NO. 12-0661

IN THE SUPREME COURT OF TEXAS

EWING CONSTRUCTION CO., INC.
Appellant,

v.

AMERISURE INSURANCE CO.,
Appellee.

On Certified Questions from the United States Court of Appeals for the Fifth Circuit, New Orleans, Louisiana
No. 11-40512

BRIEF OF AMICI CURIAE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, TEXAS BUILDING BRANCH – ASSOCIATED GENERAL CONTRACTORS OF AMERICA, TEXO – THE CONSTRUCTION ASSOCIATION, ASSOCIATED GENERAL CONTRACTORS – HOUSTON CHAPTER, ABC OF TEXAS, AMERICAN SUBCONTRACTORS ASSOCIATION, INC. AND ASA OF TEXAS, INC. IN SUPPORT OF APPELLANT EWING CONSTRUCTION CO., INC.

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TO THE HONORABLE JUSTICES OF THE TEXAS SUPREME COURT:

Amici Curiae Associated General Contractors of America, Texas Building Branch—Associated General Contractors of America, TEXO – The Construction Association, Associated General Contractors – Houston Chapter, ABC of Texas, American Subcontractors Association, Inc. and ASA of Texas, Inc. (collectively "Amici Curiae") submit this brief in support of Appellant Ewing Construction Co.,

Inc. (“Ewing”), urging the Court to answer the first certified question in the negative, rendering the second question moot. Alternatively, if the Court should answer the first question in the affirmative, Amici Curiae urge the Court to answer the second question in the affirmative, thus adopting the argument by Appellant on that question.

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 (AGCA) is the oldest and largest nationwide association representing construction contractors. Formed in 1918, the AGCA represents more than 32,000 firms in nearly 100 chapters throughout the United States. Among the association’s members are more than 7,000 of the nation’s leading general contractors, more than 11,000 specialty contractors, and more than 13,000 material suppliers and service providers to the construction industry. The association’s members engage in the construction of office buildings, apartments, condominiums, shopping centers, factories,

warehouses, highways, bridges, tunnels, airports, water works facilities, and site utilities necessary for housing development.

The Texas Building Branch of the Associated General Contractors of America ("TBB–AGC") is a branch of AGCA. TBB–AGC encompasses eleven AGCA 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.

Amicus Curiae Associated General Contractors – Houston Chapter is the local chapter of AGCA serving over 700 Houston-area members.

TEXO – The Construction Association ("TEXO") is the largest commercial contractors association in Texas and is affiliated with the national organization, Associated Builders and Contractors, Inc. (ABC), and AGCA. With over 1,900 members in north and east Texas, TEXO provides innovative programs, quality services and strategic alliances focusing on governmental representation, safety, health and environmental issues, craft workforce development, professional training and community networking events.

ABC of Texas is a state trade association consisting of seven local ABC chapters in Texas made up of over 1700 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.

AGCA, ABC 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 Casualty Co.*, 242 S.W.3d 1 (Tex. 2007) and *Gilbert Texas Construction, L.P. v. Underwriters at*

Lloyd's London, 327 S.W.3d 118 (Tex. 2010). This is another of those cases, since the Court's ruling in this case threatens the insurance coverage previously reaffirmed in *Lamar Homes.*

Whether AGCA, ABC 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. Does a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike manner, without more specific provisions enlarging this obligation, "assume liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion?

2. If the answer to question one is "Yes" and the Contractual Liability Exclusion is triggered, do the allegations in the underlying lawsuit alleging that the contractor violated its common law duty to perform the contract in a careful, workmanlike, and non-negligent manner fall within the exception to the Contractual Liability Exclusion for "liability that would exist in the absence of contract"?

INTRODUCTION

The proposition that an insurer should not be obligated to pay claims that are outside the coverage of the policy is not astounding. However, some insurers are extremely adept at finding reasons, some would say excuses, to deny what

otherwise appear to be claims more than arguably within the coverage of the policy. This is particularly true as to claims involving alleged defective workmanship by insured contractors under their commercial general liability ("CGL") policies, and if the position advocated by Amerisure is adopted by this Court, insurers will invariably have yet another excuse upon which to delay or even deny legitimate claims. Often, those insureds not only face the burden of defending against and settling an adversarial claim, but also the burden of defending against an adversarial insurer out to minimize its own obligation to defend and indemnify its insured.

The facts presented to this Court represent an all too frequently occurring dilemma for Texas insureds, particularly those engaged in construction. Contractors in Texas and throughout the United States face these issues, which accounts for the participation of national construction organizations such as AGC, ABC and ASA as amici curiae on this brief.[1] Members of these organizations must regularly manage the considerable risks associated with building construction, risks that often exceed the value of the project 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

[1] For simplicity's sake, the analysis in this brief often uses the generic term "contractor" or "builder." This term includes subcontractors and other participants in the construction industry, unless otherwise indicated.

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 actually pays premiums for, predictability and consistency in the manner in which its liability insurance policies apply in the event of a claim. Predictability and consistency as to CGL coverage for construction defect claims was confirmed by this Court in *Lamar Homes, Inc. v. Mid-Continent Casualty Co.*, 242 S.W.3d 1 (Tex. 2007), as to the costs of repairing construction defects that caused property damage that was neither expected nor intended by the insured.

In the case before this Court, Appellant, Ewing Construction Co., Inc. ("Ewing"), the general contractor, was faced with a lawsuit alleging defective construction of a tennis facility for Tuloso-Midway Independent School District in Corpus Christi. Appellee Amerisure Insurance Company ("Amerisure"), Ewing's CGL insurer, refused to defend, citing a litany of policy provisions, including the Contractual Liability Exclusion, as purported defenses, leaving Ewing no choice

but to file this action to enforce the terms of the policy it purchased to protect itself.

The district court, in *Ewing Construction Co., Inc. v. Amerisure Ins. Co.*, 814 F.Supp.2d 739, 744-45 (S.D. Tex. 2011), recognized that under *Lamar Homes* the damage to the tennis courts constituted an "occurrence" of "property damage" as those terms are defined in the CGL policy.

However, the district court, together with the Fifth Circuit and its subsequently vacated opinion at *Ewing Construction Co., Inc. v. Amerisure Ins. Co.*, 684 F.3d 512 (5th Cir. 2012), *opinion withdrawn*, 690 F.3d 628 (5th Cir. 2012), selectively ignored this Court's additional holding in *Lamar Homes* that where such unexpected and unintended property damage occurs after completion of the project, it triggers the subcontractor exception to Exclusion l, the Your Work Exclusion, preserving coverage for an insured contractor for whom work was performed by its subcontractors. In *Ewing*, the district court and the Fifth Circuit declined to uphold coverage by virtue of the subcontractor exception to the Your Work Exclusion, which clearly applied to the claim before them. Rather, these courts relied on Exclusion b, the Contractual Liability Exclusion, to deny coverage to the insured contractor. In so doing, they dashed all notions of predictability conferred by *Lamar Homes* and threw coverage for insured contractors in Texas into disarray by overextending and misapplying that exclusion.

Those courts accepted Amerisure's simplistic argument based upon this Court's holding in *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010). In so doing, it determined that any breach of contract involves the assumption of liability within the meaning of Exclusion b in order to exclude coverage for property damage arising out of the insured's breach of its own contract. The scope of Exclusion b is not and cannot be so sweeping in light of the existing Texas case law – and the realities of the construction industry and all other industries that provide a service on a contract basis. In *Gilbert v. Underwriters at Lloyd's*, this Court limited the scope of Exclusion b to contractually assumed liabilities that are in excess of those which the insured would have been liable in tort or contract "under general law" principles. *Gilbert*, 327 S.W.3d at 134. Here, Ewing did not assume any such excess liability in its contract with the school district. Rather, that contract outlined duties that are customarily set out in typical construction contracts entered by insured contractors everyday throughout Texas and across the country.

This appeal presents an attempt at an extreme over-extension of *Gilbert* by insurers that raise it as an excuse for denying claims that may otherwise be covered. The improvident denial of coverage for direct contractual obligations under *Gilbert*, despite its highly unique circumstances, appears to have become a

significant roadblock to coverage for which Texas contractors have paid substantial premiums.

Those substantial premiums have been paid by contractors for nearly fifty years for standard CGL policies that include exclusions that carefully circumscribe the types of business risks for which coverage is excluded under policies sold to the construction industry. Those policies have been marketed aggressively by insurers to contractors so as to provide coverage for property damage arising out of the defective work of subcontractors by preserving coverage from exclusion. The Contractual Liability Exclusion is not one of the business risk exclusions specifically tailored to the needs of the construction industry, and to over-broadly apply it to claims such as the one before this Court interjects uncertainty, unpredictability and an unforeseen loss of coverage, once again placing Texas contractors and other insured businesses 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 to the underpinnings of insurance as a tool for risk management.

For this reason, this amicus curiae brief seeks to inform the Court of the serious consequences of the improvident application of the Contractual Liability Exclusion to property damage arising out of an insured contractor's breach of its own contract. While Amici Curiae believe that this Court has certainly restricted

the scope of the Contractual Liability Exclusion to liability over and above those imposed upon a contractor by general law, it is not the purpose of this brief to reiterate those arguments as made by Ewing. Rather, amici curiae adopt those arguments and will provide this Court with a broader picture as to how the position urged by Amerisure is contrary to the drafting, interpretation and marketing of CGL insurance policies to the construction industry.

In consideration of these factors, Amici Curiae urge the Court to answer the First Certified Question "No." By so doing, consideration of the Second Certified Question is not necessary. Nevertheless, should the Court for some reason determine that the Contractual Liability Exclusion applies under these circumstances, Amici Curiae urge the Court to answer the Second Certified Question "Yes" in that the assumption of liability by Ewing is no greater than the liability that would exist in the absence of its contract, thus adopting the argument of Appellant Ewing on that question.

ARGUMENT AND AUTHORITIES

I. APPLYING THE CONTRACTUAL LIABILITY EXCLUSION TO THIS CLAIM UNDOES NEARLY FIFTY YEARS OF CAREFUL POLICY DRAFTING, INTERPRETATION *AND* MARKETING

Applying the Contractual Liability Exclusion to property damage to an insured contractor's work simply because that property damage may breach its contract has a profoundly negative effect on CGL coverage for the construction

industry. It is nothing short of a radical departure from the means by which CGL coverage has traditionally been provided by the insurance industry to contractors. In order to appreciate the manner in which the Contractual Liability Exclusion upsets and departs from the traditional coverage provided to the construction industry, consideration must be given to the drafting and issuance of CGL policy forms over the last fifty years.

The Contractual Liability Exclusion does not exclude coverage for property damage arising out of an insured contractor's direct breach of its construction contract. To apply it to the breach of contract by Ewing in this case would rob Ewing and other construction insureds of the coverage for which they have paid premiums for decades. This case represents the paradigm for a covered construction defect claim, in which the trial court found an "occurrence" of "property damage" within the terms of Ewing's CGL policy, and but for the application of the Contractual Liability Exclusion, Ewing was entitled to the benefit of the subcontractor exception to the Your Work Exclusion that preserves coverage for its work under Texas law. This preservation of coverage for property damage arising out of a subcontractor's work is no happenstance. It developed nearly fifty years ago when liability coverage for an insured contractor's work began to receive systematic treatment in the CGL forms, a development that cannot be overlooked in considering its scope and interaction with the Contractual

Liability Exclusion in the basic CGL policy. In fact, in *Lamar Homes v. Mid-Continent Casualty,* 242 S.W.3d 1, this Court considered coverage in an identical fact pattern, and upheld coverage for the insured contractor.

A. The History of CGL Coverage for Property Damage to an Insured Contractor's Work Does Not Support the Application of the Contractual Liability Exclusion

The claim giving rise to the certified questions before this Court involves property damage that occurred subsequent to completion and after the damaged tennis courts were put to their intended use by the School District.[2] An insured contractor's liability for property damage arising out of its completed work is a significant exposure that is akin to the products liability exposure of a manufacturer. This exposure began to receive the attention of the insurance industry with the 1966 revision to the CGL policy.[3] That revision separated the Products Hazard, the risks associated with manufacturers of products, from the Completed Operations Hazard, insuring the risks associated with providers of services, including contractors.

[2] The CGL policy, including the Amerisure policy before this Court, provides that the named insured's work is complete for purposes of the products-completed operations hazard when all of the named insured's work called for in its contract has been completed or when it has been put to its intended use by any entity other than another contractor or subcontractor.

[3] Up until 1971, standard policy forms were drafted by national insurance advisory organizations, most notably the National Bureau of Casualty Underwriters. The insurance Services Office, Inc. ("ISO") was formed in 1971 and has drafted all subsequent revisions to the standard CGL policy forms.

1. The 1966 CGL Revision: Broad Exclusion of the Insured Contractor's Work

The 1966 policy form dealt with the exposure of property damage to the work of the named insured by absolutely excluding it. Exclusion (o) in that policy form provided that the insurance does not apply:

> [T]o property damage to work performed ***by or on behalf of*** the named insured arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith.

The highlighted term "by or on behalf of" extended the exclusion to apply not only to the insured contractor's work, but also to that of its subcontractors that perform work "on behalf of" the insured.

The straightforward exclusion was applied by Texas courts to exclude coverage for property damage to the insured's work arising out of its work. *See T.C. Bateson Construction Co. v. Lumbermens Mut. Cas. Co.*, 784 S.W.2d 692 (Tex. App.—Houston [14th Dist.] 1989, writ denied); *Hartford Cas. Co. v. Cruse*, 938 F.2d 601 (5th Cir. 1991). As discussed below, the reasoning of these cases does not apply to more recent CGL policy forms that include either a broad form endorsement or an explicit subcontractor exception.

2. The 1973 Revision: Universal Acceptance of the Broad Form Endorsement Limiting the Exclusions

The CGL policy was revised again in 1973, but the revision did not modify Exclusion (o), the Work Performed Exclusion in the 1966 form, maintaining intact

the exclusion for property damage arising out of an insured contractor's work. The presence of this exclusion in the 1966 and 1973 CGL forms rendered the coverage of considerably less utility for the construction industry. As a result, in a very significant development, the Insurance Services Office (ISO) promulgated a standard endorsement to the CGL policy in 1969 that modified the Work Performed Exclusion as well as others. That endorsement became widely offered in 1973, and eventually became known as the Broad Form Property Damage Endorsement ("BFPDE").

That endorsement modified the CGL policy to replace Exclusion (o) with Exclusion (z) that states that the insurance does not apply:

> (z) with respect to the completed operations hazard and with respect to any classification stated above as "including completed operations," to property damage to work performed ***by the named insured*** arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith. [Emphasis added.]

The emphasized language reflects the elimination of the phrase "or on behalf of" from the exclusion. As a result, the intent behind this endorsement was to provide coverage for property damage arising from subcontractor work on behalf of the named insured, but not arising out of work performed by the named insured itself. Through this subtle change in wording, coverage was preserved for an insured contractor or builder that performs its work through subcontractors.

The BFPDE modification of Exclusion (o) has been frequently upheld by courts throughout the United States. In *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824 (Tex.App.—Fort Worth 1988, writ denied), the court upheld coverage under Texas law for the insured general contractor for property damage arising out of its subcontractor's work pursuant to the BFPDE.

The Exclusion (z) modification of Exclusion (o), the Work Performed Exclusion by the BFPDE applied only to property damage within the Completed Operations Hazard (after completion of the work). While that provision has been the most frequently encountered extension in CGL coverage provided to construction contractors, the BFPDE also provided extended coverage for contractors for losses taking place while construction operations are in progress. In that regard, Exclusion (y)(2)(d) provided that the insurance does not apply to:

> (d) ***that particular part*** of any property, not on premises owned by or rented to the insured**,**
>
> (i) upon which operations are being performed by or on behalf of the insured at the time of the property damage arising out of such operations, or
>
> (ii) out of which any property damage arises, or
>
> (iii) the restoration, repair or replacement of which has been made or is necessary by reason of faulty workmanship thereon by or on behalf of the insured;

The "that particular part" formulation serves to limit the scope of the exclusion only to property damage to the particular part of any property upon which operations are being performed by the insured at the time of the property damage, out of which the property damage arises, or the restoration, repair or replacement of which is necessary due to faulty workmanship by or on behalf of the insured. In other words, the exclusion is limited to "that particular part" of the property damage described in it, and not damage to other portions of the contractor's work. For a case recognizing that limitation under the BFPDE, *see, Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824, 828, applying Exclusion y(2)(d) only to the particular defective part – prefabricated masonry panels – and not to the damage to other elements of the work on the building.

Despite the extra premium charged for it, the BFPDE was extremely popular throughout the 1970's and early 1980's. In fact, most CGL policies issued to construction risks included the BFPDE. Obviously, application of the Contractual Liability Exclusion to the circumstances where damage to the insured contractor's work breaches its contract, and nothing more, contravenes the limitations on the property exclusions introduced through the standard CGL policy by the attachment of the carefully crafted BFPDE.

3. The 1986 Revision: Preservation of Coverage for Property Damage to the Insured Contractor's Work in Plain Language

Due in part to what was perceived as the complexities of the expanded coverage provided to construction insureds in the 1973 CGL policy as endorsed by the BFPDE, ISO rolled out a major revision to the policy in 1986. In doing so, it attempted to use plainer language and to lessen the cumbersome practice of adding endorsements such as the BFPDE to accomplish the desired coverage.[4] As a part of that effort, the provision of coverage for property damage arising out of a subcontractor's work was redrafted from the deletion of the "on behalf of" formulation in Exclusion (o) to an affirmative statement preserving coverage for property damage arising out of the work of subcontractors in a revised exclusion, Exclusion l, inserted into the coverage form itself in the 1986 policy. Again, that coverage applied only to property damage occurring in the completed operations context. Exclusion l, also referred to as the Your Work Exclusion, states that the insurance does not apply to:

> "Property damage" to "your work" arising out of it or any part of it and included in the "products-completed operations hazard."
>
> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.

[4] While there have been subsequent revisions to the CGL form after 1986, the basic rewriting of the form at that time is still referred to as the "1986 form" and the operative provisions before this Court have not changed since then. The Amerisure policy is written on the 1986 form.

While the provision preserving coverage for an insured contractor for property damage arising out of the work of its subcontractors was not necessarily new, having been inserted into the BFPDE in 1969 by modifying Exclusion (o), it nevertheless gained increasing acceptance and popularity on its own right. Eventually, the concept has come to be referred to as the "subcontractor exception" and has been the subject of numerous court opinions, most of them upholding coverage for a general contractor for property damage arising out of the defective work of its subcontractors.

This Court applied the subcontractor exception and upheld the existence of coverage for an insured builder arising out of the defective work of its subcontractor in *Lamar Homes v. Mid-Continent Casualty*, 242 S.W.3d 1, recognized throughout the construction and the insurance industries as a landmark opinion on this issue. In light of the prominence of the *Lamar Homes* opinion, further citation to the large body of case law upholding the subcontractor exception, both Texas and national, is not needed.

Likewise, commentators have also recognized the importance of the addition of the subcontractor exception to the 1986 form:

> The 1986 CGL arrived at the height of the great hard market. Changes in the pollution coverage and the new claims-made CGL took center stage … There was also a substantial change to the coverage for completed operations with the words:

> This exclusion does not apply if the damaged work or the work out of which the damage arises was performed on your behalf by a subcontractor.
>
> This major increase in the scope of coverage was important for those who did not have the broad form property damage endorsement to the CGL.

George B. Flanigan, *CGL Policies of 1941 to 1966: Origins of Product Liability*, 58 CPCU eJOURNAL 1, 9 (Aug. 2005).

In addition to adding an affirmative statement as to the subcontractor exception, the 1986 revision to the CGL policy moved Exclusion (y)(2)(d) from the BFPDE to the body of the policy itself. The revision clarified that the revised exclusions applied only to property damage occurring while construction operations were in progress, and they consolidated the three exclusions set out in Exclusion (y)(2)(d) above into two, Exclusions j(5) and j(6). Those exclusions state that the insurance does not apply to property damage to:

> **(5)** ***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; or
>
> **(6)** ***That particular part*** of any property that must be restored, repaired or replaced because "your work" was incorrectly performed on it.
>
> ***
>
> Paragraph **(6)** of this exclusion does not apply to "property damage" included in the "products-completed operations hazard".

By retaining the "that particular part" formulation, Exclusions j(5) and (6) in the 1986 form provide the same limitation as to damage to an insured contractor's work, i.e., only excluding the "particular part" upon which the insured is performing operations at the time of the property damage, or which must be repaired or replaced because the insured's work was incorrectly performed upon it.

Therefore, even in factual scenarios involving ongoing operations, the application of the Contractual Liability Exclusion to property damage to the work arising out of the insured's own breach of a construction contract is troublesome and contrary to the structure and application of the CGL policy to the construction industry. In addition, it robs a contractor of coverage for property damage to its own work during operations that has otherwise been upheld by cases applying Exclusions j(5) and j(6) under Texas law. In *Mid-Continent Casualty Co. v. JHP Dev., Inc.*, 557 F.3d 207 (5th Cir. 2009) and *Gore Design Completions, Ltd. v. Hartford Fire Ins. Co.*, 538 F.3d 365 (5th Cir. 2008), the Fifth Circuit limited the scope of those exclusions in the standard CGL policy to only the "particular part" of the work upon which the insured was performing operations or that had to be repaired or replaced because the insured performed its work defectively upon it. In doing so, the court preserved coverage for the property damage to other elements of the insured's work. Such coverage would

be lost if the Contractual Liability Exclusion were to be applied to the same property damage.

4. The Contractual Liability Exclusion Has Peacefully Co-Existed with the Business Risk Exclusions for the Last Fifty Years

Throughout the nearly fifty years of revisions to the CGL policy, the Contractual Liability Exclusion itself has undergone some revisions, but has not changed significantly, certainly not as significantly as the business risk exclusions targeted at the construction industry and as described above. The 1966 and 1973 forms contained identical exclusions that, in relevant part, stated that the insurance did not apply to "liability assumed by the insured under any contract or agreement except an incidental contract." The term "incidental contract," usually broadened by endorsement, included "any contract or agreement relating to the conduct of the named insured's business."

As is the case with the business risk exclusions discussed above, in 1986, the blanket contractual liability coverage added by endorsement was incorporated into the CGL form itself under the present day exclusion found in the Amerisure policy, stating that the insurance does not apply to:

b. Contractual Liability

> "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) 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" …

As can be seen, all of the CGL revisions, including the 1966, 1973 and 1986 CGL forms, exclude coverage only for liability assumed by the named insured, or liability for damages by reason of the "assumption of liability" in a contract or agreement. Thus, except for application of the first exception to the exclusion contained in the 1986 form (and the Amerisure policy), the scope of the exclusions is essentially the same, being limited to liability assumed by the insured under a contract or agreement.

Essentially, contractual liability coverage and the business risk exclusions have "co-existed" in the CGL policy for years, without the contractual liability exclusion being read in the sweeping manner as argued for by Amerisure on appeal, i.e., over-extending this Court's opinion in *Gilbert Construction v. Underwriters at Lloyd's* to apply to simple breaches of contract that do not involve assumption of additional liability. Unlike Amerisure, the Fifth Circuit at least expressed "misgivings" in undoing the nearly fifty years of careful drafting, underwriting, interpretation – and marketing – of the CGL policy by applying the contractual liability exclusion so as to disregard the limitations on the business risk exclusions, particularly the subcontractor exception. It is respectfully submitted

that such slash and burn destruction of CGL coverage for an entire industry warrants more than mere misgivings. It warrants unqualified rejection by this Court.

Amerisure argues that the Contractual Liability Exclusion and the business risk exclusions, particularly the subcontractor exception to the Your Work Exclusion, must be considered separately, again citing cases such as *T.C. Bateson Construction Co. v. Lumbermens Mutual Casualty Co.*, 784 S.W.2d 692, 699, a case that applied earlier editions of the CGL policy without the subcontractor exception that is central to CGL coverage for insured contractors in Texas, including Ewing on its appeal. The *T.C. Bateson* treatment of this issue was made in the course of interpreting an exception to the contractual liability exclusion that was contained in the 1966 and 1973 policy forms. That exception stated that the contractual liability exclusion did not apply to breach of implied warranty of fitness, quality or workmanship claims relating to contractual liability. The court actually held that the exception remained effective, but subject to and limited by all other related exclusions contained in the policy. In addition, this pronouncement was made in response to the insured's argument that the application of the Work Performed Exclusion rendered the policy ambiguous in light of the exception. That is neither the argument of Ewing nor Amici Curiae before this Court.

Amerisure's argument and the Fifth Circuit's apparent attempt to apply what it believed to be the plain language of the policy under Texas law, resulted in an incomplete analysis of the Amerisure policy. Such an incomplete analysis is impermissible, in that an insurance contract, like any other 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). Amici curiae does nothing more than ask this Court to consider all of the provisions of the CGL policy issued to contractors such as Ewing in light of how they have been marketed and interpreted for almost fifty years. When all of those provisions are considered, the Contractual Liability Exclusion should be harmonized with the other business risk exclusions that preserve coverage for defective work performed by a construction insured and its subcontractors. The disharmony caused by the argument of Amerisure, as accepted by the Fifth Circuit in its vacated opinion in *Ewing*, can be eliminated by answering the First Certified Question in the negative since an insured's breach of a construction contract by performing its work defectively, and nothing more, does not amount to the type of assumption of liability excluded under Exclusion b of the CGL policy.

B. Improvident Application of the Contractual Liability Exclusion Will Deprive Texas Insureds of Completed Operations Coverage

If Amerisure's argument is accepted, it will likely deprive the construction industry of one of the most valued components of the CGL policy – completed

operations coverage. Completed operations coverage is critical since it protects a construction insured from the long tail post-completion liabilities that accompany most construction projects, particularly multi-family residential projects such as condominiums. The need for effective completed operations coverage is demonstrated by the statute of repose under §§ 16.008-009 of the Texas Civil Practice and Remedies Code. That statute subjects a contractor to liability for up to ten years after substantial completion of the project, a period that can be extended up to twelve years based on date of discovery. Texas contractors, as well as contractors around the United States, have learned that a statute of repose is not necessarily a limitation, but instead an invitation to other parties to file suit against the contractor up to the end of that period and years after completion of the project.

Commentators have acknowledged the "critical importance to the construction industry of the scope of coverage provided by the CGL policy for third party claims of defective construction, particularly claims alleging damage to the work and completed operations of the insured." David Dekker, Douglas Green & Stephen Palley, *The Expansion of Insurance Coverage for Defective Construction*, 28 CONSTR. LAWYER 19 (Fall 2008). Dekker follows up his analysis with the observation that contractors are frequently exposed to claims by owners that defective workmanship has caused extensive damage to a completed project.

He then asks the question, "Are such claims covered by CGL policies?" *Id.* Unfortunately, the answer per Amerisure in this case is apparently "No."

As previously indicated, one of the driving forces behind the extension of coverage available under the BFPDE and the 1986 CGL policy form was to make it more acceptable to contractors, i.e., to make the CGL insurance product more marketable and to sell more policies. The Florida Supreme Court recently acknowledged this strategy of the insurance industry:

> The insurance and policyholder communities agreed that the CGL policy should provide coverage for defective construction claims so long as the allegedly defective work had been performed by a subcontractor rather than the policyholder itself. This resulted both because of the demands of the policyholder community and the view of insurers that the CGL was a more attractive product that could be better sold if it contained this coverage.

United States Fire Ins. Co. v. J.S.U.B., Inc., 979 So.2d 871, 879 (Fla. 2008) (quoting 2 Jeffrey W. Stempel, STEMPEL ON INSURANCE CONTRACTS §14.13[D] at 14-224.8 (3d ed. Supp. 2007)). *United States Fire v. J.S.U.B.* was issued shortly after this Court's opinion in *Lamar Homes v. Mid-Continent Casualty*, and they are frequently cited in tandem for their analysis of the definition of occurrence and application of the subcontractor exception upholding coverage for defective workmanship claims.

Emphasis by insurers on the heightened coverage provided to construction contractors through the BFPDE and the 1986 policy revision has contributed to the

construction industry's expectation of that coverage, and more significantly, reliance upon its existence in managing the risks associated with its business. Of course, the policy extensions, primarily the subcontractor exception and "particular part" limitations introduced in the BFPDE and the 1986 policy form, do not amount to mere public relations ploys. Rather, significant coverage was provided to construction insureds, particularly those who performed their work through subcontractors, and for losses that occurred subsequent to completion, and in many instances well after completion. As a result, some insurers that were unwilling to provide that coverage have more recently endorsed their policies with Endorsement CG 22 94 intended to eliminate the subcontractor exception, as recognized by this Court in *Lamar Homes v. Mid-Continent Cas.*, 246 S.W.2d 1, 12.[5] Nevertheless, it appears that most insurers have not adopted this approach to eliminate coverage for this exposure and the Amerisure policy before this Court does not contain Endorsement CG 22 94.

Despite the reliance of the insurance industry on broad completed operations coverage to sell policies, and the construction industry's expectation for that coverage, Amerisure's application of the Contractual Liability Exclusion to claims such as the one before this Court would virtually eliminate that coverage for the

[5] Endorsement CG 22 94 provides that Exclusion l in the policy, which contains the subcontractor exception, is replaced by a new exclusion that deletes the exception.

entire Texas construction industry. Therefore, Amici Curiae, on behalf of that industry, urge the Court to reject that application and to answer "No" to the First Certified Question.

II. IMPROVIDENT APPLICATION OF THE CONTRACTUAL LIABILITY EXCLUSION TO THE INSURED'S LIABILITY FOR BREACH OF CONTRACT RADICALLY CHANGES THE GAME FOR TEXAS INSUREDS

An unwarranted over-extension of the Contractual Liability Exclusion to an insured contractor's liability for property damage arising out of its own breach of contract is truly a game changer for the Texas construction industry and has potential ramifications well beyond that industry. While construction is a complex industry and not a game, Yogi Berra once said, "It's tough to make predictions, especially about the future." Yogi Berra was, of course, a professional baseball player, and not a Texas contractor. Nevertheless, Mr. Berra and construction insureds have similarities. For contractors, it is tough enough to make predictions as to the future risks and exposures arising out of a complex construction project. Texas insureds must now apparently try to predict how an appellate court will interpret a standard insurance policy designed to protect the contractor and smooth out the hazards to be encountered during the course of constructing a project, let alone years after the project is completed. Luckily for Yogi Berra, he never had to attempt such a prediction.

The application of the Contractual Liability Exclusion to the type of breach of contract involved in this case amounts to such a novel interpretation of the policy that it would be impossible for any Texas insured, let alone its agent or broker, to predict and then plan for. Setting aside the fact that such an interpretation is contrary to the language of the policy itself, it is simply ill-advised.

A. Predictability in the Interpretation of the CGL Policy is Imperative to Texas Construction Insureds

Traditional management of the risks of complex construction projects has always included insuring against fortuitous or accidental losses. For that reason, predictability as to the existence and scope of insurance coverage for the construction industry is critical, as is well-noted in the commentary:

> There is an alarming lack of predictability in the construction industry today about whether contractors' CGL policies will cover property damage arising out of defective construction. It is particularly unpredictable for those contractors performing work in multiple states. National contractors, especially, cannot foretell the scope of the coverage in their CGL policies. This problem isn't with the policies they procure; virtually every contractor's CGL policy form is identical and mirrors the ISO's standard General Liability Form, the CG 20 10 [sic]. The problem is the identical policy forms are being construed in radically different ways by the courts. As a result, contractors are covered in some states, but bare in others.

James Duffy O'Connor, *What Every Court Should Know About Insurance Coverage for Defective Construction*, JOURNAL OF THE AMERICAN COLLEGE OF CONSTR. LAWYERS, p. 1 (Winter 2011)("O'Connor").

O'Connor addresses lack of predictability and uniformity of results among different states. For example, a claim of the type before this Court, i.e., property damage arising out of defective construction performed by an insured contractor's subcontractor, may not be covered in Texas if Amerisure's argument is adopted, but across the state line in Louisiana, the claim would be covered. *See Broadmoor Anderson v. National Union Fire Ins. Co. of La.*, 912 So.2d 400 (La. App. 2d Cir. 2005), *cert. denied*, 925 So.2d 1239 (La. 2006) (refusing to apply the Contractual Liability Exclusion to a completed operations claim involving defective work performed by subcontractors of the insured general contractor).[6] The Fifth Circuit's initial opinion, because of its novel approach, has attracted significant attention nationwide. In the event this Court accepts Amerisure's over-extension of *Gilbert v. Underwriters at Lloyds* and applies the Contractual Liability Exclusion to Ewing's breach of contract, it is likely that such an opinion would be relied upon by other courts and insurers outside of Texas, only compounding the lack of predictability of coverage for insured contractors.

At the same time, the lack of predictability caused by the Court's opinion may result in a denial of future claims under the same policies under which the

[6] *Broadmoor Anderson v. National Union* is but one example of the majority of cases that restrict the Contractual Liability Exclusion to indemnity or hold harmless agreements, and this Court recognized its application outside that context in *Gilbert* as a minority view. To further apply the Contractual Liability Exclusion urged by Amerisure would represent an extreme minority view.

same claims would have been covered prior to the entry of the Court's opinion. In *Don's Building Supply, Inc. v. OneBeacon Ins. Co.*, 267 S.W.3d 20 (Tex. 2008), this Court applied the "injury in fact" trigger so that multiple CGL policies may apply to construction defect claims involving property damage that occurred in the past. Thus, policies that were purchased by construction insureds from their brokers and agents in the past may no longer provide coverage for claims that have been previously regarded to be covered. This type of circumstance is even more damaging to the construction industry than state-to-state variations in policy interpretation in that neither the construction risk manager, nor its broker, can ever accurately predict whether a CGL policy will respond to what was previously regarded as an insurable covered loss.

In addition, the ISO CGL policy form is used throughout the entire United States and Texas to insure all sorts of businesses from nursing homes, to dry cleaners, to small businesses, including smaller contractors and subcontractors, as well as the largest contractors in the world. Thus, the lack of predictability created by this Court's opinion will likely go well beyond the construction industry and may result in a significant reduction of coverage for any insured that does business via contract. For this reason, this Court should consider whether the loss of fifty years of predictability in insurance coverage is warranted by the over-extension of *Gilbert v. Underwriters* advocated by Amerisure.

B. Unpredictability Compounds the Difficulties Presented by New Challenges to Contractual Transfer of Risk

The construction industry has traditionally transferred risk by virtue of indemnification and hold harmless agreements. In that regard, the Contractual Liability Exclusion's exception for "insured contracts" extends the coverage under the CGL policy to these types of agreements. These agreements are found in nearly every construction contract, which is the very reason the CGL policy provides contractual liability coverage.

As of January 1, 2012, Chapter 151 of the Texas Insurance Code renders void as against public policy any indemnity clause or additional insured requirement that indemnifies the indemnitee for its own negligence or breach of contract. Therefore, an upper tier on a construction project such as a general contractor is no longer able to tender its defense or seek indemnity from lower tier subcontractors for allegations involving the general contractor's own fault but arising out of the work of its subcontractors.

If the Contractual Liability Exclusion were to be improvidently applied to the property damage alleged against Ewing, a general contractor such as Ewing would have nowhere to look for protection for the type of completed operations claim arising out of a subcontractor's work that is before this Court. Traditionally, Ewing, as the general contractor, would have coverage for property damage arising out of the defective work of its subcontractor. That coverage would be negated by

Amerisure's over-extension of the Contractual Liability Exclusion. At the same time, the subcontractor itself usually has no coverage under its own policy for property damage to its own work arising out of its breach of its subcontract, and even if it used subcontractors in its work, the subcontractor exception is again mooted under the argument of Amerisure. A yawning gap would be created which pre-*Ewing* CGL coverage previously filled. Predictability as to coverage has been lost and the extreme nature of Amerisure's position is demonstrated.

Even though the Fifth Circuit's opinion preserves coverage for property damage to third party work and property, this availability of coverage for property damage to third party property is not a panacea for most insureds. It will place higher priority on the CGL coverage of subcontractors and other lower tiers, and that subcontractor coverage will assume increased importance when funding construction defect settlements for the simple reason that the subcontractor's own work (subject to exclusion) is a smaller component of the overall project. However, usually the general contractor maintains CGL insurance with broader coverage and higher limits than lower tier subcontractors can obtain. Unfortunately, under Amerisure's position, general contractors will likely not be able to access that coverage through the subcontractor exception.

CONCLUSION

Prior to being vacated, the Fifth Circuit's opinion was heralded in some circles as signaling the death of construction defect insurance coverage in Texas. Hopefully, the news of the death of construction defect coverage is greatly exaggerated. Nevertheless, while that opinion was outstanding, resolution of construction defect claims in Texas became more difficult, with insurers relying on the opinion to take coverage from the table. In the event this Court accepts the position of Amerisure, the resolution of always complex and often high dollar claims will, again, be extremely difficult. This Court can avoid that occurrence in this appeal. Therefore, Amici Curiae respectfully request that the Court answer the First Certified Question in the negative, and if reached, to adopt the position of Appellant Ewing Construction Company and answer "Yes" to the Second Certified Question.

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, TEXO – The Construction Association, Associated General Contractors – Houston Chapter, ABC of Texas, American Subcontractors Association, Inc. and ASA of Texas, Inc. in Support of Appellant Ewing Construction Co., Inc. has been served upon counsel of record in accordance with Misc. Docket No. 11-9152 of the Supreme Court of Texas on the 21st day of December, 2012.

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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 7,566 words, excluding any parts exempted by Tex. R. App. P. 9.4(i)(1).

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