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NO. 14-0753

IN THE SUPREME COURT OF TEXAS

U.S. METALS, INCORPORATED,
Plaintiff-Appellant,

v.

LIBERTY MUTUAL GROUP, INCORPORATED,
Doing business as
Liberty Mutual Insurance Corporation
Defendant-Appellee.

On Certified Questions from the United States Court of Appeals for the Fifth Circuit, New Orleans, Louisiana

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BRIEF OF AMICI CURIAE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, TEXAS BUILDING BRANCH – ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ABC OF TEXAS, AMERICAN SUBCONTRACTORS ASSOCIATION, INC. AND ASA OF TEXAS, INC. IN SUPPORT OF APPELLANT U.S. METALS, INC.

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TABLE OF CONTENTS

TABLE OF AUHORITIES

Cases

Statutes and Codes

BRIEF OF AMICI CURIAE

Amici Curiae Associated General Contractors of America, Texas Building Branch – Associated General Contractors of America, ABC of Texas, American Subcontractors Association, Inc. and ASA of Texas, Inc. (collectively "Amici Curiae") submit this brief in support of Appellant U.S. Metals, Inc. ("U.S. Metals").

STATEMENT OF INTEREST OF AMICI CURIAE

This Amici Curiae Brief speaks for the state and local chapters of the largest construction trade associations in the United States. The sponsorship of these organizations underscores the importance of the insurance coverage issues currently on appeal for Texas construction businesses. This brief is filed in support of Appellant.

The Associated General Contractors of America ("AGC") is a nationwide trade association of construction companies and related firms. It came into existence in 1918 and it has become the recognized leader of the construction industry in the United States. Today, it has more than 26,500 members in 94 chapters stretching from Puerto Rico to Hawaii. These members construct both public and private buildings, including offices, apartments, hospitals, laboratories, schools, shopping centers, factories and warehouses. They also construct a broad range of other structures, such as highways, bridges, tunnels, dams, airports,

industrial plants, pipelines, power lines and both clean and waste water facilities. Together, the broad range of these activities and the many risks inherent in the business of construction lead AGC to take a great interest in the standard form insurance policies marketed and sold to its members and how the courts interpret those policies.

The Texas Building Branch of the Associated General Contractors of America ("TBB – AGC") is a branch of AGC. TBB – AGC encompasses eleven AGC building chapters located throughout Texas. The membership of these eleven chapters consists of approximately 370 general contractors and 3,890 specialty contractors, subcontractors and suppliers, all doing business in Texas.

ABC of Texas is a state trade association consisting of seven local ABC chapters in Texas made up of over 1,700 members representing merit shop contractors who strongly subscribe to free enterprise principles. Those chapters include Greater Houston, Texas Gulf Coast (Freeport), Texas Mid Coast (Victoria), Texas Coastal Bend (Corpus Christi), South Texas (San Antonio), Central Texas (Austin) and TEXO (Dallas – Fort Worth and East Texas).

The American Subcontractors Association ("ASA") is a national organization of construction trade contractors. Founded in 1966, ASA leads and amplifies the voice of trade contractors to improve the business environment in the construction industry and to serve as stewards for the community. ASA dedicates

itself to improving the business environment in the construction industry, with an emphasis on ethical and equitable business practices, quality construction, membership diversity, integrity, and a safe and healthy work environment. ASA has 5,000 members nationwide, including 500 members from five Texas chapters in Houston, North Texas, San Antonio, the Rio Grande Valley, and statewide.

AGC, TBB – AGC, ABC of Texas and ASA members conduct significant amounts of business in Texas and provide employment for many Texas citizens. Those members are major purchasers of insurance and insurance-related services governed by Texas insurance law. Because of their unique perspective as influential representatives of broad segments of the construction industry in Texas and the United States, Amici Curiae have submitted amicus curiae briefs to this Court on many occasions, including cases affecting the insurability of and coverage for risks encountered on construction projects such as *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1 (Tex. 2007) and *Ewing Constr. Co., Inc. v. Amerisure Ins. Co.*, 420 S.W.3d 30 (Tex. 2014). This is another of those cases, since the Court's ruling in this case could jeopardize the insurance coverage previously reaffirmed in *Lamar Homes*.

Whether AGC, TBB – AGC, ABC of Texas and ASA members can depend on their commercial general liability insurance policies for coverage for the many risks they face is a matter of continuing and urgent interest to them. Consequently,

although Amici Curiae are not parties to this appeal, this brief has been submitted through the undersigned independent attorneys, who were paid a fee by Amici Curiae to prepare it.

CERTIFIED QUESTIONS PRESENTED

1. In the "your product" and "impaired property" exclusions, are the terms "physical injury" and/or "replacement" ambiguous?

Amici Curiae adopt the arguments made by U.S. Metals, urging the Court to answer the first certified question "yes."

2. If yes as to either, are the aforementioned interpretations offered by the insured reasonable and thus, must be applied pursuant to Texas law?

Amici Curiae adopt the arguments made by U.S. Metals that the ambiguity as to these policy terms must be resolved in favor of U.S. Metals.

3. If the above question 1 is answered in the negative as to "physical injury," does "physical injury" occur to the third party's product that is irreversibly attached to the insured's product at the moment of incorporation of the insured's defective product or does "physical injury" only occur to the third party's product when there is an alteration in the color, shape, or appearance of the third party's product due to the insured's defective product that is irreversibly attached?

Regardless of the resolution of Certified Question No. 2, Amici Curiae urge the Court to determine that physical injury can take place at the time of incorporation of the insured's defective product or work into other property in that there is an alteration in the color, shape or appearance of the other property due to the irreversible attachment to, or incorporation of the insured's product or work

into it. The other property into which the defective product or work is incorporated is also physically injured when the defective work or product is repaired, removed or replaced and in the process the other work is damaged.

4. If the above question 1 is answered in the negative as to "replacement," does "replacement" of the insured's defective product irreversibly attached to a third party's product include the removal or destruction of the third party's product?

The fourth certified question should be answered "no," based upon the plain language of the policy.

INTRODUCTION AND SUMMARY OF ARGUMENT

The proposition that an insurer should not be obligated to pay claims that are outside the coverage of the policy it issued is not astounding. However, there is a tendency on the part of some insurers to deny claims that are more than arguably within the coverage of the policy. This is particularly true as to claims under commercial general liability ("CGL") policies involving alleged defective products supplied by insured manufacturers and alleged defective workmanship performed by insured contractors. Despite the efforts of insureds to control the quality of their products or work, defects may occur, and insureds purchase CGL insurance policies to cover unintended property damage arising out of those circumstances.

The facts underlying the certified questions presented to this Court represent a scenario that manufacturers and contractors often face. Manufacturers and contractors both supply, install or incorporate smaller components into larger

industrial plants or construction projects. Once installed or incorporated, defects in the insured's product or work usually must be repaired or corrected, and frequently, that repair or correction, whether by repair or removal of the defective component or work and its replacement, can seriously damage the overall project or property. While the facts of such claims are relatively straightforward, often the cost of rectifying the defects can be devastating and well beyond the cost of the defective component itself, or even the cost of the entire property or project.

What is not quite so straightforward is the application of the standard CGL policy to the damage caused to the property or project into which the defective product or work is incorporated. It is the complexity of the application of the CGL policy to this type of damage, together with the potential for huge uninsured losses, which prompted the construction industry to sponsor this amici curiae brief through the state and national chapters of the AGC, ABC and ASA. For a construction insured, the risk of causing extensive damage to other work in repairing or correcting defective work after incorporation into a complex construction project is equivalent to the risk of the incorporation of a manufacturer's defective product into a larger product and is equally catastrophic. In the construction context, these types of damages are called "rip and tear" damages, representing the cost of ripping and tearing out otherwise conforming work to repair or correct the defective work.

As to this particular claim on appeal, U.S. Metals supplied flanges for use in the piping of the "non-road diesel" (NRD) facilities at two Exxon refineries. The flanges were welded into the NRD units by a separate contractor, and then the flanges and pipes were insulated. Therefore, the flanges were irreversibly incorporated into the piping system of the NRDs. One defective flange leaked during testing. Further testing in the two refineries indicated that at least 19 others exhibited the same defect, and that none of them met applicable industry standards, so Exxon ordered that all of the 350 flanges be removed, seeking reimbursement from U.S. Metals for a $20,000,000 claim that was settled for approximately $6,000,000.

These facts represent a classic scenario where non-defective products (or good work) must be ripped and torn out in order to repair or replace defective products (or work). The hallmark of this type of operation is that the costs of ripping and tearing out the non-defective work in order to repair and replace the defective work far exceeds the cost of the defective work itself. In other words, the cost of removing and replacing the defective flanges that had been welded into the piping system of the NRDs far exceeded the cost of the flanges themselves.[1]

[1] No claim was made by U.S. Metals for the defective flanges themselves since coverage was apparently excluded for that portion of the claim under Exclusion k, the Your Product Exclusion, in the Liberty Mutual policy and there is no dispute as to those costs.

U.S. Metals submitted its claim to Appellee, Liberty Mutual Group ("Liberty Mutual"), for indemnification for the settlement with Exxon. Unfortunately, but all too predictably, Liberty Mutual denied the claim. In subsequent litigation, the District Court applied Exclusion m, holding that the Liberty Mutual policy did not cover the damages claimed by U.S. Metals. On appeal to the Fifth Circuit, that Court certified questions regarding applicability of Exclusion m to this Court, in *U.S. Metals, Inc. v. Liberty Mut. Group, Inc.*, 589 Fed.Appx. 659 (5th Cir. 2014).

While the original underwriting intent of Exclusion m was primarily to exclude coverage for loss of use claims, i.e., losses not necessarily involving physical injury to property, the arguments of some insurers seek to extend the scope of the exclusion to exclude coverage for rip and tear damages on the pretense that such damages simply amount to the cost of repairing or replacing the insured's own defective product or work. However, the plain language of the policy does not support that interpretation and nowhere in the policy is the term "property damage" limited to damage to only third party property. Insurers have made these arguments in other contexts, and they have been rejected. Moreover, attempts to make an end run around legitimate coverage by distinguishing between "satisfactory versus unsatisfactory status of property," and by introducing concepts foreign to the policy such as "combined product," should be similarly rejected by this Court. Moreover, Liberty Mutual's attempt to extend the term "replacement"

beyond the defective product or work itself in order to expand the scope of Exclusion m, and thereby reduce coverage, should also be rejected.

All of these positions advocated by insurers fly in the face of affirmation by this Court in *Lamar Homes v. Mid-Continent Casualty*, that physical injury to tangible property arising out of defective workmanship, as long as that physical injury to tangible property is unexpected and unintended by the insured, is within the coverage grant of the CGL policy. In that same opinion, the Court quite properly directed both the insurance industry and the construction industry to look to the policy exclusions in order to sort out coverage for complex construction defect claims. Of course, it is clear that not every policy exclusion will apply to deny coverage to the insured. In fact, in *Lamar Homes,* this Court further acknowledged that provisions such as the exception for property damage arising out of the work of subcontractors provides a contractor with coverage for defective work. Likewise, here, even though Exclusion m is extremely, if not overly, complex, proper application in conformance with this Court's prior directives as to determination of coverage for defective products or work leads to the conclusion that only the costs of the U.S. Metals-supplied defective flanges themselves are excluded, and it is entitled to coverage for the property damage to the other piping, insulation and other elements of Exxon's NRDs that were damaged by the repairs.

The oversimplification of the rip and tear coverage issue to mere physical injury to the insured's product or work versus physical injury to other property or work is a handy dichotomy for the insurance industry. However, it interjects uncertainty, unpredictability, and an unforeseen loss of coverage into these claims, once again, placing Texas contractors and other insured business at risk for unpredicted losses. That lack of predictability not only strikes at the heart of the construction industry's ability to manage its business effectively, but also the underpinnings of insurance as a legitimate tool for risk management.

Contractors in Texas and throughout the United States face these issues, and members of AGC, ABC and ASA must regularly manage the considerable risks associated with building construction, and as previously stated, those risks often exceed the value of the product or work itself. The construction industry as a whole has the difficult task of simultaneously protecting itself against these risks and maintaining itself as one of the driving forces behind the economic well-being of this state and nation. While contractors and subcontractors are usually successful in providing quality construction services, inadvertent mistakes occasionally occur, including mistakes that may result in defective construction. Construction insureds pay substantial premiums for liability insurance to protect them from property damage arising out of inadvertent and alleged construction defects.

Every construction insured seeks, and pays premiums for, predictability and consistency in the manner in which its liability insurance policies apply in the event of a claim. For this reason, Amici Curiae seek to inform the Court of the serious consequences of an improvident application of Exclusion m to property damage arising out of the ripping and tearing out of other work in order to repair defective work. The position advocated by insurers does not follow the original underwriting intent behind the promulgation of Exclusion m, that is, to address (then exclude) coverage for primarily economic losses not involving property damage.

The Impaired Property Exclusion was added to the standard CGL policy form in 1986, and for years the exclusion was relegated by insurers to rote citation within a string of other "business risk" exclusions as a basis for denying claims on the pretext that they involved defective work. That shallow treatment left a bad taste in insureds' mouths and added little to clarity of analysis. This Court now has a chance to provide needed guidance in an opinion devoted solely to various aspects of Exclusion m.

It is not the purpose of this brief to reiterate the arguments made by U.S. Metals; rather, Amici Curiae adopt those arguments and will provide this Court with a broader picture as to how the position urged by Liberty Mutual is contrary

to the drafting, interpretation and marketing of CGL insurance policies to the construction industry.

Due to the complexities of Exclusion m as applied to this and other claims, the exclusion is ambiguous and Certified Question No. 1 should be answered "yes," and the interpretation of U.S. Metals should be upheld as more reasonable than Liberty Mutual's interpretation in response to the second question. As to Certified Question No. 3, physical injury can take place at incorporation of the insured's defective product or work into other property as an alteration in the color, shape or appearance of that property due to irreversible attachment to it. The other property into which the defective product or work is incorporated is also physically injured when the defective work or product is repaired, removed or replaced. Finally, Certified Question No. 4 should be answered "no," based upon the applicable unambiguous definitions in the policy.

ARGUMENT AND AUTHORITIES

I. A DEFECTIVE PRODUCT OR WORK PHYSICALLY INJURES THE OTHER PROPERTY INTO WHICH IT IS IRREVERSIBLY INCORPORATED, ATTACHED OR INSTALLED

The certified questions before this Court involve the application of Exclusion m, the Property Not Physically Injured or Impaired Property Exclusion. For simplicity's sake, this brief will refer to this provision as either Exclusion m or the Impaired Property Exclusion, to which it is more often referred.

In addressing the coverage issues presented on appeal, this Court applies the same rules of construction that apply to contracts in general. *National Union Fire Ins. Co. of Pittsburgh, PA v. Crocker*, 246 S.W.3d 603, 606 (Tex. 2008). Effectuating the parties' expressed intent is the primary concern for a court. *Forbau v. Aetna Life Ins. Co.*, 876 S.W.2d 132, 133 (Tex. 1994). However, if a contract is susceptible to more than one reasonable interpretation, the court will resolve any ambiguity in favor of coverage. *Id.* at 938. Nevertheless, policy terms are given their ordinary and commonly understood meaning unless the policy itself shows the parties intended a different, technical meaning. *Gonzalez v. Mission American Ins. Co.*, 795 S.W.2d 734, 736 (Tex. 1990). No one phrase, sentence or section of the policy should be isolated from its setting and considered apart from the other provisions. *Forbau*, 876 S.W.2d at 134. In other words, the insurance contract must be interpreted as a whole so as to give meaning to all of its provisions. *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462, 464 (Tex. 1998). Finally, the court must give the policy's words their plain meaning, without inserting additional provisions into the contract. *Gilbert Texas Constr., LP v. Underwriters at Lloyd's London*, 327 S.W.3d 118, 126 (Tex. 2010).

Exclusion m is complicated if for no other reason than its sheer length, the text of which spans nearly a full page in a legal brief of this type, providing that the insurance does not apply to:

m. Damage To Impaired Property Or Property Not Physically Injured

"Property damage" to "impaired property" or property that has not been physically injured, arising out of:

(1) A defect, deficiency, inadequacy or dangerous condition in "your product" or "your work"; or

(2) A delay or failure by you or anyone acting on your behalf to perform a contract or agreement in accordance with its terms.

This exclusion does not apply to the loss of use of other property arising out of sudden and accidental physical injury to "your product" or "your work" after it has been put to its intended use. [R.2196.]

The term "impaired property" is defined as:

8. "Impaired property" means tangible property, other than "your product" or "your work", that cannot be used or is less useful because:

a. It incorporates "your product" or "your work" that is known or thought to be defective, deficient, inadequate or dangerous; or

b. You have failed to fulfill the terms of a contract or agreement;

if such property can be restored to use by the repair, replacement, adjustment or removal of "your product" or "your work" or your fulfilling the terms of the contract or agreement. [R.2204.]

In addition to its sheer length, it is incontrovertible that the exclusion is extremely complex due to the fact that it applies to two separate types of property,

i.e., property that has not been physically injured[2] or impaired property, and because the exclusion and definitions are subject to exceptions. In addition, the accompanying definition of impaired property has several parts. This has led numerous courts to conclude that the exclusion as a whole is ambiguous.[3]

The parties to this appeal have extensively briefed and argued whether the terms "your product" and "physical injury" are ambiguous within the context of Exclusion m, and Amici Curiae adopt the arguments of U.S. Metals that the reasonableness of its position dictates that any ambiguity must be resolved in favor of coverage for it as the insured. While the Impaired Property Exclusion certainly provides fertile ground to sow the seeds of ambiguity, this brief has been submitted to address the significant issues presented by Certified Questions 3 and 4, in the event the Court resolves Questions 1 or 2 adversely to U.S. Metals. Consideration of the plain and ordinary meaning of the exclusionary language, the definition of

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[2] The exclusion applies in two types of scenarios. This appeal does not involve the scenario where the sole basis is loss of use of property that has not been physically injured. This type of claim falls within the "property not physically injured prong" of the exclusion. In contrast, the claim before this Court involves physical injury to tangible property and is addressed under the "impaired property prong" of the exclusion.

[3] *See McKinney Builders II, Ltd. v. Nationwide Mut. Ins. Co.*, 1999 WL 608851, at *9 (N.D. Tex. Aug. 11, 1999) (Exclusion m is ambiguous by excluding coverage for impaired property incorporating the insured's defective work, but the same allegations can be construed as alleging physical injury to property, and the exclusion does not apply); *Computer Corner, Inc. v. Fireman's Fund Ins. Co.*, 46 P.3d 1264, 1269-70 (N.M. App. 2002) (finding Exclusion m's borrowing of the defined terms "your product" and "your work" from other parts of the policy, and combining them with the definition of "impaired property" renders the exclusion "non-sensical," making it difficult to believe that anyone genuinely interested in communicating information to another, whether in a cookbook, home appliance manual or contract, would employ that type of "convoluted, intractable language" used in the policy).

"impaired property" and the definitions of "your product" and "your work," as imported from other portions of the policy, all dictate that the NDEs were physically injured, and thus suffered property damage under the Liberty Mutual policy.

A. The NRDs Into Which the Defective Flanges Were Installed Suffered "Property Damage"

In terms of Certified Question 3, the NRDs were physically injured by the irreversible incorporation of the defective flanges into the piping systems of the NRD units and through their removal and replacement. This claim involves "property damage," defined in the policy as "physical injury to tangible property," under the standards applied by the courts, including the courts of Texas.

In *Lamar Homes v. Mid-Continent Cas.*, 242 S.W.3d at 4, this Court concluded that allegations of unintended construction defects constitute an accident or occurrence under the CGL policy and that allegations as to physical injury to homes constructed by the insured itself, i.e., its own work, may constitute property damage sufficient to trigger the duty to defend under a builder's CGL policy. Subsequent cases have followed *Lamar Homes* as to that principle. *See Lend Lease (US) Constr., Inc. v. Amerisure Mut. Ins. Co.*, C.A. No. 4:13-cv-03552 at 14-15 (S.D. Tex. June 16, 2015) ("property damage" does not automatically preclude coverage for the actual work by contractor, finding that defective flooring itself was damaged and constituted "physical injury" to a defectively installed floor).

Thus, the defective nature of an insured's work or product (the defective flanges supplied by U.S. Metals) does not affect whether the damages arising out of the defective work or product amounts to "property damage," as defined in the policy.

Coverage for that property damage is determined by application of the exclusions in the policy. *Lamar Homes*, 242 S.W.3d at 11-14. As to the certified questions before this Court, Liberty Mutual incorrectly argues that the U.S. Metals claim involves the application of one of those exclusions, the Impaired Property Exclusion.

B. The NRD Units Were Altered in Color, Shape, Appearance or Material Dimension by the Irreversible Attachment of the Defective Flanges

The Fifth Circuit phrased the third certified question in the alternative, i.e., whether physical injury occurred to the NRD units at the moment the defective flanges were irreversibly attached ***or*** whether physical injury occurred to the NRDs when there was an alteration in the color, shape or appearance of the NRDs due to the irreversible attachment of the defective flanges. In reality, the factual circumstances presented to this Court do not dictate an "either or" situation. This is because the NRDs were physically injured under Texas law at the time the flanges were welded to the piping that is, irreversibly attached to the NRDs, thus altering the NRDs in color, shape or appearance or material dimension.

Inexplicably, the third certified question from the Fifth Circuit focuses on only a partial recitation of the standard that is sometimes applied by Texas courts to determine the existence of "physical injury" in the context of property damage under a CGL policy. The standard as set out in the Fifth Circuit's question, i.e. "an alteration in the color, shape, or appearance of the third party's product," is somewhat incomplete. In contrast, Liberty Mutual itself cites to *Travelers Ins. Co. v. Eljer Mfg., Inc.*, 757 N.E.2d 41 (Ill. 2001), for a more comprehensive standard to determine the existence of "physical injury" under a CGL policy in that physical injury "connotes damage to tangible property causing an alteration in appearance, shape, color or other material dimension." *Id.* at 502. That same standard was relied upon by the Fourteenth District in *Lennar Corp. v. Great American Ins. Co.*, 200 S.W.3d 651, 678 (Tex.App. – Houston [14th Dist.] 2006, pet. denied), citing *Fidelity & Deposit Co. of Md. v. Hartford Cas. Ins. Co.*, 215 F.Supp.2d 1171, 1183 (D. Kan. 2002). In all of those cases, the formulation of the standard applied by the courts was "an alteration in appearance, shape, color or other material dimension," rather than the truncated version set out in the Fifth Circuit's certified question that omits "other material dimension" from the formulation. While the attachment of the defective flanges to the piping of the NRDs satisfies the truncated standard, Amici Curiae request that the Court render its opinion on these

issues according to the full and complete standard as addressed in *Lennar v. Great American*, *Travelers v. Eljer*, and *Fidelity & Deposit v. Hartford.*

While the court in *Lennar v. Great American* determined that the application of defective EIFS to homes did not constitute property damage to the homes, that analysis appears to have been driven by the Court's initial determination that the EIFS claim to ***each*** of the hundreds of homes constituted a separate occurrence. *Id.*, 200 S.W.3d at 683. In contrast, the claim that is the subject of this appeal involves the installation of defective flanges in two NRD units, which at most, constitutes two occurrences. Property damage occurred to each of the NRDs, while in *Lennar*, many of the homes suffered no property damage at all. In that regard, the court specifically relied upon the fact that Lennar implemented a plan to remove EIFS and replace it with traditional stucco on all homes regardless of whether the EIFS had caused any damage. *Id.* at 679. Thus, the court regarded that removal and replacement as a preventive measure. Here, nothing of the kind occurred.

Naturally, insurers tend to rely upon *Lennar* to apply the "alteration" standard in a restricted manner, that is, refusing to concede the alteration of the appearance, shape, color or other material dimension of otherwise damaged property. Liberty Mutual's position as to the claim before this Court is an example. The Fifth Circuit in its certification states that the flanges were welded

into the NRD unit pipes and were insulated and "buttoned-up" to the NRD equipment. *U.S. Metals*, 589 Fed.Appx. 659, 660. Surely, the permanent welding of the flanges to the NRD piping, irreversibly attaching the flanges to it, and then insulating it caused an "alteration in the color, shape or appearance" of the NRD piping, let alone, an alteration in "appearance, shape, color or other material dimension" according to the more completely stated (and applied) standard set out above. A flange welded on a pipe would certainly change the appearance of the pipe, its shape, and its material dimension. Moreover, the removal and replacement of the flanges more than arguably caused an alteration of the NRDs in appearance, color, shape and certainly, in material dimension. That procedure required largescale damage to the piping by stripping the temperature coating from the pipes, removing and damaging the bolts and gaskets, and grinding down millimeters of the pipes. *Id.* at 660.

This property damage to the NDRs that accompanied the removal and replacement of the flanges distinguishes a case upon which Liberty Mutual heavily relies. In *F&H Construction v. ITT Hartford Ins. Co. of the Mid-West*, 12 Cal.Rptr.3d 896 (Cal. Ct. App. 2004), the insured subcontractor supplied defective steel pile caps that were welded onto driven piles. However, the piles themselves were not removed and did not need to be removed in order to be adequately modified to correct the defect. *Id.* at 902-03. In the absence of

physical injury to any other part of the project, *F&H* provides no support for Liberty Mutual's position. Again, the irreversible installation of the defective flanges into the NRD units caused physical damage and the destruction of the units themselves could not be avoided without the considerable removal and repair costs that were incurred.

C. The Installation of the Defective Flanges Transformed the NRDs from a Satisfactory to an Unsatisfactory State

An alternative standard for determination of "physical injury" to property, relied upon by the court in *Lennar v. Great American,* and also argued for by Liberty Mutual on this appeal, is whether it "moved" from a "satisfactory" to an "unsatisfactory" state. There, the court of appeals held that the EIFS was never in a satisfactory state, but that it was defective from the get-go, i.e., it was inherently defective. *Id.*, 200 S.W.3d at 678-79. However, as set out below, application of this test does not support a denial of coverage to U.S. Metals. Rather, it supports recovery by U.S. Metals from Liberty Mutual.

The standard applied by the court in *Lennar* was borrowed from a line of first party property damage cases interpreting builders risk insurance policies, including *North American Ship Bldg., Inc. v. Southern Marine & Aviation Underwriting, Inc.*, 930 S.W.2d 829 (Tex. App. – Houston [1st Dist.] 1996, no writ).

The *North American Ship Building* opinion borrowed heavily (with little additional analysis) from *Trinity Industries, Inc. v. Insurance Co. of North America*, 916 F.2d 267 (5th Cir. (La.) 1990). In *Trinity Industries*, the court applied Louisiana law, holding that a builders risk policy insuring the construction of a ship did not provide coverage for a hull that was constructed with a "twist" that prevented the ship from planing. In the context of determining what constituted "physical loss or damage" as used in the policy, the court determined that in order to satisfy that requirement, the term strongly implied that there was an initial satisfactory state of the hull that was changed by some external event into an unsatisfactory state. *Id.* at 270-71.

However, the court emphasized that there is no coverage for contractual liabilities under the builders risk policy, and the court specifically found that an arbitration award for damages against the insured was an uncovered contractual liability. The court noted that the arbitrator found that the twist did not affect the performance of the vessel in any significant way, so that the hull was not reduced in value. *Id.* at 271, n.23. In contrast, the defective flanges installed by U.S. Metals profoundly affected the performance of the NRDs, rendering them unusable and creating a potentially catastrophic failure that risked not only severe property damage, but injury to Exxon personnel. [R.2277.]

As stated, the *Trinity Industries* case was followed by *North American Ship Bldg., Inc. v. Southern Marine & Aviation Underwriting, Inc.*, 930 S.W.2d 829. In that case, the insured ship builder also sought coverage under a builders risk policy for the replacement of welds that failed to meet specification due to improperly mixed welding gases during construction. Quoting verbatim from *Trinity Industries*, the court held that the welds that the insured replaced were never in an initial satisfactory state that was changed by some external event into an unsatisfactory state. *Id.* at 834.

A more recent application of the satisfactory/unsatisfactory test is *Lend Lease (US) Construction, Inc. v. Amerisure Mut. Ins. Co.*, C.A. No. 4:13-cv-03552, in which the court applied the test to a claim in which the insured had installed defective flooring that bubbled, separated at the seams, detached and weeped, due to the failure of the insured to properly account for slab moisture. The insurer argued that the flooring was inherently defective and under *Lennar v. Great American*, there had been no physical injury to tangible property. The court rejected this argument, observing that the claim was akin to circumstances of *Lamar Homes v. Mid-Continent Casualty*, 242 S.W.3d 1, in that the condition of the floor itself constituted "property damage." *Id.* at 14-15. The same is true here in that once installed, one of the flanges leaked and nearly two dozen additional anomalies were detected. Therefore, as in *Lend Lease*, the property damage to the

NRD units and even the flanges themselves, was not repaired or replaced solely to prevent future damage.

D. The Performance Bond Analogy Again Falls Flat

Both *Trinity Industries* and *North American Ship Building*, so heavily relied upon by Liberty Mutual, addressed scenarios in which the property into which the insured's defective product or work was installed or incorporated was also the product or work of the insured. In other words, they did not involve incorporation of the insured's work into the product or work of third parties, as is the case here. In fact, in *Trinity Industries* the court specifically relied upon the fact that the coverage was sought for the insured's contractual liability for the faulty workmanship in creating the twist in the hull. *Id.* at 271-72. The court in *North American Ship Building v. Southern Marine* took that a step further, holding that to uphold coverage under the builders risk policy for the repair of the defective welds "transforms a builder's risk policy into a performance bond." *Id.*, 930 S.W.2d at 834.

As stated, the *Trinity Industries* and *North American Ship Building* cases involved the interpretation of builders risk policies. Whether that interpretation was valid or not, this Court, in the context of a standard CGL policy such as the one issued by Liberty Mutual to U.S. Metals, has rejected the breach of contract/performance bond argument of insurers as a basis to deny coverage for

claims involving defective work or products. *Lamar Homes v. Mid-Continent Cas.*, 242 S.W.3d at 10. In fact, this Court relied principally upon the amici curiae brief filed by AGC, TBB – AGC and ASA in that appeal to find any similarities between a CGL policy and a performance bond as irrelevant, stating:

> As one amicus submits, an insurance policy spreads the contractor's risk while a bond guarantees its performance. An insurance policy is issued based on an evaluation of risks and losses that is actuarially linked to premiums; that is, losses are expected. In contrast, a surety bond is underwritten based on what amounts to a credit evaluation of the particular contractor and its capabilities to perform its contracts, with the expectation that no losses will occur. Unlike insurance, the performance bond offers no indemnity for the contractor; it protects only the owner.

Id. at 10, n.7.

Therefore, the *Trinity Industries/North American Ship Building* line of cases has been discredited in the CGL context. Nevertheless, despite the wholesale rejection of that argument by this Court in *Lamar Homes*, and the distinction between the facts of those cases and this appeal, Liberty Mutual, as well as the American Insurance Association and Property Casualty Insurers Association of America ("Amici Insurers"), the amici curiae in support of Liberty Mutual, blithely make that argument to this Court. That argument is not only tired, it has been beaten down on prior occasions and is not persuasive here.[4]

[4] As part of that position, Liberty Mutual cites to California precedent, *F&H Constr. v. ITT Hartford Ins. Co.*, 12 Cal.Rptr.3d 896, which is out of step with Texas law, as well as more recent and well-reasoned case law from other states.

E. The Life/Safety Threat Posed by the Defective Flanges Constitutes "Physical Injury" to the NDR Units

The presence of defective welds posed a life/safety threat in the form of a potentially catastrophic explosion had the welds been left in place. In that regard, Bruce R. Bellingham, the corporate representative of Exxon testified in his deposition as to the point of view of Exxon as to the presence of the defective flanges in the NRD units as follows:

> So Exxon looked at it and said, 'In this high pressure, high temperature service where I could have fires and people injured and everything else, I'm not going to operate the facility until those flanges are replaced.'

[R.2277.] It was the hazardous nature of the defective welds that caused the NRDs to be damaged for purposes of CGL coverage.

The genesis of this argument is case law that has considered installation of hazardous substances in buildings, including asbestos, to be in and of itself "property damage" for purposes of CGL coverage, thus rendering the costs of repair recoverable. The seminal case that stands for this proposition is *Armstrong World Indus., Inc. v. Aetna Cas. & Surety Co.*, 52 Cal.Rptr.2d 690 (Cal. Ct. App. 1996). In that case, the court rejected the insurer's argument that the presence of asbestos-containing building materials ("ACBM") resulted in only economic loss, that is, diminished property value, abatement costs and the costs of responding to the presence of asbestos, and not physical injury. The court rejected this view,

holding that the mere presence of ACBM caused physical injury to the building because the potentially hazardous materials were physically touching and linked with the building, and not merely contained in the building, as a piece of furniture is contained in a house and can be removed without damage to the house. In contrast, because the ACBM is physically touching and linked with the building, and not merely contained within it, the injury is physical even without a release of toxic substances into the building's air supply. *See also, Dayton Indep. School Dist. v. National Gypsum Co.*, 682 F.Supp. 1403 (E.D. Tex. 1988) (allegations of contamination and release of asbestos containing materials in schools constituted property damage and triggered excess insurance coverage).

In *Regional Steel Corp. v. Liberty Surplus Ins. Corp.*, 173 Cal.Rptr.3d 91 (Cal. Ct. App. 2014), the court held that the installation of defective seismic tie hooks did not cause property damage because they could be replaced with a different type. In doing so, the court distinguished cases involving mere defective construction from cases where the incorporation of a defective product causes physical harm to the whole. The court addressed the rationale behind *Armstrong World Indus. v. Aetna*, as follows:

> On the other hand, other cases hold that where the defective work or material must be removed or repaired to comply with building code or health and safety standards, its presence constitutes physical injury to the building – the physical linking of the defective material to the building is the physical injury.

Id. at 102 (citing *Armstrong*). The circumstances of this claim clearly fall within the realm of covered property damage in that the incorporation of the defective flanges into the piping of the NRDs caused such concern that the entire NRD units were so damaged that all of the flanges had to be removed in order to eliminate serious life/safety hazard.

The *Armstrong* case was relied upon by the court in *Watts Indus., Inc. v. Zurich American Ins. Co.*, 18 Cal.Rptr.3d 61 (Cal. Ct. App. 2004), where the insured manufacturers of municipal water systems parts brought suit against their CGL insurer seeking a defense in the lawsuit brought by municipalities alleging that the insureds' metallurgically substandard parts caused injury to the water systems and lead contamination of the water. The court upheld coverage where the manufacturers' products contained hazardous material and were incorporated into other products or structures, causing immediate harm and physical injury to the other property at the moment the incorporation occurred. The underlying complaint against the manufacturers alleged that the parts had been built into municipal water systems, and like ACBM, constituted hazardous products that leaked excess lead into the municipal water supplies and threatened public health and safety. In addition, the complaint alleged that the parts would have to be dug up and replaced, indicating that the parts were not easily removable, similar to the

ACBM in *Armstrong.* The same may be said for the defective flanges installed into the NRDs and the analogy is compelling.

While the asbestos and municipal water system claims are more akin to the life/safety hazards associated with the installation of the U.S. Metals flanges, that same rationale as to the incorporation of hazardous materials as property damage is also found in contaminated food cases. *See National Union & Fire Ins. v. Terra Indus., Inc.*, 216 F.Supp.2d 899 (N.D. Iowa 2002), *aff'd* 346 F.3d 1160 (8th Cir. 2003) (benzene-contaminated carbon dioxide which was incorporated into soft drinks caused "property damage" as a result of the introduction of the hazardous material); *Pepsico, Inc. v. Winterthur Int'l American Ins. Co.*, 24 A.D.3d 743 (N.Y.A.D. 2005) (introduction of faulty raw ingredients into beverage resulting in an off-tasting product was sufficient to establish that the product's function and value has been seriously impaired, resulting in physical damage to the product); *Shade Foods, Inc. v. Innovative Products Sales & Mktg., Inc.*, 93 Cal.Rptr.2d 364 (Cal. Ct. App. 2000) (insured processor supplied almonds that were contaminated with wood splinters which were used in almond clusters in cereal, resulting in a finding of property damage because the product could not be deconstructed to remove the injurious splinters and then recombined for their original use).

The hallmark of the hazardous substance line of cases is that the potentially hazardous material is physically touching and linked with the structure into which

it is incorporated, and is so integrated that it cannot be removed without damage or extreme measures. That is exactly the set of circumstances in this case and the Exxon NRD units were physically injured under applicable principles of insurance policy interpretation.

II. REPLACEMENT OF ANOTHER'S PROPERTY TO WHICH THE INSURED'S DEFECTIVE PRODUCT OR WORK HAS BEEN IRREVERSIBLY ATTACHED IS NOT EXCLUDED

The fourth certified question posited to this Court addresses the term "impaired property," the definitional component of Exclusion m. Under the definition, property is impaired if it can be restored to use by "the repair, replacement, adjustment or removal of 'your product' or 'your work.'" [R.2204.] In essence, the language of the policy itself answers the Fifth Circuit's question in that other property can be "impaired" only if it can be restored to use by replacement of "your product," that is, the insured's product.[5] Applied here, the NDRs could not be restored to use by mere replacement of the defective flanges.

[5] The definition of impaired property is also triggered by the repair, replacement, adjustment or removal of "your work," defined in the policy as "(1) Work or operations performed by you [the named insured] or on your behalf; and (2) Materials, parts, or equipment furnished in connection with such work or operations . . ." [R.2207.] The definition of "your work" for construction contractors is the equivalent of "your product" for manufacturers, so the Fifth Circuit's question on the replacement of U.S. Metals' product applies to the work of contractors.

Rather, they could only be restored to use by considerable destruction and demolition of other property, that is, the piping in the NRDs to which the flanges were welded and irreversibly attached.

As stated, the "replacement" provision that is the subject of Certified Question No. 4 is restricted to replacement of "your product," a term that is specifically defined in the Liberty Mutual Policy in relevant part as follows:

> **21.** "Your product":
>
> **a**. Means:
>
> **(1)** Any goods or products, other than real property, manufactured, sold, handled, distributed or disposed of by:
>
> **(a)** You;
>
> **(b)** Others trading under your name; or
>
> **(c)** A person or organization whose business or assets you have acquired; and
>
> **(2)** Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products … [R.2206-7.]

Therefore, the definition of "impaired property" imports the separately defined term "your product," but that importation should not be misinterpreted as inextricably intermixing the two concepts. Property such as the defective flanges provided by U.S. Metals are either "your product," or "impaired property." They cannot be both. This is because the definition of "impaired property" specifically

states that it includes tangible property ***"other than"*** your product or your work. There simply is no reference to repair, replacement or removal of the separately defined term "impaired property." Therefore, the NRD units themselves cannot meet the definition of impaired property under the Liberty Mutual policy because they could not be restored to use by the simple repair, replacement or removal of the flanges, "your product," as that term is defined in the policy.

A. "Replacement" of "Impaired Property" Is Not Excluded by the Plain Language of the Policy

Despite the clear dichotomy between the insured's own product and impaired property, that is, the property that is damaged by the irreversible incorporation of the insured's product, insurers such as Liberty Mutual do their best to intertwine, and in the process, to confuse those concepts. Thus, Liberty Mutual confuses the issue by ignoring the plain language of the impaired property definition and exclusion that focus only on the repair, replacement, adjustment or removal of the flanges themselves, and not the property to which the flanges were irreversibly attached, claiming that the repair or damage to the impaired property itself is all part and parcel of the insured's own product, i.e., "your product." By definition it is not.

While Liberty Mutual seeks to confuse the issue, the Amici Insurers boldly introduce into the CGL an entirely new and different term, "combined product," in order to advance its argument that "replacement" of the insured's defective product

encompasses all destruction, loss of use or replacement of the property to which the insured's product is incorporated. Amici Insurers Brief, p. 8. In other words, they attempt to combine apples and oranges, but the new term, "orapple" is not found in the policy, nor in the English language. This attempt would be somewhat whimsical or even fanciful were it not an attempt to impermissibly decimate the insured's coverage. Fortunately, introduction of the term "combined product" into the CGL policy form is prohibited under basic rules of insurance policy interpretation. In *Gilbert Texas Construction, LP v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010), this Court rejected the attempt of the insured to insert language into an insurance policy, specifically the phrase "of another" into the contractual liability exclusion in an excess policy, refusing to make a new contract for the parties. *Id.* at 127-28. This Court should likewise refuse the efforts of the insurers to insert a heretofore unheard of concept into the policy form they have written and marketed since 1986.

As previously set out above, this disingenuous attempt to intermingle the definitions of "your product" and "impaired property" runs afoul of the express policy language. The only property that can be rendered "impaired," by definition, is property ***other than*** the insured's own product or work. Therefore, the physical injury or "property damage" visited upon the NRD units, including the piping and insulation, cannot be excluded as part of the replacement of U.S. Metals' own

product, the defective flanges. This attempted distortion of the policy language conveniently ignores the typical position of Liberty Mutual and the Amici Insurers, which scrupulously attempt to maintain a distinction between the purported uninsurable business risk of damage to an insured's own defective product or work versus insurable damage to a third party's product or work. The NRD units, including the piping, insulation and associated parts are third party property and Liberty Mutual and the Amici Insurers cannot have it both ways. The insured's product under the "your product" definition and the "impaired property" definition are nothing short of mutually exclusive.

B. Case Law Applies the Intended Distinction Between the Replacement of "Your Product" or "Your Work" and "Impaired Property"

There is little, if any, authoritative support for the intertwining of the insured's product and the impaired property concepts, let alone definitions, under a CGL policy. The dichotomy between property damage to the insured's product or work and damage to impaired property as defined in the policy is the key consideration as to Certified Question No. 4. By definition, the property of others, including the property into which the insured's product or work has been irreversibly incorporated, can be impaired only if can be restored to use by repair, replacement, adjustment or removal of the insured's product or work without wholesale damage to the other property. If there is such damage, that property is

not "impaired property;" rather, it is property damage to a third party's property squarely within the coverage provided by a CGL policy.

Liberty Mutual bears the burden of proving otherwise and establishing the applicability of Exclusion m. TEX. INS. CODE §554.002. This principle applies to an insurer's attempt to rely upon the Impaired Property Exclusion. *National Union Fire Ins, Co. of Pittsburgh, Pa. v. Puget Plastics Corp.,* 532 F.3d 398, 404 (5th Cir. (Tex.) 2008) (insurer has burden to establish that property can be fixed by repairing or replacing the insured's product). Moreover, it is recognized that the requirement in the definition that the property can be impaired only if it can be restored to use by repair or replacement of the insured's product or work acts as an "internal limiting condition." *Essex Ins. Co. v. Bloomsouth Flooring Corp.*, 562 F.3d 399, 408 (1st Cir. (Mass.) 2009) (where insured's defective carpeting omitted odor that permeated building, the building was not "impaired property" because it could not be restored to use by simply by repairing, replacing, adjusting or removing the carpet). Liberty Mutual cannot meet its burden of overcoming the "replacement of the insured's product or work" limitation of its own exclusion.

The impaired property definition unequivocally states that the insured's own work or product can never be impaired, based on the explicit "other than your product or your work" formulation in it. Courts generally have little trouble in distinguishing between the insured's work and product, on the one hand, for

purposes of determining whether the property that is the subject of a claim is impaired property, on the other hand. This is particularly true in the construction industry where it is generally accepted by contractors, manufacturers, insurers and courts alike, that where the insured is a general contractor responsible for an entire project, no portion of the property can be impaired. *In re ML & Associates, Inc.*, 302 B.R. 857 (N. D. Tex. 2003) (building was not impaired property since insured was general contractor on the project). The corollary is that where an insured provides only a single product to a larger project, or where a subcontractor performs only a part of the work on a project, issues as to damage to impaired property, that is, as to property other than the insured's product or work, can arise.

Despite this relatively simple dichotomy, some courts have had difficulty in distinguishing between the two for purposes of the Impaired Property Exclusion. This is the case with one of the primary authorities cited and relied upon by Liberty Mutual, *Gentry Machine Works, Inc. v. Harleysville Mut. Ins. Co.*, 621 F.Supp.2d 1288 (M.D. Ga. 2008). In that case, the insured manufacturer of boiler parts sought coverage for claims arising out of the insured's faulty welding of pedestals that were installed on the claimant's boilers. As a result of the faulty welding, hundreds of boilers were inoperable and unsafe to use, and some boilers suffered physical damage when the pedestals failed. The insurer denied coverage for the cost of inspecting and repairing the pedestals and boilers, relying in part on the

Impaired Property Exclusion. The court held that the majority of boilers met the definition of "impaired property" because they were tangible property that incorporated the insured's defective product, and most were restored to use by simply repairing the defective pedestals.

However, the court's analysis of this issue was based upon an apparent misapplication of Georgia law as set out in *Sapp v. State Farm & Cas. Co.*, 486 S.E.2d 71 (Ga. App. 1997). *See Gentry Machine*, 621 F.Supp.2d at 1298. In *Sapp*, the homeowners, the Regents, sought to recover against the CGL insurer of a contractor that performed defective work on their home while installing hardwood floors and in a crawlspace. The damages sought were the cost to remove and replace the flooring and incidental damages to the home. *Sapp*, 486 S.E.2d at 204. Thus, there was a critical distinction between the *Sapp* analysis – a simple denial for the cost of repairing the insured's own work – as opposed to damage to work or property of others, the scenario before the *Gentry* court, as well as before this Court in this appeal. [6] Just like the manufacturer in *Gentry*, U.S. Metals makes no claim for the cost of the defective flanges themselves (excluded by the Your Product Exclusion), but unlike the Court in *Gentry*, this Court should not

[6] This aspect of *Sapp* was noted by the Georgia Court of Appeals in a subsequent opinion, *Transportation Ins. Co., v. Piedmont Constr. Co.*, 686 S.E.2d 824, 828 (Ga.App. 2009), noting that *Sapp* was limited to damages for repairing or replacing the work for which the homeowners contracted, i.e., the insured's own work.

overextend that analysis to the damage to the NRD units themselves, which are clearly not the product or work of U.S. Metals. This Court must resist the temptation to combine apples with oranges.

Despite the complexities (actual or perceived) of the Impaired Property Exclusion and its accompanying definition, the concept behind the difference in treatment of coverage for property damage to the insured's own product or work and damage to other property should not be that difficult. In fact, that difference in treatment is a bedrock for CGL coverage for manufacturers and contractors.[7]

For example, in *DeWitt Constr., Inc. v. Charter Oak Fire Ins. Co.*, 307 F.3d 1127 (9th Cir. (Wash.) 2002), the insured subcontractor sought coverage for damages associated with its negligent design and installation of defective cement piles at a construction project when the cement in the piles did not harden properly. As a result, the original holes and pile assembles were unusable, and the insured had to install 300 more piles at the site in other locations. In order to install the remedial piles, the non-defective work of other subcontractors had to be removed and reconstructed in that the pile-caps that had been installed by other subcontractors over the defective piles had to be torn out. The court held that the damage to the work of other subcontractors, which had to be removed and destroyed as a result of the insured's defective work, was "property damage"

[7] Nevertheless, it is worth taking stock of the frequency that insurers apparently forsake adherence to that difference in treatment in the context of denying specific claims.

within the scope of the insurance policies, determining that the Impaired Property Exclusion was inapplicable to the costs incurred to repair and replace the work performed by other subcontractors. The court found that the insured's installation of additional piles did not "restore to use" the work of other subcontractors' work that had to be removed from the defective piles and destroyed in the removal process. They remained destroyed notwithstanding the subsequent remedial work by the insured. *Id.* at 1134-35. The analysis of the Ninth Circuit highlights the critical role that damage to the work of others plays in the equation. The Impaired Property Exclusion does not apply to a claim such as the one before this Court where replacement of the insured's defective work or product damages other property.

Another case that applies this common sense analysis is *Employers Mut. Cas. Co. v. Grayson*, 2008 WL 2278593 (W.D. Okla. May 30, 2008), where in connection with the construction of a bridge, the insured, Ready Mix, supplied concrete that failed to harden properly, resulting in loose rebar, cracking of the bridge deck, and concrete discolorations. The insurer argued that the bridge was impaired property or property that had not been physically injured so as to preclude recovery of damages flowing from the repair and replacement of the non-conforming concrete. The court rejected the insurer's argument, finding that the bridge was not "impaired property" because it could not be restored to use by only

replacing the defective concrete, i.e., other components of the bridge had to be replaced as well. The court specifically found that the bridge was physically injured when other components of the bridge were destroyed during the repair process. *Id.* at *6. The rationale of *Grayson* is directly applicable to preserve coverage for the damage to the NRD units.

Another court has expressed the potential simplicity of the analysis. In *Amerisure Mut. Ins. Co. v Hall Steel Co.*, 2009 WL 4724303 (Mich. App. Dec. 10, 2009), the insured steel company supplied steel for the manufacture of windshield wiper blade brackets that did not meet specification and failed in use. In rejecting the insurer's argument that the wiper brackets constituted impaired property, the court stated:

> Plaintiff characterizes the defective wiper brackets as impaired property, but they in fact do not fit the definition. Specifically, while the brackets fit the first part of the definition because they are neither Hall Steel's work nor product but instead Cleveland Die's product which incorporated Hall Steel's allegedly defective steel, the second part of the definition cannot be satisfied because the resulting defective wiper brackets are not, in any practical sense, property that could be "restored to use" by "repair, replacement, adjustment or removal" of the deficient steel, or by any latter-day fulfillment of the terms of the purchase contract. ***Indeed, it requires no expertise in materials or manufacturing to understand that a product made from deficient steel is not going to be repaired, or otherwise restored to usefulness, by extracting and replacing the deficient steel.*** Nor would any subsequent perfect compliance with Hall Steel's and Cleveland Die's purchase contract remedy the existing, defective, wiper brackets made with the deficient steel.

Id. at *5 (emphasis added). The analogy to the wholesale damage that replacement of the defective flanges wreaked upon the NRD units is nothing short of compelling and dictates that the NRD units are not impaired property under the Liberty Mutual policy.

In *Hall Steel*, the Michigan Court of Appeals supported its analysis by citing to the contaminated food case, *Shade Foods, Inc. v. Innovative Products Sales & Mktg., Inc.*, 93 Cal.Rptr.2d 364 (Cal. Ct. App. 2000), for the proposition that the possibility of salvaging a damaged product that cannot be deconstructed to remove the defective component is not equivalent to restoring it to use by the repair or replacement of the defective component. *Hall Steel* at*4. In *Shade Foods*, the insured food processor supplied almonds that were contaminated with wood splinters. The almond product was used in almond clusters in cereal. Because the nut clusters were composed of congealed syrups and nuts contaminated by wood splinters, the product could not be deconstructed to remove the splinters and then recombined for their original use. Even though there was a possibility of realizing some salvage value by selling the product at a reduced value for some other use, the salvage of a damaged product was obviously not equivalent to restoring it to use by the repair or replacement of a defective component. *Shade Foods*, 93 Cal.Rptr.2d at 377. Therefore, the Impaired Property Exclusion did not apply.

A similar case is *Netherlands Ins. Co. v. Main Street Ingredients, LLC*, 745 F.3d 909, 919 (8th Cir. (Wis.) 2014), in which the court determined that the Malt-O-Meal cereal product into which the insured's salmonella-contaminated dried milk was added was not impaired property because it could not be restored to use by repair, replacement, adjustment or removal of the insured's product, the dried milk.

In contrast, Liberty Mutual relies on a food contamination case that is wholly distinguishable from not only the cases discussed immediately above, but also the circumstances on this appeal. In *Sokol & Co. v. Atlantic Mut. Ins. Co.*, 430 F.3d 417 (7th Cir. (Ill.) 2005), the insured supplied spoiled peanut butter contained in packets that were included in boxes of cookie mix. The customer retrieved the cookie mix, substituting fresh peanut butter packets and sought reimbursement of the costs of doing so from the insured. Quite understandably, the court found that there was no physical injury to the cookie mix because the paste was sealed in individual packets, and those packets were simply removed from the boxes of cookie mix. *Id.* at 422. For much the same reason, the court held that the Impaired Property Exclusion barred coverage.

Cases such as *Sokol* do not advance the ball for insurers when presented with a claim where the insured's product or work cannot be removed or replaced by something as simple as substituting a packet of peanut butter. Replacement of the

defective flanges could not be accomplished by something as simple as loosening them with a pipe wrench. They were not threaded but were permanently welded in place and simply could not be removed and replaced without largescale damage to the piping and insulation in the NRDs. The irreversible installation of the defective flanges into the NRD units caused physical damage in that the threat to the life and safety of Exxon workers and the destruction of the units themselves could not be avoided without incurring the considerable costs of ripping and tearing out the otherwise non-defective insulation and piping. The Impaired Property Exclusion does not apply to those costs.

CONCLUSION

The damage to Exxon's NRDs constitutes physical injury to tangible property, and the damage to third party property caused by unintended defects in the insured's work is not an uninsured business risk under Texas law. This is especially true where the presence of the insured's work raises a legitimate life/safety hazard. The Impaired Property Exclusion should not be applied by this Court to exclude CGL coverage for the property damage to the work of others that must be ripped and torn out in order to replace the insured's defective product or work. The exclusion is expressly limited to repair and replacement of the insured's own product, and not the repair or replacement of the NRD's into which the U.S. Metals flanges were incorporated.

Therefore, Amici Curiae respectfully request that the Court answer Question No. 1 "yes," and the interpretation of U.S. Metals should be upheld as more reasonable than Liberty Mutual's interpretation in response to Question No. 2. As to Certified Question No. 3, the Court should find that physical injury can take place at incorporation of the insured's defective product or work into other property as an alteration in the color, shape or appearance of that property due to irreversible attachment to it. The other property into which the defective product or work is incorporated is also physically injured when the defective work or product is repaired, removed or replaced. Finally, Certified Question No. 4 should be answered "no," based upon the applicable unambiguous definitions in the policy.

Respectfully submitted,

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CERTIFICATE OF SERVICE

By my signature below, I hereby certify that a true and correct copy of the foregoing Brief of Amici Curiae Associated General Contractors of America, Texas Building Branch – Associated General Contractors of America, ABC of Texas, American Subcontractors Association, Inc. and ASA of Texas, Inc. in Support of Appellant U.S. Metals, Inc. has been served upon counsel of record in accordance with Misc. Docket No. 11-9152 of the Supreme Court of Texas on the 31st day of July, 2015.

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CERTIFICATE OF COMPLIANCE

By my signature below, I hereby certify that this document complies with the typeface requirements of Tex. R. App. P. 9.4(e) because it has been prepared in a conventional typeface no smaller than 14-point for text and 12-point for footnotes. This document also complies with the word count limitations of Tex. R. App. P. 9.4(i) because it contains 10160 words, excluding any parts exempted by Tex. R. App. P. 9.4(i)(1).

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