



Texas Supreme Court Issues One of the Most Significant Insurance Coverage Opinions for 2010 – Contractual Liability Exclusion is not Restricted to Indemnity Agreements

Three years ago, the Texas Supreme Court found that claims for breach of contract may be covered under comprehensive general liability (CGL) policies. *See Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007) (disregarding the traditional view that breach of contract does not amount to an “occurrence” under the original coverage grant in a CGL policy). The *Lamar Homes* opinion was viewed as a landmark opinion favoring policyholders, particularly in the area of coverage for construction defect claims. Insurers considered the *Lamar Homes* opinion to be a substantial broadening of liability coverage under Texas law, a trend developing over the last five years in other jurisdictions in the United States.

In 2010, the Texas Supreme Court had its first opportunity to interpret the standard ISO contractual liability exclusion that is found in many CGL policies in *Gilbert Tex. Constr. Co. v. Underwriters at Lloyd’s London*, No. 08-0246 (Tex., Dec. 17, 2010). The case involved a coverage dispute between Underwriters at Lloyd’s, London and Gilbert Texas Construction Co.¹ Gilbert sought coverage for a settlement of claims asserted by third parties who suffered flood damage to a high rise office building in Dallas, Texas. The third parties brought tort and contract claims against Gilbert, a contractor on the Dallas Area Rapid Transit (DART) project, claiming that Gilbert was negligent and breached its contract with DART to protect and repair the property of third parties adjacent to the construction site. The trial court dismissed the tort claims after finding Gilbert immune from liability for negligence due to its status as a governmental contractor.

The coverage suit filed by Gilbert² claimed that Underwriters owed a duty to indemnify Gilbert for the settlement of the breach of contract claim despite Exclusion 2(b) in the standard ISO CGL form, which states:

¹ Gilbert is a division of Kiewit, one of the largest construction contractors in the United States.

² Gilbert sued Underwriters for breach of contract, treble damages under the Texas Insurance Code and estoppel, alleging damages in excess of \$25 million.



This insurance does not apply to:

...

- b. *Bodily injury or property damage for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:*
- (1) *Assumed in a contract or agreement that is an “insured contract;” or*
 - (2) *That the insured would have in the absence of the contract or agreement.*³

Relying on treatises and out-of-state precedent,⁴ Gilbert argued that Exclusion 2(b) was expressly limited to situations where the insured assumes the liability of a third party, *i.e.* indemnity agreements. Gilbert urged the Court to adopt the reasoning of the courts from the majority of states in the United States that presumed that Exclusion 2(b) was restricted to indemnity agreements and did not exclude coverage for breach of contract claims.

In determining the scope of this exclusion, the Court issued an opinion:

- (1) holding that the standard contractual liability exclusion in CGL policies is not limited to indemnity agreements, and
- (2) rejecting the insured’s motion for rehearing, which was supported by numerous *amicus curiae* policyholder associations and construction industry trade groups.

In doing so, the Court emphasized that an insurance policy is construed by its plain language and, contrary to out-of-state precedent and treatises, cannot be rewritten judicially to narrow its scope.

³ The standard ISO CGL policy defines “insured contract” in part as:
That part of any other contract or agreement pertaining to your business under which you assume the tort liability of another to pay damages because of bodily injury” or “property damage” to a third person or organization . . . Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

⁴ The Court rejected the holdings of *Federated Mutual Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 2001), *Olympic Inc. v. Providence Washington Ins. Co.*, 648 P.2d 1008 (Alaska 1982), and *Am. Family Mut. Ins. Co. v. Am. Girl, Inc.*, 673 N.W.2d 65 (Wis. 2004).



The Texas Supreme Court then held that the plain terms of the exclusion showed that it could extend beyond indemnity and hold harmless agreements. Specifically, the Court found:

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

To determine if the second exception applies, one must ascertain whether the insured proved it would have had liability for damages absent its contractual undertaking. In this case, Gilbert had been found immune from tort liability in the underlying action. Thus, the Court held that Gilbert would not have had liability outside its contractual obligations, and the exception did not apply. The Court affirmed the opinion of the Dallas Court of Appeals that no coverage exists.

Numerous insurance coverage treatises have recognized the Texas Supreme Court's opinion in *Gilbert Tex. Constr. Co. v. Underwriters at Lloyd's London* as a significant decision impacting liability insurance coverage in the United States. The National Insurance Law Forum listed the *Gilbert* opinion as one of the "most influential opinions of 2010."

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

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