* at *3. Evanston argued that taping the frames and soaping the windows constituted work on the frames and windows for the purposes of exclusions j(5) and j(6). Moreover, Evanston argued that even allowing the mortar to come into contact with the window frames constituted work on the frames. And, according to Evanston, D&L's effort to eliminate any excess mortar on the window frames also was work on the frames. Therefore, Evanston contended the exclusions applied to negate coverage. *Id.*

D&L, on the other hand, took a narrower view of its scope of work, noting that the purpose of CGL coverage is to protect the insured when its work damages someone else's property. *Id.* To that end, D&L contended that its work did not include work on the window frames; rather, their work was limited to the bricks and mortar installed *next to* the frames. *Id.*

The court first looked at the language of the exclusions. Exclusion j(5) precludes coverage for "property damage" to "that particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the 'property damage' arises out of those operations." And, exclusion j(6) precludes coverage for "property damage" to "that particular part of any property that must be restored, repaired, or replaced because 'your work' was incorrectly performed on it." *Id.* Based on the policy language, the court asked a simple question: "What work was D&L contracted to perform in connection with the renovations of the two schools in question?" *Id.* The parties agreed that D&L was hired to perform masonry work. D&L was not hired to perform work on the window frames and its contact with those frames occurred only as a prophylactic measure to attempt to prevent damage. *Id.*

In analyzing coverage, the court reviewed recent Texas case law addressing exclusions j(5) and j(6), as well as exclusion l—the "your work" exclusion. In particular, the court discussed the Fifth Circuit's decisions in *Gore Design Completions, LTD. v. Hartford Fire Ins. Co.*, 538 F.3d 365 (5th Cir. 2008), and *Wilshire Insurance Co. v. RJT Construction, LLC*, 581 F.3d 222 (5th Cir. 2009), as well as the later-vacated decision of the Western District of Texas in *Basic Energy Services, Inc. v. Liberty Mutual Insurance Co.*, 655 F. Supp. 2d 666 (W.D. Tex. 2009), *vacated pursuant to settlement*. In *Gore Design*, the Fifth Circuit limited the application of exclusion j(6) and found it did not apply to damages to an electrical system in a plane on which Gore Desing performed work on a component system because the component system—not the entire electrical system—was "that particular part" that was excluded from coverage. *D&L*

Masonry, 2011 WL 1465776 at * 4 (citing *Gore Design*, 538 F.3d at 371). In *RJT Constr.*, the Fifth Circuit analyzed the "your work" exclusion and found that it was applicable only to the insured's defective work, but it did not preclude coverage for damage to other property resulting from that defective work. *Id.* (citing *RJT Constr.*, 581 F.3d at 226; *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501, 503 (Tex. Civ. App.—Texarkana 1979, no writ) (limiting a "work performed by you" exclusion to the valve on which the insured performed repair work and not the entire engine that was damaged by the defective valve repair)). Finally, the Amarillo Court of Appeals addressed *Basic Energy*, where the Western District held that exclusions j(5) and j(6) did not preclude coverage for damage to an entire oil well because "work done on the tubing and well bore is not equivalent to working on the entire well." *Id.* (quoting *Basic Energy*, 655 F. Supp. 2d at 677.

The court of appeals rejected Evanston's reliance on *Houston Building Service, Inc. v. American General Fire & Casualty Co.*, 799 S.W.2d 308, 311 (Tex. App.—Houston [1st Dist.] 1990, writ denied), in which the Houston Court of Appeals held that the same exclusions as at issue here barred coverage for damage to wooden doors being cleaned by the insured. *D&L Masonry*, 2011 WL 1465776 at *5. The Amarillo court said *Houston Building* was distinguishable because the insured contracted to clean the building, including the doors that ultimately were damaged by the linseed oil applied to them by the insured. *Id.* (discussing *Houston Bldg.*, 799 S.W.2d at 309). The court said: "Clearly, the work performed in *Houston Bldg.* was subject to the exclusions of J(5) and J(6). But, just as clearly, the facts of the present case are unquestionably different and lead to a different result. Therefore, we do not find *Houston Bldg.* to be controlling." *Id.*

Based on its review of the foregoing case law, the court of appeals found D&L's interpretation of the exclusions to be reasonable. Accordingly, the court upheld the summary judgment in favor of coverage.

C. Commentary

The decision in *D&L Masonry* is one in a growing line of cases limiting the application of exclusions j(5) and j(6) based on the plain language of the exclusions. The courts now routinely focus on the scope of the insured's contract in determining what exactly constitutes "that particular part" for purposes of applying the exclusions. *D&L Masonry* certainly represents the most limited application of those exclusions to date.

V. *Maryland Casualty Co. v. Acceptance Indemnity Insurance Co.*, 639 F.3d 701 (5th Cir. 2011)

In the ongoing saga of determining when subrogation rights exist between insurers, the Fifth Circuit decided *Maryland Casualty Co. v. Acceptance Indemnity Insurance Co.*, 639 F.3d 701 (5th Cir. 2011), finding that the fact that a common insured had been fully indemnified did not bar one insurer from recovering another insurer's pro rata share. In addition, the court addressed a jury instruction involving the definition of an "occurrence." Finally, the court addressed arguments pertaining to the sufficiency of the evidence presented in the lower court.

A. Background Facts

Acceptance and Maryland Casualty each insured Russell Guidry d/b/a Olympic Pools ("Guidry") under CGL policies that were issued consecutively over a four-year period with Maryland Casualty covering the first year and Acceptance the following three years. Guidry was sued by a homeowner for which he had built a "negative edge" pool, who contended that the pool was designed and built inadequately, resulting in damage to and loss of use of the pool, as well as damages due to leaks from the pool. *Id.* at 703. Maryland agreed to defend Guidry, but Acceptance refused. Maryland ultimately settled the lawsuit on behalf of Guidry and then sought reimbursement from Acceptance under theories of contribution and subrogation.

Acceptance moved for summary judgment on the grounds that the holding in *Mid-Continent Insurance Co. v. Liberty Mutual Insurance Co.*, 236 S.W.3d 765 (Tex. 2007), barred the claims for contribution and subrogation. *Maryland Cas.*, 639 F.3d at 704. The district court disagreed, finding that Acceptance was obligated to defend Guidry and, therefore, Maryland was entitled to recover a pro rata portion of its defense costs. While the court granted Acceptance's summary judgment as to the contribution claim, it denied summary judgment on the subrogation claim, distinguishing *Mid-Continent* on the grounds that Acceptance wholly refused to defend Guidry and Maryland and Acceptance were not co-insurers because they issued separate, consecutive policies without any overlapping coverage. The subrogation claim went to trial, where Acceptance's motion for directed verdict was denied, and the jury ultimately found that Acceptance was responsible for 75% of the underlying settlement. *Id.* The court rejected Acceptance's motion for judgment notwithstanding the verdict. *Id.* Finally, the court rejected Acceptance's motion for a new trial. *Id.* at 704–05.

B. Subrogation under *Mid-Continent*

On appeal, the Fifth Circuit reviewed the holding in *Mid-Continent*, noting that the insured in that case had been fully indemnified, and Liberty Mutual did not have a contractual right to recover a pro rata portion of the settlement from at issue from Mid-Continent. *Id.* In that case, Mid-Continent and Liberty Mutual both provided a defense to their common insured, but disputed the settlement value of the case. *Id.*

The court noted that it previously rejected an overly broad view of *Mid-Continent*. *Id.* at 706 (citing *Amerisure Ins. Co. v. Navigators Ins. Co.*, 611 F.3d 299, 305–07 (5th Cir. 2010) (finding that subrogation is not barred simply because the insured was fully indemnified)). Moreover, the court found in *Amerisure* that contractual subrogation is not barred where an insurer has denied coverage. *Id.* (citing *Amerisure*, 611 F.3d at 07–08). Accordingly, the Fifth Circuit found that Maryland had a contractual subrogation claim for Acceptance's pro rata share of the settlement. *Id.* And, turning to defense costs, *Mid-Continent* did not bar Maryland's recovery of a pro rata share of defense costs from a co-insurer who violated its duty to defend their common insured. *Id.* (citing *Trinity Universal Ins. Co. v. Employers Mut. Cas. Co.*, 592 F.3d 687, 694 (5th Cir. 2010) (noting that *Mid-Continent* did not address that defense costs issue)).

C. Defining an "Occurrence"

Acceptance also contended on appeal that the district court erred in instructing the jury on the definition of an "occurrence." More specifically, Acceptance claimed the definition provided was incomplete and, therefore misleading and confusing to the jury. The definition of "occurrence" supplied to the jury was as follows:

> "Occurrence" means an accident, including continuous or repeated exposure to substantially the same general harmful conditions. A deliberate act, performed negligently, is an accident if the effect is not the intended or expected result.

Id. The court explained that the first sentence came directly from Acceptance's policy language, and the second sentence was gleaned from the Supreme Court's opinion in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1 (Tex. 2007). Acceptance argued that the definition should have included the following sentence: "An occurrence is not an accident if circumstances confirm that the resulting damage was the natural and expected result of the insured's actions, that is, was highly probable whether the insured was negligent or not." *Maryland Cas.*, 639 F.3d at 706–07. Acceptance contended that the court's refusal to include that sentence, which also came from *Lamar Homes*, resulted in an unbalanced instruction that favored Maryland. *Id.* at 707.

The Fifth Circuit, however, found that the proffered sentence regarding what is *not* an occurrence was "fairly close to the converse of the instruction that was already given to the jury." *Id.* And, in fact, Acceptance could not articulate how it would have argued the case differently had the instruction included the proffered sentence. *Id.* On top of the fact that it may have confused the jury to include the proffered sentence, the court sided with Maryland and found the lower court did not abuse its discretion. *Id.*

D. Sufficiency of the Evidence

Acceptance also argued that the evidence presented by Maryland was insufficient to support the jury's verdict as to the application of the "ongoing damages" exclusion and the "subsidence of earth" exclusion. The former "exclusion" actually was a modified insuring agreement requiring that any "property damage" "first occur" during the policy period. The court analyzed the evidence presented and found that sufficient evidence existed to show that at least some of the damage at issue first occurred during one of the three Acceptance policies. The court rejected Acceptance's claim that that the property damage should have merged with the failure to properly set the piers (an event that preceded Acceptance's policy) and have been deemed to have "first occurred" during Maryland's policy period. *Id.* at 708. First, evidence existed to suggest that the large crack in the pool was the result of structural movement between the pool shell and the pier-and-beam structure—distinct from any earth movement. Second, and in any event, Acceptance's "bootstrapping" argument was foreclosed as a matter of law because "property damage" occurs when it occurs and not necessarily when the negligence that caused such damage occurred. *Id.* at 709.

Regarding the "subsidence" exclusion, the court again stated that evidence existed that structural movement—as opposed to earth movement—occurred between the pool shell and the

pier-and-beam structure, the pier-and-beam structure had not moved, and no evidence indicated the existence of a landslide, mud flow, or other movement resulted from Guidry's operations. *Id.* at 710. Further, Maryland's adjuster testified that she would not have settled the claim if evidence existed of such earth movement because Maryland also had an "earth movement" exclusion in its policy that would have precluded coverage. *Id.* Thus, the court affirmed the district court's ruling on the exclusion.

E. Commentary

Although brief, the Fifth Circuit's handling of the *Mid-Continent* subrogation and contribution issues provides further insight into the viability of such claims between insurers. Again, the Fifth Circuit took the opportunity to narrow the scope of the holding in *Mid-Continent*, minimizing its effect on subrogation and contribution claims between insurers.

The court's holding on the definition of an "occurrence" and its analysis of the sufficiency of the evidence in the case probably is of less importance. That being said, though, it does provide guidance to construction industry coverage lawyers on the importance of clear jury instructions and also the importance of establishing the timing of damages in triggering insurance coverage.

VI. ***Ewing Construction Co., Inc. v. Amerisure Insurance Co.*, 814 F. Supp. 2d 739 (S.D. Tex. 2011)**

On April 28, 2011, the Southern District of Texas extended the Supreme Court of Texas' decision in *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010), finding that a lawsuit against a general contractor did not trigger an insurer's duty to defend (or indemnify) because of applicability of the "contractual liability" exclusion found in the standard-form ISO commercial general liability insurance policy. *See Ewing Construction Co., Inc. v. Amerisure Ins. Co.*, 814 F. Supp. 2d 739 (S.D. Tex. 2011).

A. Background Facts

Ewing, who was insured by Amerisure under four consecutively issued standard CGL insurance policies, was sued on February 25, 2010 by the Tuloso-Midway Independent School District for damages caused by allegedly deficient construction of a tennis facility in Corpus Christi, Texas. Ewing had contracted with the school district to serve as general contractor on the project. *Id.* at 741. Ewing tendered the lawsuit to Amerisure for a defense and indemnity, but Amerisure denied the duty to defend. Amerisure maintained its denial through subsequent amendments to the allegations in the underlying lawsuit. *Id.* As a result, Ewing filed suit against Amerisure seeking a declaration that Amerisure had an obligation to defend Ewing, and that in failing to do so Amerisure breached its duty to defend and also violated Texas' Prompt Payment of Claims Act. *Id.* Amerisure counterclaimed, seeking a declaration that it had no duty to defend or indemnify Ewing. *Id.* The parties agreed to stipulated facts and cross-moved for summary judgment. *Id.*

B. Analyzing Coverage – Satisfaction of the Insuring Agreement

After setting forth the general standards for the duty to defend and indemnify, the court explained that it had to evaluate whether the claims in the underlying lawsuit fell within the broad scope of coverage under the policies. And, if so, whether an exclusion applied to negate coverage. If an exclusion applied, the court then had to analyze whether an exception to such an exclusion reinstated coverage. *Id.* at 744.

At the outset, the court noted that Amerisure seemingly conceded that the claims against Ewing by Tuloso-Midway satisfied the policies' insuring agreement. In particular, Tuloso-Midway sought damages that Ewing would be "legally obligated to pay" as a result of "property damage" caused by an "occurrence" during the policy period. *Id.* The court found the "property damage" element was "clearly satisfied," as allegations existed of tennis court cracking and flaking. *Id.* Such allegations clearly constituted "physical injury to tangible property." *Id.*

Likewise, the "occurrence" requirement also was satisfied, as there were allegations of "negligent construction." Under the Supreme Court's decision in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1 (Tex. 2007), such allegations are sufficient to constitute an "occurrence." *Ewing*, 814 F. Supp. 2d at 745 (citing *Lamar Homes*, 242 S.W.3d at 8–9, 16). And, finally, no dispute existed that the damage allegedly occurred during one or more of the effective policy periods. *Id.*

C. The "Contractual Liability" Exclusion

Knowing the insuring agreement was satisfied, and because the allegations clearly fell within the subcontractor exception to the "your work" exclusion, Amerisure relied entirely on application of the "contractual liability" exclusion in arguing that a duty to defend did not exist. Specifically, Amerisure argued that a CGL policy "is designed to cover fortuitous events that are beyond the insured's control," and it does not cover "contractual liability that the insured voluntarily assumes." *Id.* (quoting Amerisure's briefing). The court noted that the Supreme Court has said:

> **Coverage under a commercial general liability insurance policy is for tort liability for physical damages to others and not for contractual liability of the insured for economic loss because the product or work is not that for which the damaged person bargained.** Pursuant to this understanding, certain exclusions have been included within the standard commercial general liability policy for the express purpose of excluding coverage for risks relating to the repair or replacement of the insured's faulty work or products, or defects in the insured's work or product itself. These "business risk" exclusions, as they are commonly called, are intended to provide coverage for tort liability, not for the contractual liability of the insured for loss which takes place due to the fact that the product or completed work was not that for which the other party had bargained.

Id. at 745–46 (quoting *Zurich Am. Ins. Co. v. Nokia, Inc.*, 268 S.W.3d 487, 500 (Tex. 2008) (emphasis added); *see also Lamar Homes*, 242 S.W.3d at 10 ("More often . . . faulty workmanship will be excluded from coverage by specific exclusions because that is the CGL's

structure. The CGL's insuring agreement grants the insured broad coverage for property damage and bodily injury liability, which is then narrowed by exclusions that restrict and shape the coverage otherwise afforded.") (citations omitted)).

In relevant part, the contractual liability exclusion provides as follows:

> This insurance does not apply to:
>
> **b. Contractual Liability**
>
> "[B]odily injury" or "property damage" for which the insured is obligated to pay damages by reasons of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
>
> (1) That the insured would have in the absence of the contract or agreement; or
>
> (2) Assumed in a contract or agreement that is an "insured contract" . . . .

Id. at 746. And, the court stated, the Supreme Court has explained that "such an exclusion '[c]onsidered as a whole, . . . provide[s] that the policy does not apply to bodily injury or property damage for which the insured is obligated to pay damages by reason of an assumption of liability in a contract or agreement, except for enumerated, specific types of contracts called 'insured contracts' and except for instances in which the insured would have liability apart from the contract." *Id.* Thus, according to the Supreme Court, the exclusion is not limited to situations where "the insured assumes the liability of another, such as in an indemnity or hold-harmless agreement," but rather "the exclusion's language applies without qualification to liability assumed by contract [with two exceptions]." *Id.* (quoting *Gilbert*, 327 S.W.3d at 128–29). That is, the exclusion "applies when the insured assumes liability for bodily injuries or property damages 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 of the contract or agreement." *Id.* (quoting *Gilbert*, 327 S.W.3d at 132).

The court went on to note that the Supreme Court had cited several cases holding "as we [the Supreme Court] do." *Id.* (citing *CIM Ins. Corp. v. Midpac Auto Center, Inc.*, 108 F. Supp. 2d 1092, 1099–1100 (D. Hawai'i 2000) (finding that any claim dependent on the existence of an underlying contract is not covered by insurance); *TGA Dev., Inc. v. N. Ins. Co. of N.Y.*, 62 F.3d 1089 (8th Cir. 1995) (finding coverage precluded for contractual claims made because of the contractor's failure to provide a condominium unit free of defects); *Monticello Ins. Co. v. Dismas Charities, Inc.*, 1998 WL 1969611, at *2 (W.D. Ky. Apr. 3, 1998) ("[Defendant's] assertion that this exclusion only applies to situations where a party 'contractually assumes the liability for another party,' goes against the plain meaning of the policy language. Liability under a contract does not arise only when a party assumes the liability for another party. Any party to a contract assumes potential liability under the agreement.")). But, as correctly noted by the district court, the Supreme Court was clear that the exclusion does not bar *all* breach of contract claims. *Id.* at 747 (citing *Gilbert*, 327 S.W.3d at 128, which found that the exclusion bar claims when the insured assumes liability for damages in a contract). Even so, the court concluded:

> Gilbert, therefore, 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.

Id. Importantly, the court noted in a footnote: "This Court's reading of *Gilbert* is in line with what appears to be a *quite expansive interpretation* of the 'assumption of liability' phrase in the contractual liability exclusion." *Id.* at 747 n.5 (emphasis added).

Addressing the issue of "assumption" the court said that Ewing assumed liability with respect to its own work on the tennis courts, which were the subject of the contract. *Id.* According to the underlying lawsuit, Ewing impliedly represented that it would build quality tennis courts lasting twenty-five years. *Id.* But Ewing failed to do so, according to Tuloso-Midway, which claimed Ewing breached its contract, breached an implied duty of ordinary care, breached an implied warranty of good workmanship, breached an implied warranty of merchantable quality, breached an implied warranty that the tennis courts would be suitable for their intended purpose and breached an express warranty that it would execute the work in the contract. *Id.* Thus, the court concluded that "Ewing assumed liability for its own construction work pursuant to the parties' contract" because "Ewing is liable if the work it agreed to perform under that contract is defective." *Id.* "Applying *Gilbert*, the Court concludes that Ewing assumed liability for its own defective work when it entered into the contract with Tuloso–Midway for construction of the tennis courts at issue." *Id.* at 748. The court summarily dismissed Ewing's argument that the instant case was more in line with *Lamar Homes* than *Gilbert*, noting that the contractual liability exclusion was not at issue in *Lamar Homes*. *Id.* Moreover, the court said it relied on *Gilbert* for its "legal interpretation" of the exclusion, essentially rejecting Ewing's argument that *Gilbert* involved the duty to indemnify only and the instant case dealt with the duty to defend. *Id.* Thus, the court concluded that the exclusion applied in the circumstances before it, noting, however:

> The Court recognizes Ewing's concern that "Amerisure's interpretation of the Contractual Liability exclusion would essentially wipe out any coverage for a general contractor for 'property damage' that occurs to the project." While the Court may not read *Gilbert* as broadly as Amerisure does, and indeed makes no general findings about its application beyond this case, it does agree with the conclusion that it operates to exclude coverage in the present circumstances and in that sense is quite broad in application.

Id. at 748 n.7.

D. The Exception to the Exclusion

Having found the contractual liability exclusion applied, the court turned to Ewing's argument that the exception for liability that "the insured would have in the absence of the contract or agreement" applied to reinstate at least the potential for coverage and thus a duty to defend. *Id.* at 748–49. In particular, Ewing argued that because claims for negligence also existed alongside the breach of contract claims in the underlying lawsuit, liability existed (or at least potentially existed for purposes of the duty to defend) in the absence of the contract. Amerisure

countered that, notwithstanding the pending negligence claims, the claims actually sound solely in contract and that no liability exists independent of the contract between the parties. *Id.* at 749.

In evaluating the parties' arguments, the court relied on the Fifth Circuit Court of Appeals' decision in *Century Surety Co. v. Hardscape Construction Specialties, Inc.*, 578 F.3d 262 (5th Cir. 2009), where the court allegedly confronted a similar situation to the one before the court in *Ewing*. *See Ewing*, 814 F. Supp. 2d at 749. In that case, the court analyzed whether the "insured contract" exception to the contractual liability exclusion was applicable. *Id.* That exception only was triggered if the underlying petition "properly alleges a tort cause of action against Hardscape under the 'eight corners' rule applied by Texas courts." *Id.* (quoting *Hardscape*, 578 F.3d at 266) (noting the *Hardscape* analysis was directly relevant notwithstanding the fact that it analyzed a different exception than raised by Ewing because the definition of "tort liability" was the same as in the applicable exception). Focusing on the difference between common law tort claims and breach of contract causes of action, the Fifth Circuit said:

> To determine the nature of a Texas lawsuit, we must look to the substance of the cause of action and not necessarily the manner in which it was pleaded. Texas courts characterize actions as tort or contract by focusing on the source of liability and the nature of the plaintiff's loss:
>
> > . . . Tort obligations are in general obligations that are imposed by law-apart from and independent of promises made and therefore apart from the manifested intention of the parties-to avoid injury to others. If the defendant's conduct-such as negligently burning down a house-would give rise to liability independent of the fact that a contract exists between the parties, the plaintiff's claim may also sound in tort. Conversely, if the defendant's conduct-such as failing to publish an advertisement-would give rise to liability only because it breaches the parties' agreement, the plaintiff's claim ordinarily sounds only in contract.
> >
> > **In determining whether the plaintiff may recover on a tort theory, it is also instructive to examine the nature of the plaintiff's loss. When the only loss or damage is to the subject matter of the contract, the plaintiff's action is ordinarily on the contract.**

Id. at 750 (quoting *Hardscape*, 578 F.3d at 267 (internal citations omitted) (emphasis added)).

Looking specifically at the allegations in the underlying lawsuit in *Hardscape*, the Fifth Circuit said most of them easily were classified as giving rise only to contract claims because the damages at issue occurred only to the subject matter of the contract. Because no allegations existed that the faulty construction damaged the owner's business interests or adjacent property, the damages all only existed as a result of the contract. Thus, the court in *Hardscape* concluded the exception did not apply. *Id.* (discussing *Hardscape*, 578 F.3d at 267–70).

Applying *Hardscape*, the court explained that the damages complained of by Tuloso-Midway in its lawsuit against Ewing related solely to the subject matter of their contract—the

tennis courts. "Tuloso-Midway does not claim damages to, or seek recovery for, any other property on the school grounds not covered by the contract." *Id.* at 752. The court said:

> This analysis necessarily leads to the conclusion that Tuloso–Midway's claims against Ewing in the Underlying Lawsuit sound only in contract, not tort, consistent with *Hardscape*. As such, the Court must conclude that the exception to the contractual liability exclusion, providing for coverage for liability that "the insured would have in the absence of the contract or agreement," is not applicable.

Id. at *12.

Accordingly, despite the fact that the negligence claims remained pending against Ewing, the court held that Amerisure did not have a duty to defend. And, for the same reasons that negated the duty to defend, the court also held that Amerisure never would have a duty to indemnify Ewing in connection with the underlying lawsuit. *Id.* at 752–53 (citing *Farmers Tex. County Mut. Ins. Co. v. Griffin*, 955 S.W.2d 81, 84 (Tex. 1997)). Further, because no duty to defend existed, Amerisure was not liable under Texas' Prompt Payment of Claims Act. *Id.* (citing *Progressive County Mut. Ins. Co. v. Boyd*, 177 S.W.3d 919, 922 (Tex. 2005)).

E. Commentary:

In this author's opinion, if *Gilbert* was not bad enough for the construction industry, *Ewing* certainly makes things a lot worse for insureds that do business pursuant to contracts—that is, everyone. Essentially, the "property damage" coverage under a CGL policy is virtually meaningless under this extension of the contractual liability exclusion—at least where the construction is performed pursuant to a contract and the damages are to the contracted-for work. Notably, the most difficult part to comprehend is the court's comment that it does not read the exclusion as broadly as Amerisure. This author cannot fathom a scenario in which the exclusion could be applied even more broadly.

First, the court appears to have entirely missed the concept of an "assumption" as used in the contractual liability exclusion. While the Supreme Court made clear in *Gilbert* that the contractual liability exclusion did not preclude coverage for *all* breach of contract claims, the court basically said it did (although noting it was an "expansive" reading). In *Gilbert*, the Court went to great pains to highlight the *specific* assumption of liability in the contract that went beyond Gilbert Texas Construction's "common law" obligations. Notably, because of governmental immunity, Gilbert could not have been liable for damages "but for" its contractual assumption. Here, the court seemingly concluded that general contractors "assume" liability *every time they enter into a contract*. That is a scary interpretation and one that contravenes the very intent behind the contractual liability exclusion and the evolution of the CGL policy as a whole. Simply put, the facts in *Gilbert* were somewhat unique. The *Ewing* case, on the other hand, is a garden-variety construction defect lawsuit.

Second, even assuming there was an "assumption" of liability sufficient to trigger the contractual liability exclusion, the court wholly ignored the fact that *Gilbert* was a duty to indemnify case and the issue in *Ewing* was whether a duty to defend existed. The court quickly

dismissed that argument, failing to recognize that the duty to defend is broader than the duty to indemnify. The court also failed to recognize that the Supreme Court in *Gilbert* made a point of distinguishing between the duty to defend and the duty to indemnify. In fact, that was one of the primary bases on which the Supreme Court distinguished *Lamar Homes.* Even worse, in applying *Gilbert* to the duty to defend, the court utilized a liability defense (i.e., the "economic loss" rule) to render an advisory opinion that the negligence claims pending against Ewing in the underlying lawsuit were not "viable." That has never been part of the duty to defend analysis and directly contradicts the statement in *Lamar Homes* that the economic loss rule is not a useful tool for determining insurance coverage. Thus, whether ultimately viable or not, the negligence claims clearly existed in the underlying lawsuit, and, hence, a potential for liability existed in the absence of the contract or agreement between Ewing and Tuloso-Midway. Therefore, the first exception to the contractual liability exclusion should have applied to reinstate at least a duty to defend. Interestingly, while those negligence claims were not "viable" according to the court when analyzing the exception to the exclusion, the court relied on the very same allegations to conclude that an "occurrence" existed as a matter of law.

Third, the court's decision renders the "subcontractor exception" to the "your work" exclusion entirely meaningless. In particular, any damage to "your work" necessarily constitutes damage to the subject matter of the contract. The "subcontractor exception," however restores coverage if the damaged work or the work out of which the damage arises was performed on the insured's behalf by a subcontractor. A literal reading of *Ewing*, however, renders the subcontractor exception surplusage because the exact same damage would be excluded by the contractual liability exclusion. Notably, the dynamics of that issue were not addressed in *Gilbert* because the damage at issue was to third-party property, which necessarily fell outside the definition of "your work." Because insurance policies are to be construed so that every word has meaning, this holding appears to be in error on its face.

The ultimate outcome of this case will depend on the Fifth Circuit's (or, on certification, the Supreme Court of Texas') interpretation of *Gilbert.* In *Gilbert*, the Supreme Court rejected Gilbert's claim that the Court's decision would result in a finding of no coverage whenever liability defenses knock out the negligence claims against a contractor and leave only claims for breach of contract. In response, the Court said:

> We understand Gilbert's concerns, but speculation about coverage of insurance policies based on surmised factual scenarios is a risky business because small alterations in the facts can warrant completely different conclusions as to coverage. It is proper that we await a fully developed, actual case to decide an issue not presented here.

Gilbert, 327 S.W.3d at 135. *Ewing* is that case—that "fully developed, actual case" where a small alteration in the facts warrants a completely different result than in *Gilbert*. That is, coverage should exist where the insured did not assume specific liability beyond its common law obligations. Moreover, a duty to defend certainly should exist when alternative allegations of negligence remain pending against the insured. And, a coverage court should not be allowed to issue an advisory ruling as to the application of liability defenses such as the economic loss rule.

Ewing filed an appeal to the Fifth Circuit and filed an unopposed motion requesting that the following issues be certified to the Supreme Court of Texas:

I. Does a general contractor that enters into a contract in which it agrees to perform its construction activities in a good and workmanlike manner "assume liability" within the meaning of the Contractual Liability Exclusion?

II. Did the Supreme Court of Texas' holding in *Gilbert Texas Construction, L.P. v. Certain Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010), with respect to the Contractual Liability Exclusion in the indemnity context, extend to the duty to defend?

III. If the Answer to Question II is "Yes," do tort allegations in the underlying lawsuit fall within the exception in the Contractual Liability Exclusion for "liability that would exist in the absence of the contract"? Or, is the judge in the coverage case permitted to evaluate the merits of the other claims (such as applying the "economic loss" rule to negligence allegations) in determining the duty to defend?

Oral argument was heard on March 6, 2012. The Panel gave no indication that it was going to certify the issues to the Supreme Court of Texas. So, it appears that it is now in the hands of the Fifth Circuit to see what lies beyond *Gilbert* and whether this truly is the demise of the CGL policy for claims of "property damage" to the work itself.

VII. *Lexington Insurance Co. v. National Oilwell NOV, Inc.*, 355 S.W.3d 205 (Tex. App.—Houston [1st Dist.] 2011, no pet.)

On May 12, 2011, the First District Court of Appeals in Houston decided a duty to defend case, analyzing the application of two exclusions and key issues pertaining to self-insured retentions. *See Lexington Ins. Co. v. National Oilwell NOV, Inc.*, 355 S.W.3d 205 (Tex. App.—Houston [1st Dist.] 2011, no pet.).

A. Background Facts

National Oilwell NOV was sued in federal court in Arkansas for damages allegedly caused by defective fiberglass downhole tubing ("DHT") National had manufactured and sold to Albemarle Corporation. *Id.* at 207. Lexington agreed it had an obligation to defend National on exhaustion of its SIR. Once the Albemarle suit settled, Lexington filed the instant case, claiming that no duty to defend existed because coverage was excluded. Alternatively, Lexington argued that National failed to timely notify Lexington that it had exhausted its SIR, so Lexington did not owe any defense costs incurred following that exhaustion.

In the underlying lawsuit, Albemarle alleged that the DHT pipe it used to transport brine from subsurface deposits split, separated and leaked, leaving the company unable to continue operations in several disposal wells. National's predecessor company informed Albemarle that its testing revealed that the tensile strength in the pipe was inadequate for transporting the hot brine. *Id.* at 208. Albemarle sought damages to repair or replace the defective DHT, lost income and profits incurred when the injection wells were out of operation for the DHT repairs, lost business opportunities, incidental and consequential damages and attorneys' fees. *Id.*

National notified Lexington of the underlying lawsuit in April 2005 and defense counsel provided Lexington with a status report in December 2005. Four months later, Lexington issued a reservation of rights letter acknowledging a potential for coverage, but citing exclusions that could preclude some or all of the damages sought. *Id.* at 209. Lexington instructed National to notify the insurer when it appeared likely that the SIR would be fully eroded. *Id.* After incurring more than $700,000 in defense costs, National settled the underlying lawsuit, but Lexington refused to reimburse National for the costs in excess of the SIR. *Id.*

B. Coverage under the Lexington Policy

Lexington contended that the damages sought by Albemarle all "arose from or flowed from its need to repair or replace [National's] damaged product—the defective DHT." *Id.* at 211 (citing *Building Specialties, Inc. v. Liberty Mutual Ins. Co.*, 712 F. Supp. 2d 628 (S.D. Tex. 2010), for the proposition that a defective product is not "property damage"). The appellate court disagreed, finding Albemarle's claims for "other incidental and consequential damages due to the defective condition of the DHT" and that its injection wells were not operational "while being repaired" were sufficient to allege "property damage." *Id.* More specifically, the court found that a reasonable interpretation of the allegations was that the failure of the DHT caused damage to the wells themselves, as they were out of commission "while being repaired." *Id.* at 211–12 (noting that the court did not read the allegations to state that the wells were out of operation "while [the DHT was] being repaired"). Thus, construing the pleadings in favor of the insured, Albemarle's plea for "other incidental and consequential damages" was sufficient to allege a potentially covered claim for damages beyond the defective DHT itself. *Id.* at 212.

For similar reasons, the court found the exclusions relied on by Lexington did not preclude the duty to defend. *Id.* at 213. Those exclusions, which precluded coverage for damage to the insured's product or the withdrawal of the insured's product from the market, did not preclude coverage for the "other incidental and consequential damages" sought by Albemarle. *Id.* Again, the court resolved the issue in favor of coverage instead of ignoring the allegation as "meaningless". *Id.* at 213–14.

C. Notice of Exhaustion of the SIR and "Other Insurance"

The court also rejected Lexington's notice defense with respect to the exhaustion of National's SIR. Lexington did not dispute that National adhered to the policy provision requiring notice of "any occurrence, claim or suit which may serve to deplete the self-insured retention by 50% or more." Rather, Lexington argued that its request in its reservation of rights letter that National inform it when the SIR appeared likely to be eroded constituted an additional requirement that National failed to follow. *Id.* at 214. The court disagreed, noting that "[a] unilateral request in a reservation of rights letter cannot create duties beyond those set forth in the policy." *Id.* (citing *Tex. Ass'n of Counties Risk Mgmt. Pool v. Matagorda County*, 52 S.W.3d 128, 131–32 (Tex. 2000)). Further, the policy's merger clause precluded the possibility of any extracontractual reporting duties. *Id.* Finally, in addressing Lexington's challenge of the lower court's grant of summary judgment on National's claims for breach of contract and violations of the Texas Insurance Code, the court rejected Lexington's claim that National had to contribute to its own defense after exhaustion of the SIR. *Id.* at 215. Texas law is well-settled that an SIR is not "other insurance" within the meaning of an "other insurance" clause. *Id.* (citations omitted).

Thus, Lexington's failure to pay all of National's reasonable defense costs and its failure to do so in a timely manner justified the lower court's summary judgment ruling. *Id.*

D. Commentary

While not necessarily a monumental case, *National Oilwell* is important for its discussion of the "property damage" requirement under an insuring agreement. The court appeared to take a liberal view of the allegations in finding that claims existed for damage beyond the DHT itself. In doing so, the court reiterated Texas law that favors a finding of a duty to defend when allegations are less than clear. Despite the *National Oilwell* opinion, if the facts support it, it is always better to plead clear allegations of property damage beyond the scope of the defective work in order to trigger insurance coverage. The decision also is important for the proposition that an insurer cannot unilaterally create duties not found in an insurance policy.

VIII. *Cook v. Admiral Insurance Co.*, 438 F. App'x 313 (5th Cir. Aug. 19, 2011)

In *Cook v. Admiral Insurance Co.*, 438 F. App'x 313 (5th Cir. Aug. 19, 2011), the Fifth Circuit issued a per curiam opinion addressing the "occurrence" and "property damage" requirements found in CGL policies, as well as exclusions j(5) and j(6). While finding that an "occurrence" existed, the court nonetheless found that coverage did not exist because of the exclusions.

A. Background Facts

Cook was retained by MJ Brogdin Consulting ("Brogdin") to deliver casing and oversee its installation in Brogdin's oil well. After delivering the casing, Cook miscounted the casing and took away more excess from the site than he should have. As a result, the well was completed at the wrong depth, missing the zone targeted for completion. *Id.* at 314. Brogdin incurred increased costs to rework the well and to have casing reinstalled at the correct depth. *Id.* Cook sued Admiral seeking a declaration that Admiral owed him a defense in any lawsuit brought by Brogdin and owed him indemnity for all damages awarded in such suit. *Id.* In the district court, Admiral moved for summary judgment and the court found that because no "loss of use" existed, there was no "property damage" and, hence, no duty to defend or indemnify Cook. *Id.* at 315. On appeal, the court affirmed but on wholly different grounds.

B. An "Occurrence" and "Property Damage"

Noting that the Supreme Court of Texas previously had held that an accident "is generally understood to be a fortuitous, unexpected, and unintended event," the court found that an "occurrence" existed in the instant case. *Id.* at 317. More particularly, the Supreme Court has cited as an example of an "occurrence," "[t]he wrong number of boxes was shipped because someone made a mistake in counting." *Id.* (citing *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 8 (Tex. 2007)). Because the casing issue was caused by a mistake in counting, an "occurrence" existed under the CGL policy. *Id.*

The district court found that "property damage" did not exist because in order for there to be a "loss of use of tangible property" the well at issue had to be *in use* prior to the damage. *Id.* Because Cook's actions did not result in the loss of use of an *existing* well, there was no

"property damage." Moreover, there were no allegations of damages for the loss of use. *Id.* But, because the Fifth Circuit affirmed on other grounds—exclusions in the policy—the court did not address the "property damage" requirement. *Id.*

C. Exclusions J(5) and J(6)

In addressing exclusions j(5) and j(6), the court assumed that any "property damage" that existed was the completion of the well at an incorrect depth. *Id.* at 318. That damage, however, "undeniably *arose out of* Cook's operations; and it was precisely that well which had to be reworked because Cook's negligence in retrieving too much casing from the site left an insufficient quantity of casing to reach the proper depth for completion." *Id.* Additionally, Cook was responsible for overseeing the running of the insufficient amount of casing into the well. *Id.*

Cook claimed that the court's ruling in *Mid-Continent Casualty Co. v. JHP Development, Inc.*, 557 F.3d 207 (5th Cir. 2009), supported his position because a gap in time existed between the "occurrence"—i.e., the removal of the casing—and the "property damage"—i.e., the loss of use of the well when the casing was run. *Cook*, 438 F. App'x at 318. The court disagreed, noting that Cook missed the point of the court's holding in *JHP* where exclusion j(5), which requires damages during "ongoing operations," did not apply during a suspension of construction activities. *Id.* In the instant case, no suspension of construction activities existed, as the well was damaged when it was completed to the wrong depth "*while* Cook was 'deliver[ing] and oversee[ing] the running of casing on [the] well,"—i.e., his work. *Id.*

Similarly, the court found that exclusion j(6) applied, rejecting Cook's claim that the removal of the casing was the defective work and the loss of use was to the well, a separate property. *Id.* Cook was hired to provide casing for the well as an "integral part" of drilling and completing the well as a whole *and* to oversee the running of that casing. *Id.* The court agreed with Admiral that the casing was not a component of the well that functions independently, and the court found that he caused defects in the "construction" of the well as whole when he oversaw the installation of an insufficient amount of casing caused by his negligence in taking too much casing from the site. *Id.* at 318–19. The court distinguished the instant case from the situation in which defective repair work on a already constructed well damages the casing, which is a pre-installed component of the finished well. *Id.* at 319 (citing *Underwriters at Lloyd's London v. OSCA, Inc.*, 2006 WL 941794, at *18–19 (5th Cir. 2006) (per curiam) (unpublished)).

Interestingly, the Fifth Circuit admitted that the district court never addressed exclusions j(5) and j(6) in its opinion, but found that it could affirm a district court's judgment for reasons supported by the record even if not relied on by the lower court. *Id.* Thus, any exclusion in the policy was "fair game" as grounds for affirming the lower court's decision. *Id.* The court rejected Cook's argument that those defenses were waived because they were not raised as affirmative defenses, as "there is some play in the joints" of the general waiver rule. *Id.* In fact, because the district court ruled on the lack of "property damage," no need existed to address the exclusions. But the Fifth Circuit found that issue to "raise a difficult question," so it requested supplemental briefing on the two exclusions, which Cook filed after only two days instead of the seven provided by the court. *Id.* at 319–20. As such, Cook was not prejudiced by the court's sua sponte raising of the issue, and the court found the exclusions to be the correct legal basis on which to affirm the district court's summary judgment. *Id.* at 320. For the same reasons that the court

found no duty to defend existed—application of the exclusions—the court also found no duty to indemnify existed. *Id.*

D. Judge Owens' Concurring Opinion

Believing that the court's majority opinion was based on arguments not advanced in the district court, Judge Owens issued a concurring opinion, arguing that reasons existed to uphold the lower court's ruling without reaching new arguments. *Id.* In particular, Judge Owens respectfully noted that the court's jurisprudence did not allow it to affirm a lower court's judgment on *any* grounds, but only on grounds advanced by the parties in the district court. *Id.*

According to Judge Owens, Admiral also argued in the lower court that the claims against Cook in the underlying lawsuit did not fall within the "Classifications" covered by the Admiral CGL policy. *Id.* at 322. Those Classifications were limited and Judge Owens contended the "erroneous removal of casing from the site that hindered completion of the well at the desired depth" did not fall within them. *Id.* at 323. Cook claimed that it constituted "oil or gas lease work by contractors," which was in the Classifications, but Judge Owens noted that that phrase was followed by a dash and references to "oilfield lease road and ditch maintenance, excavation and beautification of oilfield lease site." The erroneous removal of casing bore no resemblance to those statements of coverage. *Id.* And if Cook's argument was accepted, there would have been no need for the examples following the dash in the Classifications section. *Id.* Finally, Judge Owens found that the provisions were not ambiguous and, therefore, it should be enforced as written. *Id.* Moreover, Admiral had not waived the defense, as Cook was not prejudiced by Admiral's failure to raise it until filing its motion for summary judgment. *Id.* at 324.

E. Commentary

The decision in *Cook* is notable more for the dispute between the majority and concurring opinions as to the court's ability to sua sponte raise coverage issues in connection with the application of exclusions found in the policy. Taken to its logical conclusion, the Fifth Circuit could rely on any single provision in a CGL policy to disclaim coverage—even where an insurer never thought a particular exclusion or limitation was applicable. Aside from that dispute, the court's finding that exclusions j(5) and j(6) applied to negate coverage was not monumental by any means. As clearly explained by the court, Cook was retained to deliver the casing and oversee its installation. Cook's failure to provide a sufficient amount of casing directly caused the well to not be drilled to the correct depth as it was constructed. All the "property damage"—if any existed—was to the particular part of Cook's work on which he was performing operations.

IX. *American Home Assurance Co. v. Cat Tech L.L.C.*, 660 F.3d 216 (5th Cir. 2011)

In a per curiam opinion, the Fifth Circuit addressed the scope of a "your work" exclusion in a CGL policy. *See Am. Home Assurance Co. v. Cat Tech L.L.C.*, 660 F.3d 216 (5th Cir. 2011). The court ultimately held that three categories of damage exist in any given case involving the "your work" exclusion, but only one of them falls outside the scope of the exclusion.

A. Background Facts

Cat Tech was hired to service a hydrotreating reactor owned by Ergon Refining, and while doing so, Cat Tech damaged several of the reactor's components. *Id.* at 218. More specifically, Cat Tech replaced certain catalyst "reactor internals" of the Ergon reactor. After the work was completed, the start up process was initiated but had to be shut down. Ergon discovered damage to certain components, including the reactor internals. Cat Tech returned to the site, and repaired and replaced the damaged internals. Another problem occurred during the start up process and Ergon hired a different contractor to repair the damaged reactor. *Id.* at 219. Cat Tech was found responsible for the damage following an arbitration and sought indemnification from two of its insurers. Each insurer denied coverage under the "your work" exclusion, which is found in standard-form CGL policies, and then filed the instant declaratory judgment action. *Id.* at 218; *see also id.* at 219 (noting the exclusions precluded coverage for "'property damage' to 'your work' arising out of it or any part of it and included in the 'products-completed operations hazard'").

B. The "Your Work" Exclusion

In interpreting the "your work" exclusion, the court noted three categories of damages at issue: (1) property damage to those parts of the reactor on which Cat Tech performed defective work; (2) property damage caused by Cat Tech's defective work to those parts of the reactor on which Cat Tech performed non-defective work; and (3) property damage to other Ergon property on which Cat Tech did not perform any work. *Id.* at 221. The court held that the first two categories were excluded from coverage under the "your work" exclusion, but coverage was not precluded for any damage to Ergon's property on which Cat Tech did not perform any service or repair work. *Id.*

In support of its holding, the court relied on *Wilshire Insurance Co. v. RJT Construction, L.L.C.*, 581 F.3d 222 (5th Cir. 2009), in which it interpreted an identical exclusion. In that case, the court ruled that coverage did not exist for damage to the insured's defectively constructed foundation, but coverage did exist for any damage to other property resulting from that defective work. *Cat Tech*, 660 F.3d at 221 (citing *RJT Constr.*, 581 F.3d at 226); *see also Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.—Texarkana 1979, no writ) (finding coverage for damage to portions of an engine damaged by an insured's service work on other parts of the engine). The Fifth Circuit also relied on other decisions, noting that "Texas courts have made clear, however, that the 'your work' exclusion not only precludes coverage for property damage to insured's defective work, but also excludes coverage for all damage to an insured's work, whether defective or non-defective." *Cat Tech*, 660 F.3d at 222 (citing *T.C. Bateson Constr. Co. v. Lumbermens Mut. Cas. Co.*, 784 S.W.2d 692 (Tex. App.—Houston [14th Dist.] 1989, writ denied) (holding that the "your work" exclusion is not ambiguous and "clearly denies coverage for damage to work of the insured that is not defective"); *Eulich v. Home Indem. Co.*, 503 S.W.2d 846 (Tex. Civ. App.—Dallas 1974, writ ref'd n.r.e.) (addressing a similar "your work" exclusion and noting that the contractor is insured "against liability for damages *other than to the building itself* as a result of his performance, whether defective or otherwise" (emphasis added)).

The Fifth Circuit acknowledged that other Texas decisions exist that appear to be in conflict with the court's findings. *Id.* (citing *Dorchester Dev. Corp. v. Safeco Ins. Co.*, 737

S.W.2d 380, 382 (Tex. App.—Dallas 1987, no pet.), *abrogated on other grounds by Don's Bldg. Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008); *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824 (Tex. App.—Fort Worth 1988, writ denied)). While the decisions in *Dorchester* and *Mid-United* allowed coverage for damages to the insured's otherwise non-defective work, the exclusions at issue in those cases "provided that the policy did not apply 'to property damage . . . to . . . *that particular part of any property* not on premises owned or rented to the insured, . . . the restoration, repair or replacement of which has been made or is necessary by reasons of faulty workmanship thereon by or on behalf of the insured." *Id.* (citations omitted). The importance of the distinction between a "your work" exclusion and a "particular part" exclusion already had been addressed by the court in *JHP Development*, 557 F.3d at 211.

Finally, the court rejected the insured's claim that the exclusion only applied to damage to its own intangible repairs (that is, its "work") but not damage to third-party property. *Cat Tech*, 660 F.3d at 223. The court found that such a position was wholly inconsistent with *RJT Construction* and *Volentine*. *Id.* at 224.

With the foregoing understanding of the exclusion, the court addressed whether summary judgment properly was issued in favor of the insurers. Analyzing the evidence before it, the court concluded that the arbitration award was too vague in describing the damages to apply the exclusion appropriately. As such, the court remanded the case for additional fact-finding to determine whether the exclusion applied to all or part of the arbitration award. *Id.* at 225.

C. Commentary

The Fifth Circuit's holding in *Cat Tech* as to the scope of the "your work" exclusion is an important ruling for the construction industry because it interprets the scope of the "your work" exclusion in a situation where the "subcontractor exception" does not apply. The opinion clarified that the "your work" exclusion, which only applies to completed operations, excludes coverage for the insured's work—whether defective or non-defective. Moreover, the court illuminated the distinction between the "your work" exclusion and its "course of construction" counterparts—exclusions j.(5) and j.(6)—noting that the latter exclusions are narrower in scope and do not preclude coverage for the insured's work that is damaged but otherwise not defective.

X. *National Fire Insurance of Hartford v. C. Hodges & Associates*, 2011 WL 5822190 (W.D. Tex. Oct. 27, 2011)

On October 27, 2011, Judge Harry Lee Hudspeth issued an opinion addressing the insuring agreement requirements found in standard-form CGL policies—i.e., "property damage" caused by an "occurrence". *See Nat'l Fire Ins. of Hartford v. Hodges & Assocs.*, 2011 WL 5822190 (W.D. Tex. Oct. 27, 2011).

A. Background Facts

C. Hodges & Associates and its affiliates were developers of a shopping center in San Antonio. *Id.* at *2. During lease negotiations with prospective tenants, the developers claimed that space in the center already was committed to several tenants, including that 70% of the center already had been leased. Based on those representations, and that the center would

become "an urban village where people live, work and play," the prospective tenants signed leases with the Developers. *Id.* Ultimately, the tenants determined that the representations were not true and the center would never be what they were told it would become. When the tenants filed suit against the developers, the developers sought a defense from their insurers, who denied coverage for the claims because the tenants did not seek damages for "bodily injury" or "property damage" caused by an "occurrence". *Id.*

B. "Occurrence"

First, the court found that no "occurrence" existed because there was not an "accident." *Id.* at *3. In particular, "Texas courts have consistently held that intentional misrepresentations are not an 'occurrence' or 'accident' because they are made with the intent to defraud and thus, are not accidental." *Id.* (citations omitted). Negligent misrepresentations, although addressed only once, also were held to not be an "occurrence". *Id.* (citing *State Farm Lloyds v. Kessler*, 932 S.W.2d 732 (Tex. App.—Fort Worth 1996, writ denied)). Despite the ruling in *Kessler*, the Southern District of Texas issued an opinion six weeks later, claiming that "in the absence of state court precedent, this Court must predict how the highest court of the state would rule if presented with the same issue." *Id.* at 4 (citing *The Aetna Cas. & Sur. Co. v. Metropolitan Baptist Church*, 967 F. Supp. 217 (S.D. Tex. 1996) (concluding that Texas courts would find that negligent misrepresentation could constitute an occurrence)). Finding the Southern District was wrong in light of the *Kessler* decision, the Western District of Texas followed state court precedent and ruled that negligent misrepresentations do not constitute an occurrence. *Id.*

C. "Property Damage"

Although its ruling on the "occurrence" requirement was sufficient to grant summary judgment in favor of the developers' insurers, the court also addressed the "property damage" requirement of the policies. *Id.* No dispute existed that there were no allegations of "physical injury to tangible property" but a dispute did exist as to whether there was any "loss of use" damages. *Id.* The insurers contended that only "economic losses"—not "loss of use"—were alleged. *Id.* While the court agreed with the developers that the "economic loss" doctrine could not be used to interpret insurance policies, *see Lamar Homes*, 242 S.W.3d at 12–13, the court said that that did not mean that economic damages—in and of themselves—can satisfy the "property damage" requirement. *See C. Hodges & Assocs.*, 2011 WL 5822190 at *5. Rather, "Texas courts have continued to find that 'as a matter of law . . . "loss of use" in the property damage insurance context must be something more than purely economic loss to trigger coverage and a duty to defend." *Id.* (quoting *Daneshjou Daran, Inc. v. Truck Ins. Exch.*, 2009 WL 2410932 at *2 (Tex. App.—Austin Aug. 5, 2009, no pet.)). Because the tenants never were denied use of their property—and because they never alleged as much—there simply were no allegations of "loss of use," just lost revenue. Accordingly, the "property damage" requirement also was not satisfied.

D. Commentary

Judge Hudspeth's decision in *C. Hodges & Assocs.* serves as a reminder of the key requirements necessary for an insured to present a prima facie case of coverage under a CGL policy. In particular, as has always been the case, a misrepresentation alone is not enough to

constitute an "occurrence." In addition, although *Lamar Homes* clarified that the "economic loss" doctrine is not to be used to determine insurance coverage, a distinction still exists between a claim for purely "economic losses"—which are not covered by CGL insurance—and a claim for "property damage" accompanied by associated "economic losses." In the latter scenario, coverage can exist for the economic losses so long as they are "damages because of 'property damage'".

XI. *Gilbane Building Co. v. Admiral Insurance Co.*, 664 F.3d 589 (5th Cir. 2011)

On December 12, 2011, the Fifth Circuit Court of Appeals issued an important decision emphasizing the distinction between the duty to defend and the duty to indemnify as it pertains to determining an entity's status as an additional insured. *See Gilbane Bldg. Co. v. Admiral Ins. Co.*, 664 F.3d 589 (5th Cir. 2011). In doing so, the court made clear that, as in *D.R. Horton-Texas, Ltd. v. Markel International Insurance Co.*, 300 S.W.3d 740, 743 (Tex. 2009), sometimes an insurer's duty to indemnify exists even if its duty to defend does not.

A. Background Facts

Michael Carr was injured while climbing down a ladder on a construction site. As a result, he filed suit against Gilbane Building Co.—the general contractor on the project—and Baker Concrete—the company responsible for installing and maintaining the ladders at the site. Because of the workers' compensation bar, Parr did not sue his employer, Empire Steel. Parr alleged that Gilbane failed to keep the worksite free of mud after recent rainstorms, and the mud allegedly caused him to slip on the ladder. *Gilbane*, 664 F.3d at 592.

Empire Steel was insured by Admiral Insurance Co. and Gilbane sought coverage as an additional insured under the CGL policy Admiral issued to Empire. The additional insured endorsement provided coverage for ongoing operations, "but only if coverage as an additional insured is required by written contract or written agreement that is an 'insured contract,'" and only if the "property damage" was "caused, in whole or in part, by: [Empire's] acts or omissions; or the acts or omissions of those acting on [Empire's] behalf." *Id.* The definition of "insured contract" included an agreement "under which [Empire] assume[d] the tort liability of another party." *Id.* at 593. Gilbane contended that its Trade Contractor Agreement ("TCA") between it and Empire in which Empire agreed to name Gilbane as an additional insured and also agreed to "indemnify and hold harmless" Gilbane for any losses caused by Empire, regardless whether those losses were causes in party by Gilbane. *Id.*

Admiral denied coverage and Gilbane and Parr settled the underlying lawsuit. Gilbane filed a declaratory judgment action against Empire and Admiral, contending Admiral had an obligation to defend and indemnify Gilbane. The district court initially ruled that a duty to defend existed, but denied summary judgment on the duty to indemnify because of a fact issue. A trial was held by written submission on stipulated facts, and the district court found that a jury would have determined that Parr or Empire was at least 1% responsible for Parr's injuries. Therefore, the district court ruled that a duty to indemnify existed as well, and Admiral appealed. *Id.*

B. The Duty to Defend

The district determined that the TCA was an insured contract in that Empire assumed the tort liability of Gilbane in that agreement. *Id.* at 594. On appeal, Admiral contended it was not an insured contract because the indemnity was not enforceable under Texas law. *Id.* at 594–95. In particular, Admiral argued that the provision did not comply with the express negligence doctrine. *Id.* Assuming it to be unenforceable, the court was left to determine whether the TCA still qualified as an insured contract. Although an issue not resolved by the Supreme Court of Texas, the court found that its own decision in *Mid-Continent Cas. Co. v. Swift Energy Co.*, 206 F.3d 487 (5th Cir. 2000), "largely resolved" the issue. *Gilbane*, 2011 WL 6153360 at *3. In *Swift*, the insurance company argued that a master service agreement violated the Texas Oilfield Anti-Indemnity Act and, therefore, it was not an "insured contract" because it did not assume any liability. *Id.* (citing *Swift*, 206 F.3d at 492–93). Based on the principle that an insurance policy should be construed broadly in favor of coverage and in light of a lack of relevant precedent, the court found that the agreement was an insured contract because the parties intended to assume Swift's tort liability. *Id.* (citing *Swift*, 206 F.3d at 492–93). As such, Swift qualified as an additional insured. *Id.* (citing *Swift*, 206 F.3d at 493; *see also LeBlanc v. Global Marine Drilling Co.*, 193 F.3d 873, 875 (5th Cir. 1999) (holding that an indemnity provision need not be valid and enforceable to trigger obligations under the contract, so long as the parties agreed to indemnity); *Travelers Lloyds Ins. Co. v. Pac. Employers Ins. Co.*, 602 F.3d 677, 683 n.20 (5th Cir.2010)). The court found that its decision in *Swift* was consistent with Texas law because the Supreme Court has refused to apply requirements for indemnification clauses to additional insured endorsements. *Id.* (citing *Getty Oil Co. v. Ins. Co. of N. Am.*, 845 S.W.2d 794, 806 (Tex. 1992) ("[T]he express negligence doctrine in Texas has been applied only to indemnity provisions, not insurance-shifting provisions.")).

As in *Swift*, the Fifth Circuit noted that the definition of insured contract is not governed by enforceability of an indemnity provision. Rather, it turns on whether Empire Steel agreed to "assume the tort liability of another party." *Id.* at 596. The court explained that Empire had done just that:

> In the TCA, Empire Steel contracted not only to indemnify Gilbane, but also to secure insurance on its behalf; by doing so, it agreed to assume Gilbane's tort liability. That provision is not rendered void by the indemnity provision, even if it is unenforceable.

Id. Accordingly, Gilbane qualified as an additional insured because Empire Steel agreed to assume Gilbane's tort liability. *Id.*

Having found that the TCA was an insured contract, the court turned to whether the pleadings against Gilbane were sufficient to trigger the duty to defend. *Id.* That is, the court analyzed whether the allegations against Gilbane "sufficiently allege that Empire or someone acting on its behalf, including Parr, caused Parr's injuries." *Id.*

After explaining the "eight corners" rule, the court noted the Supreme Court of Texas' recent reiteration that a "policy imposes no duty to defend a claim that might have been alleged but was not, or a claim that more closely tracks the true factual circumstances surrounding the

third-party claimant's injuries but which, for whatever reason, has not been asserted." *Id.* at 597 (quoting *Pine Oak Bldrs., Inc. v. Great Am. Lloyds Ins. Co.*, 279 S.W.3d 650, 654 (Tex. 2009)). As such, the court could not infer facts that are not in the pleadings filed by Parr. *Id.*

Turning to the terms of the policy, Gilbane argued that the phrase "with respect to" in the additional insured endorsement, which has been interpreted as requiring something less than proximate cause, should govern the ultimate outcome. *Id.* (citing *Evanston Ins. Co. v. ATOFINA Petrochems., Inc.*, 256 S.W.3d 660, 666 (Tex. 2008)). Unlike in *Evanston*, though, the policy issued to Empire Steel explicitly required that the bodily injuries be "caused, in whole or in part, by" Empire Steel. *Id.* And, moreover, the Supreme Court has found that "caused by" requires proximate causation. *Id.* at 598 (citations omitted). "As such, Admiral owes Gilbane a duty to defend only if the underlying pleadings allege that Empire, or someone acting on its behalf, proximately caused Parr's injuries." *Id.*

Looking at the allegations against Gilbane, the court found that only one cause was alleged: "[Parr's] injuries were brought to occur, directly and proximately by reason of the negligence of the Defendants herein (the 'Gilbane Defendants')." *Id.* After quoting the pleading at length, the court noted that the District Court found that Parr was potentially contributorily negligent because "the injuries occurred when Parr was walking down the ladder with muddy boots." *Id.* But the allegations against Gilbane did not state as much, as they merely stated that Gilbane allowed the job site to become "slippery and hazardous," causing Parr's injuries. *Id.* At the district court level, the court agreed with Gilbane that the pleading did not foreclose the possibility that Parr was negligent and contributed to his own injuries. *Id.*

The Fifth Circuit rejected that position, however, finding that it improperly shifted the burden of proof to the insurer to establish that the pleadings against a potential insured *do not* potentially support a covered claim. *Id.* at 599. The court noted that the Supreme Court only has used the "potentiality" standard "to characterize the description of claims in the petition, determining whether they potentially were covered." *Id.* In employing that standard, courts cannot "imagine factual scenarios" that would trigger coverage. *Id.* (citation omitted). Thus, the district court only should have determined whether the facts pleaded against Gilbane "affirmatively implicated Parr's or Empire's negligence." *Id.* Applying that standard, the court found that the pleadings did not implicate either Parr's or Empire's negligence. *Id.* Accordingly, the court found that Admiral did not have a duty to defend.

The Fifth Circuit also rejected Gilbane's request that the court adopt an exception to the "eight corners" rule "even though the Texas Supreme Court has never done so." *Id.* at 600. The court explained that it was foreclosed from doing so by the Supreme Court's decision in *Pine Oak Builders*, where that Court had held that a duty to defend is not triggered even where the true factual circumstances would trigger such a duty but, "for whatever reason, has not been asserted." *Id.* The court refused to assume that a plaintiff is contributorily negligent for purposes of a duty to defend. *Id.* Explaining its position, the court noted that Texas law only requires a trier of fact to consider contributory negligence where an allegation of such is found in the pleadings and evidence to that end is presented at trial. *Id.* Further, the issue of Parr's negligence went to the merits of the underlying lawsuit as well as the coverage dispute, and in such situations the Supreme Court of Texas specifically has refused to create such an exception. *Id.*

(citing *GuideOne Elite Ins. Co. v. Fielder Road Baptist Church*, 197 S.W.3d 305, 309 (Tex. 2006)).

In addition, the court refused to follow Gilbane's argument that an exception to the "eight corners" rule should exist because Parr was unable to plead his employer's negligence without triggering workers' compensation issues. *Id.* Even though the pleading was silent as to the existence of the workers' compensation policy that precluded Parr's allegations of negligence against his employers, the court refused to recognize an exception where the true facts were known to the parties because the Supreme Court previously had refused the same exception. *Id.* at 601 (citing *Pine Oak Builders*, 279 S.W.3d at 655). In light of the foregoing, the court reversed the district court's ruling on the duty to defend.

C. The Duty to Indemnify

Unlike the duty to defend, the Fifth Circuit made quick work in upholding the district court's finding that a duty to indemnify existed. The facts proven at trial established that Parr was injured when he slipped on the ladder while carrying an extension cord in which he apparently got his feet wrapped. *Id.* On those facts, the district court found that a duty to indemnify existed because Parr would have been found at least 1% liable for his own injuries. *Id.* Admiral did not dispute the duty to indemnify issue on those facts, but on the argument that a duty to indemnify did not exist because the TCA was not an insured contract—an argument already rejected by the court in analyzing the duty to defend. *Id.* Accordingly, the court upheld the district court's ruling that Admiral had a duty to indemnify Gilbane for its settlement with Parr. *Id.* at 601–02.

D. Commentary

The decision in *Gilbane* is influential in that it upholds the Supreme Court of Texas' finding that a duty to indemnify can exist even absent a duty to defend. Such a scenario will remain likely in future cases in which employees are injured, as the court acknowledged the difficulties that arise in this context given the exclusive remedy provision in the workers' compensation statutes. In other words, the Fifth Circuit upheld the "eight corners" rule and—like the Supreme Court of Texas has done before it—refused to adopt a "true facts" exception. Despite the foregoing, insureds may be able to convince their insurers that a duty to defend is warranted on the front end in situations in which a duty to indemnify may be all but inevitable at the end of the day. After all, if the insurer is going to have to pay indemnity dollars to the claimant, then it may be in the insurer's best interest to control the defense of that litigation so as to minimize any such risk of indemnity.

XII. *Vines-Herrin Custom Homes, LLC v. Great American Lloyds Insurance Co.*, 357 S.W.3d 166 (Tex. App.—Dallas 2011, no pet.)

Just before the end of 2011, the Dallas Court of Appeals issued *Vines-Herrin Custom Homes, LLC v. Great American Lloyds Insurance Co.*, 357 S.W.3d 166 (Tex. App.—Dallas, 2011, no pet.). At issue before the court was the extent of proof necessary to establish "actual injury" and trigger coverage under a CGL policy.

A. Background Facts

The facts underlying the *Vines-Herrin* case can be summarized briefly. The insured homebuilder built a house that ultimately was purchased by Emil G. Cerullo. Completed in 2000, Cerullo noticed problems with the house within days of moving in. Damages began to occur in 2000 and continued into 2001 and 2002. When Vines-Herrin refused to repair the damages, Cerullo sued the company. Vines-Herrin tendered the suit to its insurers, which covered him from November 9, 1998 until September 18, 2002, but they disclaimed coverage. Ultimately, Vines-Herrin was found liable for more than $2 million in damages in an arbitration at which the insurers refused to participate. *Id.* at 168.

The insured initiated a coverage action and Cerullo intervened. Initially, in 2008, the case was tried utilizing the "manifestation" trigger rule. *Id.* at 169. While post-judgment motions were pending, the Supreme Court issued its decision in *Don's Building Supply* in which it adopted the "actual injury" trigger rule and specifically rejected the "manifestation" trigger. *Id.* Because of the change in law, the trial court vacated its judgment and reopened the evidence in order to determine when actual damage to the residence occurred. After hearing the evidence, the trial court rendered a take-nothing judgment in favor of the insurers. *Id.* In the judgment, the judge emphasized his concern that an exact date of when the damage occurred was not supplied by expert testimony. Rather, all that was determined was that there was an uninterrupted period of coverage and damages that manifested during that period. *Id.*

B. Establishing "Actual Injury"[2]

The court began its review of the merits of the appellants' arguments by addressing the holding in *Don's Building Supply*. In particular, the court emphasized that the Supreme Court made clear that, in determining CGL coverage, "the key date is when injury happens, not when someone happens upon it" and that the focus should be on "when damage comes to pass, not when damage comes to light." *Id.* at 171 (citing *Don's Bldg. Supply*, 267 S.W.3d at 22). Thus, damage occurs when it occurs, not when it is discovered. *Id.*

Looking at the facts set forth in the trial court's judgment, it was clear that the cause of damages to Cerullo's house was defective framing, and Cerullo suffered damages because of that issue. What was not clear was when those damages actually occurred. *Id.* The court explained:

> The judgment set out that evidence at the initial trial was "uncertain as to what date the damages occurred *(when the house was designed or sometime after the framing was constructed)*" and therefore the trial court reopened the evidence "for this limited purpose under the new guidelines set out by the Texas Supreme Court." Finally, the judgment noted that appellees had argued the court "should require [appellants] to identify what was the date of actual injury and which of the policies is triggered." The trial court agreed and determined that "although the Court believes that [appellants] have established, by a preponderance of the evidence, that the damages to Mr. Cerullo's home are covered by insurance and occurred within the periods of insurance coverage, [appellants] have again failed

[2] On appeal, the court first addressed a jurisdictional issue that is beyond the scope of this paper.

to show the date of the actual injury and therefore judgment for [appellees] is required."

Id. (emphasis in original).

It was clear from the trial court's judgment and amended findings of fact and conclusions of law that the court interpreted *Don's Building Supply* to require (1) an exact date of actual injury; and (2) expert testimony establishing that date. *Id.* at 172. The court of appeals disagreed, noting that the Supreme Court held only that "property damage under the CGL policy 'occurred when actual physical damage to the property occurred.'" *Id.* (citing *Don's Bldg. Supply*, 267 S.W.3d at 24). In that case, damage occurred when a home suffered wood rot or other property damage, and so long as that damage occurred during the policy period it was covered. *Id.* (citing *Don's Bldg. Supply*, 267 S.W.3d at 24).

With that background, the court addressed the duty to defend and the duty to indemnify in the instant case. First, the court found the petition, which noted the date of construction of the house (1999), the date of purchase (May 2000), and the date of manifestation of damages (by April 2001), sufficiently alleged "property damage" caused by an "occurrence" that triggered a duty to defend. More specifically, under the "eight corners" rule, it was sufficient that Cerullo alleged the house was built in 1999 and showed signs of damage by 2001 to trigger a duty to defend under each policy beginning with those provided by Great American Lloyds and which covered Vines-Herrin from November 9, 1998 to November 9, 2000, and continuing with those provided by Mid-Continent and which covered Vines-Herrin from November 9, 2000 to September 18, 2002. *Id.* at 173. In other words, a potential for coverage existed and, therefore, a duty to defend existed under each. *Id.*

With respect to the duty to indemnify, the court of appeals focused on the trial court's finding that a flood occurred in May 2000 and the resulting property damage manifested during the period insured by Great American's policy that was effective November 9, 1999 until November 9, 2000. *Id.* "As a matter of law, actual damages must occur no later than when they manifest; in other words, by the time damages manifest, they necessarily have occurred." *Id.* Because no dispute existed that the home suffered from defective framing, and such framing had to occur after construction began, and because Great American insured Vines-Herrin from a date before the house was constructed, actual damages must have occurred during Great American's coverage period. *Id.* This was especially true because no difference existed between the two policies issued by Great American. *Id.* "Thus, contrary to the trial court's determination otherwise, the evidence showed Great American's duty to indemnify was triggered, and expert testimony establishing the exact date of injury was not required to trigger the duty." *Id.*

C. Commentary

The *Vines-Herrin* decision is a very important case for insured contractors. One of the largest concerns following the issuance of *Don's Building Supply*—and a concern even the Supreme Court raised in its opinion—was the difficulty that would exist in establishing an exact date on which "property damage" occurred. As evidenced by this decision, though, the task may not be as onerous as once thought. More specifically, so long as it can be determined that the damage occurred during a particular period, or consecutive periods covered by the same insurer

under nearly identical policies, then coverage should exist. Simply put, at least as far as the Dallas Court of Appeals is concerned, an insurer should not be able to escape its duty to indemnify merely because its insured cannot identify the precise date and time when damage occurred. The coverage under a CGL policy is the same whether the damage occurs on the first day of the policy or the last and thus, an insured should be entitled to the benefit of its bargain if it can establish that damage occurred on one of those dates or anywhere in between.

XIII. *GEICO General Insurance Co. v. Austin Power, Inc.*, 357 S.W.3d 821 (Tex. App.—Houston [14th Dist.] 2012, no pet.)

The New Year began where 2011 left off, as the Fourteenth District Houston Court of Appeals addressed an insurer's duty to defend its insured where an exact date of injury was not alleged in the pleading against the insured. *See GEICO General Ins. Co. v. Austin Power, Inc.*, 357 S.W.3d 821 (Tex. App.—Houston [14th Dist.] 2012, no pet.).

A. Background Facts

In *GEICO*, an underlying lawsuit existed in which Weldon Bradley and his wife claimed that Austin Power, Inc., among others, was responsible for injuries he suffered in connection with exposure to asbestos-containing products and machinery. *Id.* at 823. The Bradleys did not identify the specific date on which his injuries occurred. *Id.* Ultimately, Austin Power was dismissed from the case, but sought recovery from its insurer for the defense costs it incurred in defending the *Bradley* lawsuit. *Id.*

GEICO's predecessor insured Austin Power from December 31, 1969 to December 31, 1970, and had a duty to defend Austin Power "against any claims arising out of an occurrence that results in bodily injury during the coverage period, even if the allegations are groundless, false or fraudulent." *Id.* The trial court granted summary judgment in favor of Austin Power, and GEICO appealed, contending that the pleadings lacked a "specific temporal factual allegation" and therefore was not a potentially covered claim that could trigger a duty to defend.

B. The Duty to Defend

In analyzing the duty to defend, the court agreed that a specific date of injury was not alleged. *Id.* at 824. Nevertheless, the court found "other indications of time of injury." *Id.* In particular, the court stated:

> Plaintiffs alleged that Austin Power "created hazardous and deadly conditions to which Mr. Bradley was exposed and which caused him to be exposed to a large amount of asbestos fibers." By re-incorporation, the plaintiffs alleged that Mr. Bradley was exposed to asbestos "on numerous occasions," and that "each exposure" caused or contributed to his injuries. In the conspiracy count against all defendants, we find the allegation that "for many decades, Defendants [acted] . . . individually, jointly and in conspiracy with each other and other entities . . . ." Finally, the plaintiffs alleged damages resulting from "asbestos-related lung disease."

Id.

In arguing that the foregoing is insufficient to trigger a defense obligation, GEICO sought to distinguish the holding in *Gehan Homes Ltd. v. Employers Mutual Casualty Co.*, 146 S.W.3d 833 (Tex. App.—Dallas 2004, pet. denied), in which the insured was sued for "past" bodily injuries and property damage. The Dallas Court of Appeals construed the pleadings liberally as required under Texas law, finding that the insurer did not establish that no potential for coverage existed within the policy period. *Id.* at 846.

GEICO contended that *Gehan Homes* was distinguishable because the *Bradley* petition did not include the signifier, "past". *GEICO*, 357 S.W.3d at 825. But just like in *Gehan Homes*, the underlying plaintiffs in the instant dispute used the past tense in alleging that Weldon Bradley "*has suffered* injuries" from asbestos exposure. *Id.* (emphasis in original). Further, the Bradleys alleged numerous exposures and a decades-long conspiracy. Moreover, it can take years of exposure to produce asbestos-related diseases. *Id.* (citations omitted). The court stated:

> In effect, the Bradleys alleged that Weldon was injured sometime before the petition was filed. Nothing in the pleadings negates the possibility that the injury occurred between December 31, 1969 and December 31, 1970. Construing the pleadings liberally and resolving any doubts in the insured's favor, we agree with the trial court that this is an allegation of a potential occurrence within the policy's coverage period.

Id. See also id. (rejecting GEICO's claim that *Gehan Homes* also was distinguishable because the court of appeals placed the burden of proof on the insurer to establish a lack of coverage, as the court noted that as a movant for summary judgment, the insurer does have that burden).

GEICO also claimed that under *Pine Oak Builders, Inc. v. Great American Lloyds Insurance Co.*, 279 S.W.3d 650 (Tex. 2009), the court could not infer a claim that might have been, but was not, alleged. *GEICO*, 357 S.W.3d at 825–26. In *Pine Oak*, however, the insured sought to introduce extrinsic evidence that would have brought the claim against within coverage. The extrinsic evidence, though, contradicted the pleadings and, therefore, the Supreme Court refused to read facts into the pleadings that were not actually alleged. *Id.* at 826. In the instant case, the Houston Court of Appeals noted that Austin Power's coverage claim was not dependent on extrinsic evidence, but on the allegations themselves when liberally construed under well-established Texas law. In particular, "[t]he allegations in the *Bradley* petition, when construed liberally in favor of Austin Power, support the inference that Weldon's injury potentially occurred during the policy period, and therefore the claim is potentially covered. This is sufficient to trigger GEICO's duty to defend the suit." *Id.*

C. Commentary

The decision in *GEICO* is another example of the liberal standards applied to the duty to defend. In particular, the opinion correctly follows in the footsteps of *Gehan Homes* and even the recent *Vines-Herrin* decision (although it was not cited by the court in *GEICO*). Put simply, even a date-deprived pleading can be sufficient to trigger a duty to defend, so long as *some* indication of timing of damages is alleged.