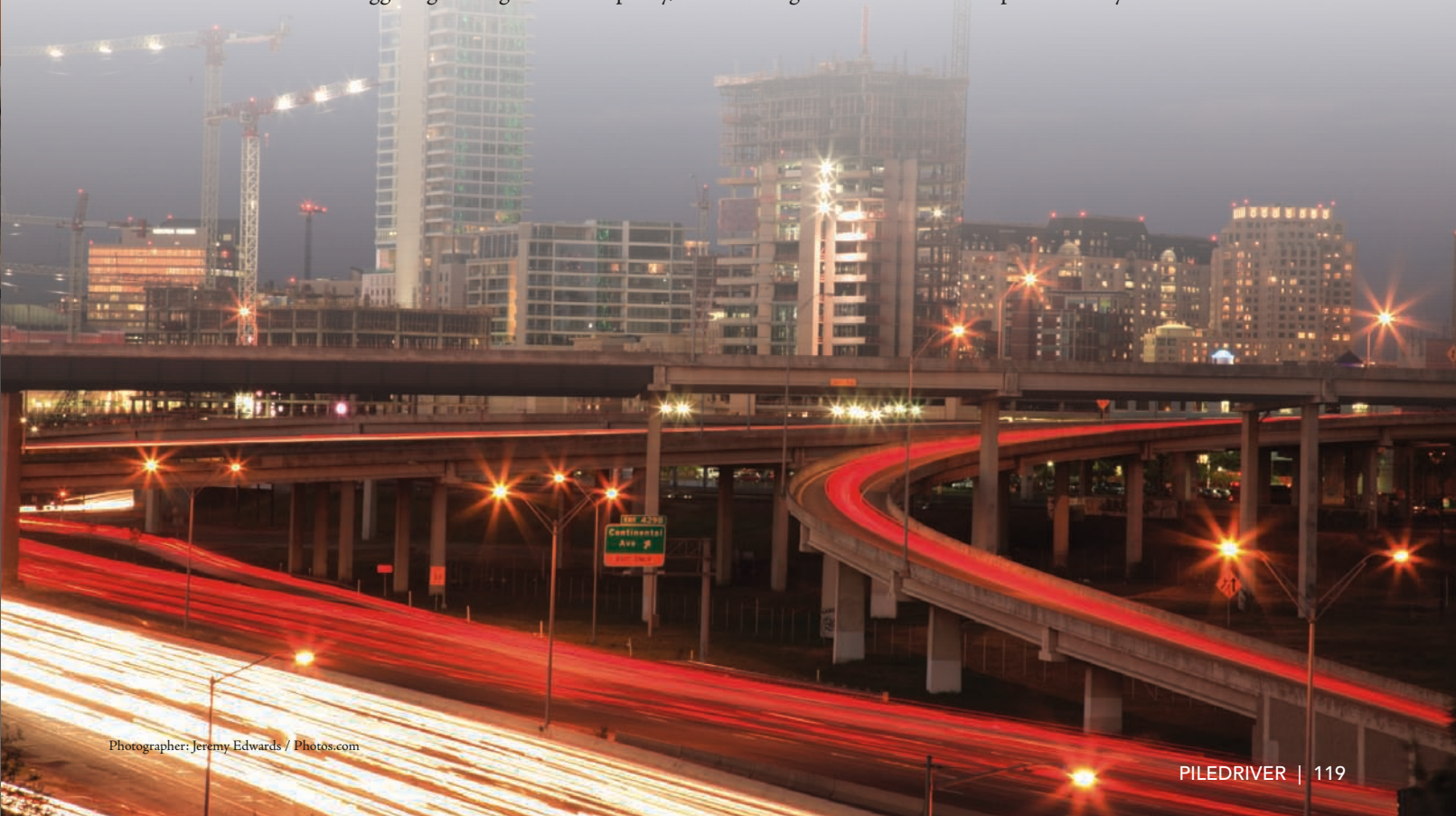
Changes to Comprehensive General Liability?

Insurance coverage for construction defects in Texas may be in jeopardy

By C. Ryan Maloney, Foley & Lardner LLP

Those in the construction industry doing work in Texas should be aware of a pending court decision that could have the potential to drastically limit the scope of insurance coverage for claims of defective construction work in Texas under the standard Comprehensive General Liability (CGL) insurance policies most commonly used in the industry. As background, it should first be understood that CGL policies do not always provide coverage for property damage resulting from faulty construction work. Often, this is because defective work is either not considered to be an "occurrence" triggering coverage under the policy, or if it is considered an "occurrence," the standard "your work" exclusion in CGL policies, which excludes coverage for "[w]ork or operations performed by or on your behalf," is applied to exclude coverage. However, in a number of jurisdictions, such as Texas and Florida for example,[1] defective work is considered an "occurrence" and the standard "subcontractor" exception to the "your work" exclusion, which provides that the "your work" exclusion does not apply to work "performed on your behalf by a subcontractor," has been read to provide insurance coverage for certain types of property damage arising out of defective work performed by a subcontractor.



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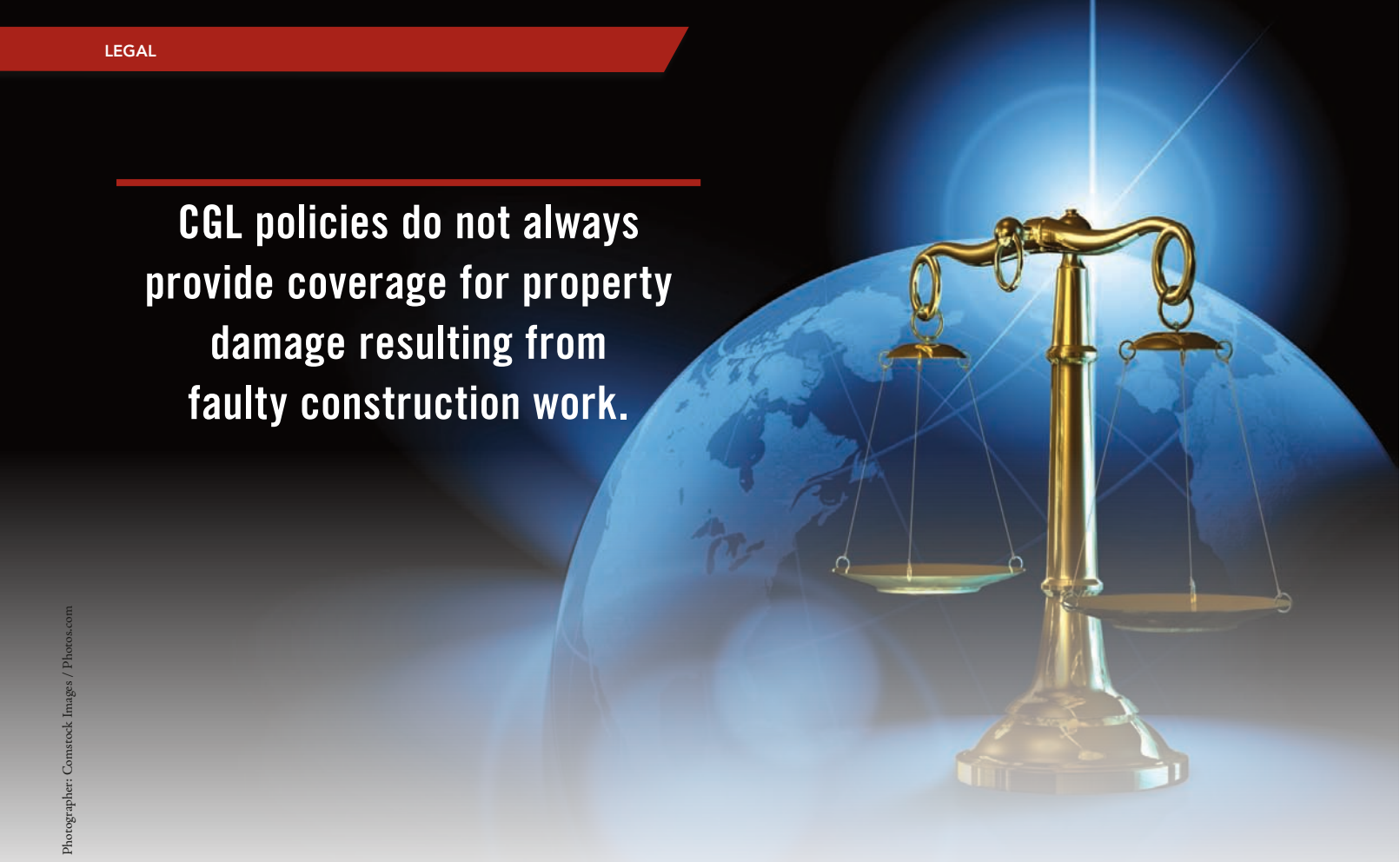

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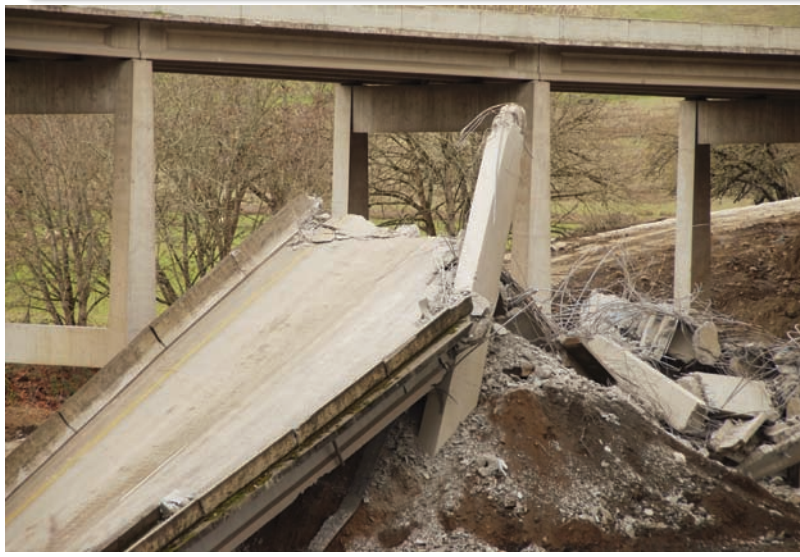
However, in June 2012, the Fifth Circuit Court of Appeals, the federal appellate court covering Texas, Louisiana and Mississippi, issued a ruling in Ewing Construction Co. v. Amerisure Insurance Co.,[2] that, if its reasoning is approved by Texas Supreme Court, could drastically change the scope of such coverage under CGL policies in Texas. In Ewing, the insured contractor had contracted with a school district to construct tennis courts at a school. Soon after the tennis courts were completed, they started cracking and flaking, rendering them unfit for tennis. The school district sued the contractor for breach of contract and negligence alleging defective work by the contractor and/or its subcontractors.

Because the allegations by the school district included claims of defective work by subcontractors, under prior law in Texas, this would have triggered the subcontractor exception to the "your work" exclusion in the CGL and created at least a duty for the insurer to defend the contractor.[3] However, the insurer denied coverage, relying on the standard contractual liability exclusion in the CGL, which excludes coverage for "damages by reason of the assumption of liability in a contract or agreement."

The Fifth Circuit in Ewing agreed with the insurer, holding that by entering into a contract to construct the tennis courts, the insured contractor had by definition "assumed liability for defective construction" and therefore triggered the contractual liability exclusion under the policy. The court rejected the contractor's argument that simply entering into the construction contract was not the same as expressly assuming liability for faulty workmanship under the contract, and also rejected the argument that an exception to the contractual liability exclusion for liability the insured would otherwise have in absence of the contract applied. Instead, the Ewing Court held that the plain language reading of the



contractual liability exclusion called for in a prior decision by the Texas Supreme Court in Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London,[4] required that the exclusion apply to any assumption of contractual liability. The Ewing Court also held that the construction contract was the only source of any liability for the construction defect claims against the contractor, so the exception for liability the contractor otherwise would have had absent the contract did not apply.

Despite the fact that the prior Gilbert decision by the Texas Supreme Court involved unique facts in which the insured contractor had actually expressly assumed responsibility in the contract to pay damages to third parties in a manner not present in Ewing, the Fifth Circuit's Ewing decision significantly expanded the effect of Gilbert to essentially preclude coverage in Texas for any defective construction work if the work was performed pursuant to a construction contract, thereby also rendering the "your work" exclusion and "subcontractor" exception in the CGL meaningless in most cases. As recognized by the dissenting judge in Ewing, this represented a significant expansion of the contractual liability exclusion and a significant change in Texas insurance law.[5]

On Aug. 8, 2012, recognizing that its opinion raised important issues of Texas law that could have a significant impact on insurance law and the bargained for expectations of parties to CGL polices in Texas, the Fifth Circuit withdrew its Ewing opinion from June 2012 and certified the issue to be decided by the Texas Supreme Court.[6] The Texas Supreme Court has taken up the issue, but a decision is not expected for several months.

This situation bears close watching by those in the construction industry, particularly those working in Texas. Although the Texas Supreme Court could decide to limit the scope of the contractual liability exclusion or find the exception for liability otherwise existing applicable, it could also agree with the broad interpretation of the contractual liability exclusion by the Fifth Circuit in Ewing, which would effectively eliminate insurance coverage for any construction defect claims in Texas. In either case, the Texas Supreme Court's decision could also potentially be persuasive to courts in other states, and so is important to those in the construction industry outside Texas as well. ▼

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References

1. See Lamar Homes, Inc. v. Mid-Continent Casualty Co., 242 S.W.3d 1, 4 (Tex. 2007); United States Fire Ins. Co. v. J.S.U.B., Inc., 979 So. 2d 871 (Fla. 2007).
2. Ewing Const. Co. v. Amerisure Ins. Co., 684 F.3d 512 (5th Cir. 2012).
3. It might have also created a duty to indemnify the contractor for damages caused by defective subcontractor work, but only to the extent determined by proof in the case.
4. Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London, 327 S.W.3d 118 (Tex. 2010).
5. Ewing, 242 S.W.3d at 527, n.6 (dissent).
6. Ewing Constr. Co. v. Amerisure Ins. Co., Case No. 11-40512, 2012 U.S. App. LEXIS 16493 (5th Cir. Aug. 8, 2012).