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NEW TEXAS COVERAGE CASE ALERT – April 28, 2011

Federal Judge Reads *Gilbert* Broadly—"Contractual Liability" Exclusion Eliminates Duty to Defend Construction Defect Claims Even When Negligence Alleged If There Are No Allegations of Any Damage to Anything Other Than The Construction That Was the Subject of the Insured's Contract

Since the Texas Supreme Court's opinion last year in *Gilbert Texas Construction v. Underwriters*, 327 S.W.3d 118 (Tex. 2010), Texas coverage lawyers have been left to wonder whether *Gilbert's* application of the standard CGL's "contractual liability" exclusion to claims alleging the insured's own contractual liability, as opposed to only an assumption of someone else's liability, would be applied beyond the specific *Gilbert* facts more generally to run-of-the-mill construction defect and other similar cases. In *Gilbert*, the Court whetted practitioners' curiosity on how broad, or narrow, its holding really was by reaffirming that construction defect claims potentially allege both an "occurrence" and "property damage" as it had held in *Lamar Homes* and by stating conspicuously in the opinion that its decision should not be construed as holding that all breach of contract claims were excluded by the "contractual liability" exclusion. Did this mean that *Gilbert* was going to be limited to its own somewhat specific and unusual facts or, instead, would courts apply it more broadly to negate coverage in construction defect scenarios?

In the first and only case to date to now apply *Gilbert*, Corpus Christi federal district Judge Janice Jack, in a carefully drafted April 28, 2011 decision that recognizes the tension between *Gilbert* and *Lamar Homes* , and uncertainty as to how broadly *Gilbert* should be read, held that the "contractual liability" exclusion meant that a CGL carrier had no duty to defend its insured contractor against breach of contract *and negligence* claims involving alleged construction defects in tennis courts the insured constructed for a school district in South Texas. *Ewing Construction Co., Inc. v. Amerisure Ins*. Co., Civ. Action No. C-10-256 (S.D. Tex. April 28, 2011).

In *Ewing*, Judge Jack held that where the only damage alleged is property damage to the thing that was the subject matter of the insured's contract, the "contractual liability" exclusion, as construed in *Gilbert*, applies even where there are negligence claims in addition to breach of contract and breach of warranty. She acknowledged the *Gilbert's* statement that *Gilbert* did not mean that all breach of contract cases were necessarily excluded by the exclusion, but concluded that *Gilbert* nevertheless stood for the proposition that the exclusion applies "when an insured has entered into a contract and, by doing so, has assumed liability for its own performance under that contract." Judge Jack seems to have fully appreciated the potential significance of her decision because she noted in footnote 7 the insured's concern that the carrier's position on the exclusion "would potentially wipe out any coverage for a general contractor" and stated that, while she did not necessarily read *Gilbert* that broadly, she did "agree with the conclusion that it operates to exclude coverage in the present circumstances and in that sense is quite broad in application." She then examined whether the exception to the exclusion for liability that the insured would have, even in the absence of the contract applied to the negligence claims, but held that it did not. She reasoned that where the only damage sought is to the subject matter of the contract (*i.e.*, the tennis court), all the claims were, in essence, contract claims at their

root, notwithstanding *Lamar Homes'* rejection of the "economic loss rule" as rule of decision in coverage cases.

PRACTICE POINTERS: If *Ewing* is the start of a trend among courts, especially federal courts, to give *Gilbert* a broad application and find no duty to defend contractors in construction defect cases, then it will prove to be a very significant case. But only time will tell if it is, indeed, the start of a trend or instead merely an anomaly among other decisions yet to be issued applying *Gilbert* more narrowly. If this decision is appealed to the Fifth Circuit, then this district court opinion may not be the last word. And, *Ewing* does not hold that the exclusion applies if there are allegations of consequential damage to other structures or work other than the work contracted for by the insured, as there frequently will be if the insured is a subcontractor. But where, as in *Ewing*, the only damage alleged is to the subject matter of the insured's contract, as is often the case, then *Ewing* potentially means that a CGL carrier has no duty to defend or coverage. Ultimately, the Texas Supreme Court is probably going to have to construe the exact contours of *Gilbert* in a later case. For now, though, carriers and insureds need to be aware of *Ewing* and govern themselves accordingly and carefully.

If you wish to discuss any insurance-related issues or needs, please feel free to contact Schubert & Evans, P.C. at 214.744.4400 or visit our website at www.schubertevans.com.