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Texas Supreme Court Rejects Insurer Attempt to Expand Limited Insurance Exclusion for Liability Assumed by Contract, Holding that Insurer Must Defend Construction Defect Dispute Against Insured

Posted on January 28, 2014

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In a highly anticipated ruling earlier this month, the Texas Supreme Court rejected Amerisure Insurance Company's attempt to radically expand the scope of a common exclusion for liability assumed by contract found in many comprehensive general liability insurance policies. See *Ewing Constr. Co., Inc. v. Amerisure Ins. Co.*, No. 12-0661, 2014 WL 185035 (Tex. Jan. 17, 2014). The Court's ruling reversed the insurer's denial of coverage for claims arising out of a construction defect dispute. In rendering its decision, the Court emphasized the narrow scope of its prior ruling in the *Gilbert Texas Construction* case, which upheld the applicability of the same exclusion in "unusual circumstances" three years earlier. See *Ewing Constr.*, 2014 WL 185035, at *4-5 (discussing *Gilbert Texas Constr., L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010)).

Ewing Construction Company had entered into a standard construction contract with the Tuloso-Midway Independent School District, agreeing to build tennis courts and to perform its work in a "good and workmanlike manner." *Id.* at *1, 6. Shortly after construction was completed, the tennis courts began flaking, crumbling, and cracking. *Id.* at *1. The school district filed suit against Ewing Construction for negligence and breach of contract. *Id.*

Ewing Construction provided notice of the underlying suit to Amerisure Insurance under its comprehensive general liability policy. *Id.* Amerisure Insurance wrongfully refused to defend Ewing Construction, citing a common policy provision excluding coverage for damages the insured is obligated to pay "by reason of the assumption of liability in a contract or agreement." See *id.* at *1, 3. Ewing Construction filed suit in the U.S. District Court for the Southern District of Texas, seeking a declaration that Amerisure had breached its duties to defend and indemnify Ewing Construction in the underlying construction dispute with the school district. *Id.* at *1.

The district court agreed with Amerisure Insurance that the assumed contractual liability exclusion barred coverage. *See id.* at *2. In reaching its decision, the district court cited the Texas Supreme Court's recent decision in the *Gilbert Texas Construction* case upholding the applicability of the exclusion in "unusual circumstances." *See id.**2, 5. The district court concluded that, by agreeing to perform its work for the school district in a "good and workmanlike manner," Ewing Construction "assumed liability" through contract and, therefore, under *Gilbert Texas Construction*, was barred from coverage by the exclusion for assumed contractual liability. *See id.* *2. On appeal, the Fifth Circuit, in a 2-1 opinion, initially affirmed the district court's judgment, but later withdrew its opinion and asked the Texas Supreme Court to clarify its position. *See id.*

The Texas Supreme Court rejected the expansive application of the contractual liability exclusion urged by Amerisure Insurance and adopted by the district court. The Court explained that *Gilbert Texas Construction* established that the phrase "assumption of liability" in the policy exclusion means that the insured has assumed a liability that *exceeds* the liability it would already have under general law. *See id.* at *5. The Court noted that it had decided in *Gilbert Texas Construction* that the standard exclusion in comprehensive general liability policies for liability assumed under contract did not apply to a contractual duty that "mirror[ed] [the insured's] duty . . . [of care] under general law principles." *Id.* On the contrary, the Court held that the exclusion only applied in the "unusual circumstances" where the contractual liability "extends beyond [the insured's] obligations under general law . . . so [the insured's] *only* potential liability . . . was liability *in excess of* what it had under general law principles." *Id.* (emphasis added).

Turning to current case, the Court observed that Ewing Construction had a common-law duty, separate and apart from its contractual duty, to perform its work with skill and care. *See id.* at *6. Accordingly, the Court concluded, consistent with *Gilbert Texas Construction*, that the assumed contractual liability exclusion did not apply to Ewing Construction, holding that "a general contractor who agrees to perform its construction in a good and workmanlike manner, without more, does not enlarge its duty to exercise ordinary care in fulfilling its contract, thus it does not 'assume liability' for damages arising out of its defective work so as to trigger the Contractual Liability Exclusion." *Id.* at *7.

Although there are good arguments that the Texas Supreme Court could and perhaps even should have gone further than it did in limiting the insurer's bid to expand the scope of the assumed contractual liability exclusion, it did not need to do so in the context of the *Ewing Construction* case. Its ruling there precluded the insurer's attempt to avoid its coverage obligations based on the exclusion, and required the insurer to defend the construction defect claims at issue. The decision is highly significant in the context of insurance coverage for construction defect claims, where insurers regularly argue that common contract provisions requiring work to be performed in a workmanlike manner bar coverage for property damage caused by allegedly negligent work. Taken together with the Court's earlier decision in *Gilbert Texas Construction*, the *Ewing Construction* case establishes that, in Texas, the assumed contractual liability exclusion will only apply in "unusual circumstances" that rarely, if ever, will occur.

But the significance of this pair of cases is not limited to construction defect disputes. Commercial contracts, particularly those involving the provision of services, frequently state that the parties need to meet some standard of performance. Insurers will continue to argue that such clauses trigger application of the assumed contractual liability exclusion. In some cases – although emphatically not in Texas – insurers have made some headway with such arguments.

Given insurer efforts to twist the exclusion beyond its true scope in this fashion, contracting parties would be well served to modify relevant language in construction defect and other commercial contracts to minimize the likelihood of insurer mischief in this regard. For example, instead of stating an obligation to exercise a duty of care, conform to workmanlike standards, or otherwise act in a reasonable fashion, parties to commercial contracts instead could simply acknowledge that general legal principles (separate and apart from the contract) impose such duties. Doing so would undercut the ability of insurers to dramatically expand the scope of the assumed contractual liability exclusion at the point of claim.