INSURANCE COVERAGE FOR CONSTRUCTION DEFECTS

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I. INTRODUCTION

When faced with an alleged construction defect, insurance adjusters and attorneys are often faced with complex, multi-layered and often-conflicting contractual relationships and insurance obligations. Often a defect in a construction project will result in manifold claims for insurance coverage and omnifarious lawsuits pointing fingers in every direction of the construction work. Similar to walking into a hall of mirrors, coverage is sometimes determined more upon the angle from which it is interpreted rather than the reality for which it is intended to reflect. Even though each party to a construction defect claim believes that their insurance policies cover certain facets of a construction project, in the end, it is sometimes the direction from which a court interprets the policies that controls each party's coverage reality.

There are typically a variety of coverages available when something goes wrong on a construction project, all of which must be analyzed and evaluated. Often there is some form of property insurance such as builders risk insurance or some form of a surety bond or bonds at issue on the project. The commercial general liability insurance available to the parties involved is another form of insurance to which contractors look for coverage when a construction defect arises. This paper is dedicated to exploring the various angles from which commercial general liability coverage can be judged a reality. Upon consideration of the judicial interpretation of commercial general liability policies by Texas courts, it is the intent of this paper to aid insurance adjusters and attorneys in looking beyond the hall of mirrors with a narrowed focus on the reality of coverage for construction defect claims.

II. COMMERCIAL GENERAL LIABILITY COVERAGE

The commercial general liability (CGL) policy form grants a wide range of coverage for liability incurred on a construction project. However, at the outset, it is important to remember that CGL policies are not intended to cover all liability that is incurred on a construction project. In particular, contractors who seek coverage for the possibility that one of their own workers may be injured on the project or for the possibility that the contractor's work fails to meet building code or other standards, should not look to a CGL policy to provide such coverage. The former is more appropriately covered by worker's compensation policies governed by the Texas Worker's Compensation Act. Worker's compensation policies are specifically directed to provide benefits to workers who are injured in the course of their employment. The latter field of coverage is more appropriately handled by a builder's risk policy. Builder's risk insurance is first party property insurance typically covering projects under construction, renovation or repair. As will be discussed in more detail below, the worker's compensation and builder's risk lines of insurance more appropriately address certain injuries and defects inherent in construction projects.

A. The CGL Coverage Grant

The current CGL policy form evolved in 1986 from the prior 1973 policy form as well as the "broad form property damage endorsement" which was attached to the 1973 form. The current CGL policy form casts a broad net of coverage in the insuring agreement which is more narrowly-tailored in the exclusions that follow. This broad grant of coverage is evident in the current CGL policy form insuring agreement which generally provides something similar to the following:

1. Insuring Agreement
   a. We will pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies. We will have the right and duty to defend any suit seeking those damages. We may at our discretion investigate any occurrence and settle any claim or suit that may result. But:
   (1) the amount we will pay for damages is limited as described in LIMITS OF INSURANCE, SECTION III, and
   (2) our right and duty to defend end when we have used up the applicable limit of insurance in the payment of judgments or settlements under Coverages A or B or medical expenses under Coverage C.

> No other obligation or liability to pay sums or perform acts or services is covered unless explicitly provided for under SUPPLEMENTARY PAYMENTS, COVERAGES A AND B.

Two prerequisites to coverage under this insuring agreement are (1) the insured must be legally obligated to pay damages because of bodily injury or property damage; and (2) such damages must arise out of an occurrence. What constitutes "bodily injury" is typically more clear and in any event is not the general scope of this paper, as construction defect cases are primarily focused on property damage. However, what constitutes an "occurrence" and "property damage" is far from conclusively determined by the language of the policy. The first two angles one must consider in interpreting the standard form CGL policy are (1) what constitutes an occurrence, and (2) did the occurrence result in "property damage" under the terms of the policy.

B. What Constitutes an "Occurrence"

Underlying the determination of whether a construction defect constitutes an occurrence are the principles of "accident" and "fortuity," which lay the foundation for all insurance in general. It is well-settled that insurance is not designed to cover inevitable results which predictably and necessarily emanate from deliberate actions. *See Meridian Oil Production Co. v. Hartford Accident & Indemnity Co.*, 27 F.3d 150, 152 (5th Cir. 1994). Beginning with the 1966 comprehensive general liability form, CGL coverage turned away from the relatively-undefined and anomalous concept of "accident" and based coverage on whether an "occurrence" had occurred. In 1973, a revision of the CGL form redefined "occurrence" to include continuous and repeated exposure to conditions resulting in injury or damage, thus further defining the concept of "accident." The 1986 CGL form and its subsequent iterations deleted the phrase "neither expected nor intended from the standpoint of the insured" from the 1973 CGL form, choosing to incorporate this language in the intentional injury exclusion of that form. Presently, the term "occurrence" is defined as follows:

> "Occurrence" means an accident including continuous or repeated exposure to substantially the same general harmful conditions.

Despite its revisions, the term occurrence remains less than self-defined. Reference to the older concepts of "accident" and "fortuity" still are necessary in determining coverage.

The term "accident" means an unexpected, unforeseen, or undesigned happening or consequence from either a known or unknown cause. *See Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.–Texarkana 1979, no writ); *Employers Casualty Co. v. Brown-McKee, Inc.*, 430 S.W.2d 21 (Tex. Civ. App.–Tyler 1968, writ ref'd n.r.e.). More specifically, the term "accident" encompasses acts of the insured which are negligent, unintentional or unexpected. *See Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967). *See CU Lloyd's of Texas v. Main Street Homes*, 79 S.W.3d 687 (Tex.App.–Austin 2002, no pet.) (Homeowners' allegations that general contractor built homes after learning that foundation designs were inadequate for soil conditions and failed to disclose that knowledge to purchasers stated an accident and thus an occurrence within the meaning of the general liability policy where the homeowners alleged negligence and did not limit their claims to intentional tort or shoddy workmanship, but claimed loss from erroneous soil surveys and faulty or inadequate design by the engineering firm.). In further defining this concept, the Federal Court of Appeals for the Fifth Circuit has particularly focused its attention on whether the insured's injury was the natural and probable consequence of intentional conduct. In pertinent part, the Fifth Circuit stated in *Meridian Oil Production Co. v. Hartford Accident & Indemnity Co.*, 27 F.3d 150 (5th Cir. 1994):

> Texas courts afford coverage for fortuitous damages but deny coverage when damages are the natural and probable consequence of intentional conduct. Regardless of whether the policies involved are worded to cover "accidents" or "occurrence," all offer minor variations of the same, essential concept; coverage does not exist for inevitable results which predictably and necessarily emanate from deliberate actions.

Id. at 152 (footnote omitted).

Thus, at the heart of the accident/fortuity analysis, the focus is not on whether the policyholder's acts were intentional, but instead on whether the resulting injury or damage was expected or intentional. *See Hartford Casualty Co. v. Cruse*, 938 F.2d 601, 604-05 (5th Cir. 1991); *Bituminous Cas. Corp. v. Vacuum Tanks, Inc.*, 75 F.3d 1048 (5th Cir. 1996). Therefore, to determine whether an occurrence has taken place, it is imperative to analyze the acts of the insured that lie beneath the particular construction defect at issue. To aid in this analysis, Texas courts have handed down several analogous decisions illustrating circumstances involving negligent acts and unintentional results and deliberate or intentional acts and expected or foreseen results. These contrasting lines of decisions provide substantial guidance for the occurrence analysis.

1. Unintentional Acts and Unintended Consequences Qualify as an Occurrence

Cases involving unintentional or negligent acts leading to unintentional results are the easy cases, as these clearly constitute an occurrence. It is those involving more intentional or deliberate acts that demand a more careful analysis. Since it is well established that Texas law focuses not on whether the insured's conduct or actions are intentional, but on whether the insured intended the damages or injuries which are the subject of the underlying claims, it should come as no surprise that coverage is often afforded despite the fact that the policyholder's actions may appear rather deliberate. In an important decision, the Texas Supreme Court declared that the term "accident" as used in a pre-1966 liability policy includes the negligent acts of the insured causing damage which is undesigned and unexpected. See *Massachusetts Bond & Ins. Co. v. Orkin Exterm. Co.*, 416 S.W.2d 396 (Tex. 1967). In this case, a jury in the underlying cause of action found Orkin was negligent in the application of lindane in August of 1955 to the rice and premises of Gulf Coast Rice Mills. Orkin paid the judgment and demanded reimbursement from Massachusetts Bonding under the general liability policy issued for the period January 1, 1955 to January 1, 1956. Within this policy, "Coverage C—Property Damage Liability—Except Automobile" set forth Massachusetts Bonding's intention to pay on behalf of Orkin all sums which Orkin "shall become legally obligated to pay as damages because of injury or destruction of property caused by an accident." Massachusetts Bonding attempted to argue that the application of lindane was not an accident as it resulted from a gradual application of the pesticide from 1964 to 1965. The court summarily rejected this argument binding Massachusetts Bonding to the underlying Gulf Coast litigation which was predicated on a single application of lindane in August of 1955. Furthermore, Massachusetts Bonding attempted to argue that the application of lindane constituted gross negligence bringing the allegations outside the scope of an "accident" as used in the policy. Again, the Supreme Court held Massachusetts Bonding was bound by the underlying result, as the jury in the Gulf Coast litigation had found that Orkin's application of lindane was mere negligence.

When the negligent acts of an insured cause damage which is undesigned and unexpected, this constitutes an "accident." *Id.* at 400 (citations omitted). This finding of an accident extends to where the insured defectively performs work but does not intend the full range of damages to occur. In *Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Civ. App.—Texarkana 1979, no writ), the court considered the liability of a garage owner for the defective performance of valve work. In the underlying lawsuit, a customer brought his automobile to Volentine to perform a valve job in Volentine's garage. Volentine rendered defective performance in that the valve keeper failed to function, resulting in the destruction of the entire engine. Volentine turned to Travelers Insurance Company, his liability insurer, to defend him in the underlying lawsuit. Travelers rejected coverage, arguing that the defective performance did not constitute an "occurrence" under the terms of its CGL form. The court disagreed with this argument, holding that the term "accident" as used in a policy of this type means an unexpected, unforeseen or undesigned happening or consequence from either a known or unknown cause. *Id.* at 503 (citations omitted). Further, although the alleged defective performance of the work might or might not be considered an accident, the destruction of the entire engine as a result of the malfunction of one of the repaired valves certainly was unexpected and unintended and therefore constituted an accident within the meaning of the policy provisions.

Thus, the argument can be made that where a contractor renders defective performance in part of a project, unintended or unexpected consequences of that defective performance which affect other parts of the project may be covered as an "occurrence." This principle provides the basis for the often used argument in these types of cases that damage to other property, regardless of whether the act was deliberate, is covered under a CGL policy.

The Fifth Circuit addressed the application of the principles set forth in *Volentine* to a construction defect case in *Hartford Cas. Co. v. Cruse*, 938 F.2d 601 (5th Cir. 1991). In *Cruse*, the Fifth Circuit applied Texas law in considering whether J & J House Leveling Services defectively performed a foundation leveling service at the home of Aubrey and Judy Cruse. The Cruses sued J & J in state court for breach of warranty, negligence and violation of the Texas Deceptive Trade Practices Act, claiming that J & J's defective performance resulted in a diminution of the house's market value. Hartford Casualty Company, which had issued a comprehensive general liability policy to J & J, refused to defend J & J in the underlying suit and refused to cover the Cruses' damages. With this action, Hartford sought a declaratory judgment that J & J's defective performance did not constitute an "occurrence" within the language of its policy. In pertinent part, the court stated:

> Considered in tandem with the business risk exclusion, the "occurrence" requirement illuminates the allocation of risk. Direct (as opposed to consequential) damages that naturally flow from a breach of contract are conclusively presumed to have been in the contemplation of the parties and may therefore constitute expected or intended damages. A comprehensive general liability policy does not cover this cost of doing business. A builder who fails to abide by the specifications of a contract, for example by substituting a weaker building material, may, by that breach, produce expected property damage to his or her work and may thus fail to show covered occurrence.

However, the Fifth Circuit determined that where the resulting injury or damage was unexpected and unintended, an occurrence results, regardless of whether the policyholder's acts were intentional. *Id.* at 605 citing *Dayton Indep. School Dist. v. Nat'l Gypsum Co.*, 682 F. Supp. 1403, 1408 (E.D. Tex. 1988), reversed on other grounds sub nom. *W.R. Grace & Co. v. Continental Cas. Co.*, 896 F.2d 865 (5th Cir. 1990). Citing *Volentine*, the court stated: "The requisite accident may inure in the scope of damages." *Volentine*, 578 S.W.2d at 503. Although it is obvious that J & J intended to render defective performance, and therefore breach its contract, because J & J did not anticipate the extent to which the Cruses' house would be damaged, the court found that the resulting injury or damage was unexpected and unintended. Therefore, the Fifth Circuit concluded that the damages to the Cruses' home gave rise to a covered "occurrence."

The Fifth Circuit followed its holding in *Cruse* with *LaFarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389 (5th Cir. 1995). In *LaFarge*, suit was filed against LaFarge and various other defendants by All American Pipeline Company as a result of a defect in the construction of a pipeline to run from Santa Barbara, California to McCamey, Texas. Some time around February 1988, All American discovered that the protective coating supplied by a subcontractor to the project, Leonard Pipeline—Anchor Wate (LAC), had failed to protect the pipeline from corrosion. As LAC was LaFarge's alter ego, LaFarge applied to Hartford under its CGL policy which was in effect from April 1, 1987 through April 1, 1988. Among other reasons for denying a defense and coverage to LaFarge, Hartford argued that the failure of the LAC pipe coating did not constitute an occurrence. Citing *Cruse* and *Volentine*, the Fifth Circuit declared the failure of the coating caused unintended damage to the pipeline and therefore constituted an occurrence.

Texas appellate courts that find that damages resulting from construction errors do constitute an "occurrence" under a CGL policy include *Lennar Corp. v. Great American Ins. Co., et al,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpulished) (construction errors causing water damage to homes constituted an "occurrence" under CGL policy; inquiry is not whether insured damaged its own work or whether claim sounds in contract, but instead whether the resulting damage was unintended and unexpected from the insured's standpoint); *Archon Investments,*

Inc. v. Great American Lloyds Ins. Co., 174 S.W.3d 334 (Tex. App. – Houston [1st Dist.] 2005, pet. review filed November 17, 2005) ("Because Archon could not have intended that the negligent work of its subcontractors cause physical damage to Braden's home, damage to Braden's property due to the negligence of Archon's subcontractors falls within the scope of an occurrence under the language of the CGL policy…"); *Gehan Homes, Ltd. v. Employers Mutual Cas. Co.,* 146 S.W.3d 833 (Tex. App. – Dallas 2004, pet. filed) (damages to home resulting from insured home builder's negligence are an "occurrence" under a CGL policy); *CU Lloyd's of Texas v. Main Street Homes, Inc.,* 79 S.W.3d 687 (Tex. App. – Austin 2002, no pet.) (homeowner's claims of improperly designed foundation are an "occurrence" under the policy.

Federal district courts finding that damages resulting from construction errors do constitute an "occurrence" under a CGL policy include *Home Owners Management Enterprises, Inc. v. Mid-Continent Cas. Co.,* ___ F.Supp. 2d ____, 2005 WL 2452859 (N.D. Tex. 2005) (claims for structural and cosmetic damage related to foundation movement caused by alleged negligent defective construction by homebuilder were considered an occurrence); *Mid-Continent Cas. Co. v. JHP Development, Inc. and TRC Condominiums, Ltd.*, ___ F.Supp.2d ___, 2005 WL 1123759 (W.D. Tex. 2005) (court held that where allegations failed to assert that insured intentionally caused damage, construction defects constitute an "occurrence"); *Luxury Living, Inc. v. Mid-Continent Cas. Co.,* 2003 WL 22116202 (S.D. Tex. 2003) (construction errors causing water damage to home do constitute an "occurrence" under the policy); *Great American Ins. Co. v. Calli Homes, Inc.,* 236 F. Supp.2d 693 (S.D. Tex. 2002) (damage to home from negligent construction constitutes an "occurrence" under CGL policy); *Mt. Hawley Ins. Co. v. Steve Roberts Custom Builders, Inc.,* 215 F.Supp.2d 783 (E.D. Tex. 2002); *First Texas Homes, Inc. v. Mid-Continent Cas. Co.,* 2001 WL 238112 (N.D. Tex. 2001) (foundation problems of home resulting from insured's failure to perform in good and workmanlike manner constitutes "occurrence" under CGL policy); *E&R Rubalcava Const., Inc. v. Burlington Ins. Co.,* 147 F.Supp.2d 523 (N.D. Tex. 2000).

A complaint attempting to recast allegations as unintentional acts or consequences will not suffice; the underlying allegations must support an accident or occurrence for a duty to defend or coverage to arise. Conclusory allegations of negligence cannot serve to overcome specific facts that demonstrate that the real complaint is that a contractor did not live up to his contractual obligations to build the home properly. *See Lamar Homes, Inc., v. Mid-Continent Cas. Co.,* 335 F.Supp. 2d 754 (W.D. Tex. 2004) (broad and conclusory allegations of negligence in underlying complaint against insured homebuilder did not implicate coverage for "accident" under CGL policy, since gravamen of complaint was for breach of warranty; although negligent acts that caused undersigned and unexpected damage would have qualified as accident, factual allegations read as contractual breach of contract resulting in economic loss in the form of required repair or replacement of construction defects); *Jim Johnson Homes, Inc. v. Mid-Continent Casualty Company,* 244 F.Supp.2d 706, 717 (N.D.Tex. 2003). *See also Tealwood Const., Inc. v. Scottsdale Ins. Co.*, 2003 WL 22790856 (N.D.Tex. 2003) (Defects in construction renovations are not "occurrences" where the complaint is void of facts sufficient to determine coverage and breach of contract, and warranty claims are merely recast as negligence.); *Devoe v. Great Am. Ins.*, 50 S.W.3d 567, 570 (Tex.App.–Austin 2001, no pet.); *Hartick v. Great American Lloyds Ins. Co.*, 62 S.W.3d 270 (Tex.App.–Houston [1st Dist.] 2001, no pet.). However, the proper allegations can support coverage, even when the allegations forming the basis of finding an occurrence are defective construction and workmanship. *See Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 270 (5th Cir. 1999); *Mid-Continent Cas. Co. v. JHP Development, Inc. and TRC Condominiums, Ltd.*, ___ F.Supp.2d ___ , 2005 WL 1123759 (W.D. Tex. 2005) (court held that where allegations failed to assert that insured intentionally caused damage, construction defects constitute an "occurrence"); *Luxury Living, inc. v. Mid-Continent Cas. Co.*, 2003 WL 2211602 (S.D.Tex. 2003) (The underlying lawsuit against the homebuilder for defective construction of residence contained general allegations of negligence, rendering the damages to the residence an "accident", thus constituting an "occurrence" within the scope of the general liability policy according to the Court.); *Mt. Hawley Ins. Co. v. Steve Roberts Custom Builders, Inc.*, 215 F.Supp.2d 783 (E.D.Tex 2002); *Great American Ins. Co. v. Calli Homes*, 236 F. Supp. 2d 693 (S.D. Tex. 2002) (Allegations that the insured homebuilder negligently constructed or supervised contractors in

construction of the home, particularly with respect to the installation of exterior insulation and finish system, stated accidental "occurrence" within the commercial general liability policy, absent any claim that homebuilder intentionally performed substandard work, intentionally failed to follow specifications, or had actual knowledge of improper installation.); *Archon Investments, Inc. d/b/a Gems Custom Homes v. Great American Lloyds Ins. Co. and Mid-Continent Cas. Co.,* 174 S.W.3d 334 (Tex. App. – Houston [1st Dist.] 2005, pet. review filed November 17, 2005) (duty to defend insured contractor was triggered by allegations of damages caused by defective construction of subcontractor on the basis that contractor could not intend that subcontractor' negligent work cause damages).

However, false misrepresentations do not constitute an occurrence under a liability policy in Texas. In *State Farm Lloyds v. Kessler*, 932 S.W.2d 732, 737 (Tex.App.–Fort Worth 1996, writ denied), the claimants alleged that the Kesslers knowingly made false statements concerning the condition of a home they were selling. These statements were in violation of the DTPA. The State Farm policy at issue in *Kessler* defined "occurrence" as "an accident, including exposure to conditions, which results in . . . property damage during the policy period." *Id.* at 739. The Forth Worth Court of Appeals held that there was no occurrence because all of the allegations involved the Kesslers' intentional acts and because a misrepresentation is not a condition that the claimant is exposed to as required under the definition of occurrence. *Id.* at 738-739 citing *Columbia Mut. Ins. Co. v. Fiesta Mart, Inc.*, 987 F.2d 1124, 1128 (5th Cir. 1993) (Alleged inducement to invest through false representations was not exposure to conditions and therefore not an occurrence.); *Metropolitan Prop. & Cas. Co. v. Murphy*, 896 F.Supp. 645, 648 (E.D.Tex. 1995) (Any alleged misrepresentations or failure to disclose under the DTPA is not an occurrence.). *See also Freedman v. Cigna Ins. Co.*, 976 S.W.2d 776 (Tex.App.–Houston [1st Dist.] 1998, no pet.) (The court held that no occurrence was alleged because the lawsuit was based on misrepresentations and nondisclosure.).

Based on this line of cases, it is obvious that where unintended or unexpected damages result from the negligent or otherwise defective performance of a product or service, an occurrence has resulted. If there are sufficient allegations supporting the unintended or unexpected damages, the insurer may not deny coverage based upon the lack of fortuity or an occurrence until an insurer can demonstrate that the damages resulting from the policyholder's act are calculated or expected damages.

2. Intentional Acts and Consequences That Do Not Qualify as an Occurrence

There has been some controversy with regard to what qualifies as an occurrence when a policyholder's actions necessarily and consequentially lead to certain consequences and damages. This jurisprudence began with relatively unquestionable decisions holding that intentional torts which lead to intended injuries fall outside the scope of an occurrence under a CGL policy. Subsequent decisions have viewed the occurrence requirement from a different, yet consistent angle, holding that intentional acts which lead to unintentional, yet necessary and probable consequences, also fall outside the definition of occurrence in a CGL policy. Most recently, controversy surrounding the occurrence analysis has focused on whether injuries which result from a breach of contract qualify as an occurrence. These recent decisions have held that there is no occurrence where injuries result as a natural and probable consequence of a breach of contract. This trend of cases has led to the often-cited notion that there is "no coverage for breach of contract," which is not necessarily the case, as explained more fully below.

a. No Coverage for Damages That Ordinarily or Naturally Flow from a Deliberate Act

Public policy dictates that the courts and insurers take the term "accident" seriously. "To hold otherwise would inappropriately enhance rather than minimize the moral hazard inherent in insurance." *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997). Because insuring agreements are based upon principles of fortuity, they are not meant to provide coverage for intentional torts of their policyholders which result in intended consequences. In many cases, it is obvious why public policy dictates that no coverage should be provided. The claim itself often arises out of deviant or criminal activity. See *State Farm Fire & Cas. Co. v. S.S. & G.W.*, 858 S.W.2d 374 (Tex. 1993) (Excluding coverage for intentional transmission of genital herpes by insured); *Maayeh v. Trinity Lloyds Ins. Co.*, 850 S.W.2d 193, 197 (Tex. App.–Dallas 1992, no writ) (No

occurrence where insured's sexual molestation of child was intentional because such conduct was so extreme and outrageous that intent to injure could be inferred as a matter of law.); *American States Ins. Co., et al. v. Bailey, et al.*, 133 F.3d 363 (5th Cir. 1998) (No occurrence where pastor perpetrated sexual misconduct upon church member he was counseling.); *New York Life Ins. Co. v. Travelers Ins. Co.*, 92 F.3d 336 (5th Cir. 1996) (No occurrence where life insurance agent engaged in fraudulent and misleading conduct relating to the sale of an insurance policy.).

A closer question exists where the insured's acts are voluntary and intentional, but the insured did not intend the specific injury to be visited upon a third party. Despite the insured's subjective intent not to cause the specific injury, when the insured's acts are voluntary and intentional, results and injuries even if unexpected, are not caused by an "accident" and therefore the event is not an "occurrence." *State Farm Lloyds v. Kessler*, 932 S.W.2d 732, 738 (Tex. App.–Fort Worth 1996, writ denied). Instead, the standard is subjective; a person intends the natural and probable results of the person's acts, even if he or she did not subjectively intend or anticipate those consequences. *Wessinger v. Fire Ins. Exchange*, 949 S.W.2d 834, 837-841 (Tex. App.–Dallas 1997, no writ) (Insured's action in hitting companion was intentional and not accidental despite fact that insured was drunk and did not intend to injure companion.).

These cases have been followed in the construction context as well. Damages that result are not accidental if the damages are the natural and probable consequence of the intentional act. *Argonaut Southwest Ins. Co. v. Maupin*, 500 S.W.2d 633 (Tex. 1973). In *Maupin*, Maupin Construction Company entered into a contract with the State of Texas to make certain improvements to a state highway in Travis County. The contract required Maupin to obtain and furnish material for roadway fills. A partner in the Maupin Company entered into an agreement to purchase borrow material from a third party. Approximately 5700 cubic yards of borrow material subsequently was removed from property occupied by the third party. It was later determined that the third party was not the owner of the property, but was merely a tenant and that therefore Maupin had trespassed against the owner of the property, Meyer. Meyer brought suit claiming that Maupin had trespassed and Maupin called upon its insurance carrier, Argonaut Insurance Company, to defend such suit. Argonaut denied coverage based upon Maupin's intentional trespass upon the Meyer property. The court held that the removal of over 5,000 cubic yards of borrow material from Meyer's property was intentional and deliberate. Although Maupin had no intent to injure Meyer, the removal of the material was a result of the trespass even if caused by mistake or error. The court found no insurance coverage against liability for damages caused by mistake or error. Thus, the court concluded the damage was not an accident or occurrence within the meaning of the policy and Maupin was not afforded any coverage.

If nothing else, *Maupin* teaches contractors to ensure that the parties they are dealing with are legally entitled to grant access to or sell the materials for which the parties contract. As *Maupin* sets forth, even if a contractor mistakenly relies upon a tenant's representations, once the contractor trespasses upon and damages that property, the deliberateness of this trespass constitutes an intentional act which necessarily leads to damages to the true owner of the property. In such a case, the contractor's actions would not be covered under the CGL policy.

Texas appellate courts of appeal finding that damages resulting from construction errors do not constitute an "occurrence" under a CGL policy include *Hartrick v. Great American Lloyds Ins. Co.,* 62 S.W.3d 270 (Tex. App. – Houston [1st Dist.] 2001, no pet.) (builder's breach of implied warranty in preparing the soil and constructing a foundation was not an "accident" and therefore not an "occurrence" under the policy); *Devoe v. Great American Ins.,* 50 S.W.3d 567 (Tex. App. – Austin 2001, no pet.) (claims by homeowner of substandard construction resulted from intentional and voluntary acts of the insured, and therefore did not constitute an "accident" or "occurrence" under the policy).

Federal district courts finding that damages resulting from construction errors do not constitute an "occurrence" under a CGL policy include *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 335 F.Supp. 2d 754 (W.D. Tex. 2004); *Courtland Custom Homes, Inc. v. Mid-Continent Cas. Co.,* 395 F.Supp. 2d 478 (S.D. Tex. 2004) ("The Court agrees that the better reasoned authorities hold that claims such as the [Turmans} are making against the plaintiff are not claims of accidental damage to property, but rather are allegations that the

contractor has failed to perform its work in a good and workmanlike manner."); *MidArc, Inc. v. Mid-Continent Cas. Co.,* 2004 WL 1125588 (W.D.Tex. 2004) (builder's failure to properly grade and landscape property causing flooding not an "occurrence"); *Tealwood Construction, Inc. v. Scottsdale Ins. Co*., 2003 WL 22790856 (N.D. Tex. 2003) (claims against contractor for damage to siding of home do not constitute an "occurrence" under CGL policy); *Jim Johnson Homes, Inc. v. Mid-Continent Cas. Co*., 244 F.Supp.2d 706 (N.D. Tex. 2003) (construction errors causing damage to the subject of the contract arose from voluntary and intentional work by the insured, and therefore do not constitute an "accident" or "occurrence" under the policy); *Malone v. Scottsdale Ins. Co.,* 147 F.Supp. 2d 623 (S.D. Tex. 2001) (insured's faulty workmanship does not constitute an "accident" or "occurrence" under CGL policy); *Acceptance Ins. Co. v. Newport Classic Homes, Inc.*, 2001 WL 1478791 (N.D. Tex. 2001) (damage to home from insured's failure to construct home in good and workmanlike manner and in compliance with building code does not constitute "occurrence" under policy).

Where an insured knowingly violates a state or local code, especially one dealing with public safety, no occurrence results and no coverage is afforded by virtue of unintended damages to public areas. *Baldwin v. Aetna Cas. & Sur. Co.*, 750 S.W.2d 919 (Tex. App.–Amarillo 1988, writ denied). Baldwin was a trucking company that admitted it had knowingly overloaded its trucks and repeatedly and intentionally violated the state regulating vehicle size and weight limitations for Texas highways. Baldwin was advised that he was going to be sued by the State of Texas for causing damage to state highways as a result of this violation. Baldwin negotiated a settlement and sought indemnification from Aetna based upon a CGL policy issued by Aetna. Aetna pointed to the petition that would have been filed in the underlying *State v. Baldwin* action in which it would have been alleged that "Defendant's repeated criminal law violations have created a nuisance per se and public nuisance . . ." and that damages would have resulted "as a direct result of this Defendant's deliberate overloading said trucks." *Id.* at 921. Based upon Baldwin's knowing violation of state statute, Aetna argued and the court agreed that no occurrence had taken place and thus no coverage was afforded. Further, in response to Baldwin's denial that he "knowingly" overloaded his trucks, the court cited *Argonaut Southwest Ins. Co. v. Maupin* for the idea that the intent of the insured is immaterial.

Baldwin has potentially far-reaching application and should not be read restrictively to focus upon intentional violations of state statutes regulating vehicle size and weight limitations on Texas highways. Instead, it may be argued that *Baldwin* stands for the proposition that any knowing violation of statute or code meant to protect public safety could fall outside the realm of an occurrence. Furthermore, as *Baldwin* and *Maupin* point out, the intent of the insured is immaterial. Thus, it may be argued that even unintentional or unknowing violations of state statutes or local codes could place an insured's actions outside the scope of an occurrence. For instance, where a construction contractor's work fails to conform to local building code, *Baldwin* and *Maupin* suggest that all consequential injuries to the construction project would fall outside of coverage. Additionally, as will be discussed more thoroughly below, such faulty workmanship most likely would be specifically excluded by policy language.

b. *Cowan* - The Supreme Court's Take on"Occurrence"

The Supreme Court of Texas defined the extent to which an occurrence may be found where an insured's intentional act leads to unintended consequences. *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819 (Tex. 1997). Gregory Gage, the insured, was working as a grocery store photolab clerk when a roll of film containing somewhat revealing pictures of Nicole Cowan was delivered for developing. Gage made extra prints of four of these pictures and later showed them to some friends. Eventually the photos were shown to an acquaintance of Cowan who advised Cowan that the pictures had been distributed. Cowan sued Gage and Gage sought coverage from his homeowner's policy issued by Trinity Universal Insurance Company. Ultimately Trinity denied coverage because Trinity argued that the facts of the case were not an "accident" such as to invoke an "occurrence." It was undisputed that Gage intentionally made copies of Cowan's photographs and showed them to his friends. However, Gage testified that he did not intend for Cowan to learn of his actions. Therefore, Gage argued, he accidently caused Cowan to suffer severe mental anguish, among other damages. In response, Trinity argued that no

"accident" could arise where an actor intends to engage in the conduct which gave rise to the injury. The court, citing *Maupin*, took an approach that was somewhere in the middle of these two extremes that resulted in precluding coverage for Gage based on the lack of an occurrence. The court reaffirmed that the actor's subjective intent or awareness of the potential for resulting injury was not the test in determining an "accident." Rather, Gage's conduct was not an "accident" because the damages naturally flow from Gage's intentional acts.

Because the injury to Cowan was the type of injury that "ordinarily follows" from Gage's conduct and the injuries could be "reasonably anticipated from the use of the means or an effect" that Gage can "be charged with . . . producing." *Id.* at 828 citing *State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 377 (Tex. 1993) (no occurrence or intentional transmission of genital herpes). Further, the court rejected Trinity's argument that there is never an occurrence when the insured's acts are intentional, finding that Trinity's approach would render coverage illusory for many of the things for which insureds commonly purchase insurance. Specifically, the Court held that Trinity's approach would directly conflict with their earlier holdings that an "accident" includes the "negligent" acts of the insured causing damage which is undesigned and unexpected. *Id.* at 828 citing *Massachusetts Bonding & Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967). At least one court has seized on this comment by the Supreme Court in *Cowan* to note that the mere fact that the insured intended to engage in the act or conduct that gave rise to the alleged damage does not mean that there can be no accident or occurrence. *See E&L Chipping v. Hanover Ins. Co.*, 962 S.W.2d 272, 276 (Tex. App.–Beaumont 1998, no writ)(Holding that the intentional spraying of contaminated water to put out a fire resulting in damage to adjacent property was an accident or occurrence and was not excluded by the "expected and intended" exclusion.).

The decision in *Trinity Universal v. Cowan* is particularly applicable to construction defect claims in its establishment of a test for CGL occurrences. As *Cowan* sets forth, an injury that is a type that "ordinarily follows" from a policyholder's conduct and which could be "reasonably anticipated from the use of a means or an effect that [the policyholder] can be charged with . . . producing" does not qualify as an accident and therefore is not an occurrence under a CGL policy. For instance, where a contractor supplies all materials according to the terms of his contract, yet intentionally utilizes an inadequate means of incorporating those materials into a construction project, a resulting collapse of the project arguably ordinarily follows from the contractor's conduct and the collapse could have been reasonably anticipated from the use of inadequate means such that the contractor could be charged with producing the collapse of the construction project even if the contractor did not intend such damages to occur.

c. "Coverage for Breach of Contract" - Negligent or Intentional Breach

The question of whether the insuring agreement of a CGL policy applies to liability resulting from a breach of contract has never actually been answered under Texas law. However, the Fifth Circuit as well as the Federal District Court for the Northern District of Texas have addressed the issue with some interesting results. It appears, at least based on federal law interpreting what a Texas court would do, that the whole question turns on how the claim against the insurer is pled.

The Fifth Circuit began its foray into this area in *Data Specialties, Inc. v. Transcontinental Ins. Co.*, 125 F.3d 909 (5th Cir. 1997). In *Data Specialties*, the plaintiff was an electrical contractor which had installed an electrical switchboard as part of its subcontract with Haggar Clothing Company. During the testing of this electrical switchboard, the switchboard and other property in the Haggar plant were damaged as a result of an explosion caused by a short circuit in the switchboard. As a result, Data Specialties completed its contract by hiring a local electrical contractor to repair and rebuild portions of the electrical system.

No one contended that Data Specialties was responsible for the accident, but Data Specialties nonetheless incurred additional overhead expenses for its supervision of the repair. Data Specialties applied to its CGL insurer, Transcontinental, for the expenses it incurred to complete its contract with Haggar. Transcontinental denied coverage because Data Specialties was seeking to recover out-of-pocket expenses arising from the explosion and no one claimed that Data Specialties was potentially at fault for the explosion. In light of the fact that Data Specialties was

not accused of committing a tort, the issue boiled down to whether Transcontinental could be obligated to pay so that Data Specialties could avoid breaching its contract.

The Fifth Circuit found no Texas authority for the proposition that a standard CGL policy was designed to cover a contractual obligation triggered by an event for which the insured was not at fault. In its analysis, the court reviewed cases in which liability of the insured was based upon allegations of negligence and tortious conduct. Further, in light of decisions by other states' highest courts, the Fifth Circuit determined that the insuring agreement encompassed liability that the law imposed on all insureds for their tortious conduct and not liability that a particular insured may choose to assume pursuant to contract. *Id.* at 912,*citing Action Ads, Inc. v. Great American Ins. Co.*, 985 P.2d 42 (Wyo. 1984). This led to the Fifth Circuit's conclusion that in the absence of Texas authority to the contrary, Texas courts would not require an insurer to pay under a CGL policy unless its insured had tort based liability. Instead, the coverage requested by Data Specialties would have been more appropriately provided by a builder's risk policy.

Data Specialties is particularly instructive for instances in which a CGL insured seeks coverage for going over budget on a particular construction project. In the absence of specific Texas authority, *Data Specialties* demonstrates that insureds may not seek coverage for expenses incurred to ensure compliance with their construction contract. Without tort-based liability, there is no CGL coverage. Instead, as *Data Specialties* indicates, a construction contractor seeking such coverage for out-of-pocket expenses should procure such coverage from a builder's risk policy.

The Federal District Court for the Northern District of Texas, Dallas Division, went a step further than *Data Specialties* and actually held that a breach of contract does not qualify as an occurrence so as to invoke CGL coverage. *Gibson & Assoc., Inc. v. Home Ins. Co.*, 966 F. Supp. 468 (N.D. Tex. 1997). In *Gibson & Associates*, the City of Dallas sued Gibson in an underlying lawsuit arising out a construction contract awarded to Gibson by the City of Dallas in October 1992, according to which, Gibson was to perform street, sidewalk and public underground utility upgrades along Main Street in downtown Dallas. As a result of this construction, storeowners and tenants along Main Street brought two separate actions against the City of Dallas claiming that "due to poor or inadequate planning," the City had failed to anticipate the total closing of Main Street in late 1992 or early 1993 which created significant interference with access to their storefronts. The City contended that because the construction contract required Gibson to ensure continued access to businesses along Main Street, Gibson had breached its contractual duties as best evidenced by the shopowners' separate actions against the City of Dallas.

Gibson applied to its CGL carrier, Home Insurance Company, for coverage of this breach of contract lawsuit. Home denied coverage based on the fact that a breach of contract does not represent an occurrence within the meaning of the CGL policy. The Federal District Court agreed, citing various authorities from around the country. Specifically, the Federal District Court cited the Wyoming Supreme Court case *Action Ads, Inc. v. Great American Ins. Co.*, 685 P.2d 42, 43-44 (Wyo. 1994) for the idea that "courts universally have interpreted liability coverage provisions identical to that found in [the quoted policy] as referring to liability sounding in tort not in contract." Further, the Federal District Court cited Eighth Circuit authority in holding that coverage simply does not exist when the insured becomes obligated to pay damages incurred by a third party because of the insured's own breach of contract. *Id.* at 474 citing *Pace Constr. Co. v. United States Fidelity & Guar. Ins. Co.*, 934 F.2d 177, 179-80 (8th Cir. 1991) (applying Missouri law). In light of the universal decisions that CGL policies ordinarily do not encompass coverage for damages arising from an insured's breach of contract, the Federal District Court was of the opinion that Texas courts would apply the same standard and that Home Insurance Company therefore was under no obligation to defend or indemnify Gibson & Associates for its breach of contract with the City of Dallas.

In *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 1999), the Fifth Circuit purported to summarize Texas law interpreting the definition of “occurrence” and then found that a claim for negligent breach of contract constitutes an “occurrence.” *Grapevine* involved a contractor, Grapevine Excavation, Inc. ("GEI"), who subcontracted to provide foundation services in the construction of a Wal-Mart parking lot. According to the terms of the

subcontract, GEI was responsible for furnishing and installing materials which had a California Bearing Ratio ("CBR") of 15. Allegedly, GEI supplied materials in the range of 3.7 to 4.9 CBR. As a result, the Wal-Mart parking lot fell below the specifications and the foundation allegedly was weaker than required. The general contractor for the project sued GEI for breach of contract and GEI sought CGL coverage from Federated Mutual and Maryland Casualty. The Court then drew its conclusion of what it thought a Texas court would do when presented with the question of whether a breach of contract constitutes an "occurrence."

The Court segregated Texas cases on the issue of what constitutes an "occurrence" into two lines of cases, one in which coverage is precluded and the other in which coverage is afforded. The whole question therefore becomes, according to the Fifth Circuit, which line of cases a particular claim for breach of contract falls into. The first line of cases identified by the Fifth Circuit are those cases involving coverage for claims against an insured for damages caused by an alleged intentional tort. The Court notes that cases that fall within this line of cases are not covered because the act for which the insured is being sued is a voluntary and intentional act and damages that are a result of such a voluntary and intentional act are not caused by an occurrence, no matter how unexpected, unforeseen, and unintended those damages may be. The Court identifies *Argonaut Southwest Ins. Co. v. Maupin* as the first case in which the Texas Supreme Court enunciated this line of cases. The *Maupin* case is a construction case and the facts and the Court's holding in that case are described more fully above. The claims in that case against the insured, Maupin Construction Company, were for trespass and were brought by the owner of some property from which Maupin had removed dirt pursuant to a contract with the owner's tenant. The Court found that even though Maupin had not intended to injure the plaintiff and the damages in question were caused by mistake or error, the insured nevertheless voluntarily and intentionally engaged in the act of removing the dirt from the property belonging to the owner and in the process was guilty of trespassing on the owner's property. The Fifth Circuit noted that trespass in Texas is a strict liability tort without a scienter requirement and surmised that the Texas court therefore concluded that an inquiry into whether Maupin expected or intended to cause damage to the owner was not relevant.

The Fifth Circuit then identified a second line of cases concerning what constitutes an "occurrence" under Texas law following the Texas Supreme Court's opinion in *Massachusetts Bonding and Ins. Co. v. Orkin Exterminating Co.*, 416 S.W.2d 396 (Tex. 1967). In *Orkin*, coverage was sought for a claim against the exterminating company for damage to rice caused by the application of a pesticide in a rice mills facility. The plaintiff claimed that Orkin was negligent in its application of the pesticide and the Court found that the claim constituted an occurrence because it was one for a negligent act of the insured causing damage that was undesigned and unexpected. The Court then cites a number of cases finding coverage under Texas law that it claims fall within the *Orkin* line and involve damage that is the unexpected, unforeseen, or undesigned happening or consequence of an insured's negligent behavior.

The Fifth Circuit's decision in *Grapevine* appears to focus exclusively on the tort alleged. If the claim against the insured alleges that the insured negligently breached its contract, then there will be a duty to defend under the policy. This is true regardless of whether the claim also alleges that the insured intentionally breached his contract. In fact, those were the actual allegations in *Grapevine*. The claim against Grapevine initially alleged that Grapevine breached its contract by substituting lesser grade select fill. The negligence claim was made in the alternative and was not raised by the plaintiff until it filed its Fourth Amended Petition in the underlying action. The Fifth Circuit actually goes beyond the appropriate analysis under established Texas insurance law and misreads the facts in the underlying complaint in order to reach its conclusion. The Court notes that Grapevine denies intentionally substituting inferior materials. An insured's denial of the claims made against it is irrelevant to any analysis of whether the complaint against the insured gives rise to a duty to defend. The duty to defend is determined under the eight corners rule and the only thing that is relevant to that analysis is the insurance policy and the complaint itself, not the insured's answer or any other pleadings or facts. The insured's position on the issue is not supposed to come into play.

Further, the Court in *Grapevine* found that nothing in the facts alleged by the plaintiff against

Grapevine supported a claim of knowing or intentional breach of contract by substituting inferior fill matter. The facts from the complaint itself specifically asserted that Grapevine breached its contract and the claim for negligence is only asserted in the alternative. At the very least, the facts alleged in the complaint could be read to include a claim for intentional or knowing breach of the contract in addition to or in the alternative to the claim for negligence. The Court summarily dismissed the allegation of knowing conduct made by the plaintiff elsewhere in the complaint where it noted in conjunction with its claim under the Texas Deceptive Trade Practices Act ("DTPA") that all of Grapevine's acts complained about were committed knowingly.

The Fifth Circuit's delineation of Texas cases concerning the issue of what constitutes an "occurrence" into two distinct lines of cases is probably a bit too simple of an answer to the question. The cases that the Fifth Circuit groups under the *Maupin* line of cases are primarily cases involving intentional torts that have been committed by the insured. The vast majority of these cases involve some sort of claim for inappropriate behavior, primarily sexual in nature. *See State Farm Fire & Cas. Co. v. Brooks*, 43 F. Supp. 2d 695, 702 (E.D. Tex. 1998); *Metropolitan Prop. & Cas. Co. v. Murphy*, 986 F. Supp. 645, 648 (E.D. Tex. 1995); *Trinity Universal Ins. Co. v. Cowan*, 945 S.W.2d 819, 828 (Tex. 1997). *See also State Farm Fire & Cas. Co. v. S.S.*, 858 S.W.2d 374, 377 (Tex. 1993). A principal problem in addressing these type of cases is of course the fact that the question of whether the insured intended the damages is a question that is left to the subjective intent of the insured. This has led to the rule under Texas law, most recently pronounced in *Cowan*, that damages that naturally flow from an insured's intentional acts are not covered, regardless of whether the insured intended such damages. The question becomes far more muddy when the "intentional act" that is alleged to have occurred involves the fulfillment of an insured's obligations pursuant to a contract that the insured has entered into. The Fifth Circuit has now held that so long as those acts by the insured in fulfilling that contract are labeled as "negligent breach of contract," then there will be a duty to defend under the policy.

Interestingly, the Fifth Circuit's ruling in *Grapevine* appears to be contrary to its own ruling in an earlier construction case in which the Court noted that where an insured's acts in failing to abide by contract specifications, which appear to be voluntary and deliberate acts, do not constitute an occurrence even though the results or injury may have been unexpected, unforeseen, or unintended. In *Hartford Cas. Co. v. Cruse*, 938 F.2d 601 (5th Cir. 1991), the Fifth Circuit stated in pertinent part:

> A builder who fails to abide by the specifications of a contract, for example, by substituting a weaker building material, may, by that breach, produce expected property damage to his or her work, and may thus fail to show a covered "occurrence."

Id. at 647. According to *Grapevine*, the question of coverage now all turns on whether the insured is found to have negligently breached his contract. If the complaint alleges negligent breach of contract then there will be a duty to defend, apparently regardless of what the facts in the complaint allege. The question of a duty to indemnify on the policy would of course be far from determined. In fact, in a good number of construction cases, perhaps the majority involving claims for breach of contract, the determination could very well be in favor of no coverage, with the jury finding that the insured breached the terms of the contract, by failing to comply with specifications or otherwise.

Other Federal Courts interpreting Texas law have also made this distinction between the *Maupin* and *Orkin* line of cases. In *McKinney Builders II, Ltd. v. Nationwide Mut. Ins. Co.*, 1999 WL 608851 (N.D. Tex., August 11,1999), an unpublished opinion out of the Northern District of Texas, the Court addressed a claim for coverage by some developers who sought a defense and indemnification for claims brought against them for the improper construction of two homes. The developers sold two houses that the plaintiffs later claimed encroached on neighboring lots. The homeowners sued the developers claiming negligence in misplacing the houses, and hiring the surveyors who performed the survey on which the homeowners relied, and for misrepresentation and fraud. At the time of the sale, the developers gave the homeowners a copy of an on-the-ground survey of their properties performed by the surveyor. The developers argued that the claims did

not constitute an "occurrence" because the homeowners mistakenly built their houses in the wrong spots.

The developers relied on *Maupin* and *Hardware Mut. Cas. Co. v. Gerrits*, 65 So.2d 69 (Fla. 1953) in support of their argument that the claims did not constitute an "occurrence." The Court, as did the Fifth Circuit in *Grapevine*, distinguished *Maupin* as a suit involving the intentional tort of trespass and noted that the insured was being sued instead for negligence. The Court then referred to *Orkin* and found it to be more applicable as it involved a claim for negligence. The Court also distinguished the *Gerrits* case of out Florida, which was cited by the Supreme Court in *Maupin* and was argued by the developers in *McKinney Builders* because its facts were very similar. The Court noted that the Supreme Court of Florida has since "receded from" from its holding in *Gerrits* in a decision which noted that in *Gerrits* the analysis was improperly focused on the natural and probable consequence of the insured's deliberate or voluntary act in building the house on the adjoining property and not on whether the insured actually intended or expected to harm. The subsequent Florida case, *State Farm Fire & Cas. Co. v. CTC Development Corp.*, 720 So.2d 1072 (Fla. 1998) focused on the latter and found that the claim for misplacement of the house did constitute an "accident."

The Court in *McKinney Builders* also went to the trouble to distinguish the district court's opinion in *Grapevine*, which was of course overruled a few months later by the Fifth Circuit. The Court noted that the district court's opinion in *Grapevine* found that Grapevine's defective construction was not an accident because Grapevine's actions in failing to meet the contract specifications are the natural and probable consequence of its conduct in allegedly breaching its contract by failing to meet the contract specifications. The Court then found that the homeowners' construction of the houses in the wrong spots is not the natural and probable consequence of the plaintiffs' reliance on the survey that they believed to be correct and noted that it would "absurd" to find no occurrence by concluding that the homeowners expected or intended to place the houses in the wrong spots when they did not expect or intend such a result. Citing to *Orkin*, the Court focused on the damages and noted that they were undesigned and unexpected from the homeowners' point of view. Finding that the homeowners did not expect or intend to build their homes on adjoining properties, the Court held that the claim constituted an "occurrence."

3. Certified Question to the Supreme Court

Recently, the Fifth Circuit certified the following question to the Texas Supreme Court:

> When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege an "accident" or "occurrence" sufficient to trigger the duty to defend or indemnify under a CGL policy?

Lamar Homes, Inc. v. Mid-Continent Cas. Co., 428 F.3d 193 (5th Cir. 2005).

4. Number of Occurrences - A Way to Expand Coverage

Because the standard CGL policy contains a "per occurrence" limit providing dollar amount coverage for each occurrence under the policy, an insured's liability for more than one construction defect or more than one type of damage will often invoke an issue as to how many occurrences have taken place. The general rule is that the inquiry into how many occurrences have taken place should focus on the cause of the claimant's loss, rather than the effect of the insured's negligent act. *Ran-Nan, Inc. v. Gen. Accident Ins. Co. of America,* 252 F.3d 738 (5th Cir. 2001); *Transport Ins. Co. v. Lee Way Motor Freight*, 487 F. Supp. 1325, 1330 (N.D. Tex. 1980); *Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished); *Goose Creek Consol. v. Continental Cas. Co.*, 658 S.W.2d 338, 340 (Tex. App.–Houston [1st Dist.] 1983, no writ). A leading decision for this theory held that whether a claim involves more than one occurrence depends on the events or incidents for which the insured is liable, rather than the number of injurious effects.. *Maurice Pincoffs v. St. Paul Fire and Marine Ins. Co.*, 447 F.2d 204 [5th Cir. 1971]. In *Pincoffs*, the Maurice Pincoffs Company imported 110,000 pounds of canary seed from Argentina, which Pincoffs sold in 110 lb. bags between January 24 and February 2 to eight different feed and grain dealers in Texas and Oklahoma. These dealers sold the seed to

owners of canaries. The seed allegedly was contaminated with aldrin, a chemical insecticide toxic to birds and many of the canaries were killed. Pincoffs applied to its liability insurers for coverage on claims brought by canary owners. The central issue involved whether the contamination of the seed involved one occurrence or whether Pincoffs distribution of the seed involved eight separate occurrences. Although the cause of the contamination was not clear, it was apparent that Pincoffs received the seed in a contaminated state and did not itself contaminate the seed. The court held that it was the separate acts of distribution and not the act of contamination that gave rise to liability in the underlying suits. Therefore, the court found eight separate occurrences. *See also H.E. Butt Grocery Co. v. Nat'l Union Fire Ins. Co.,* 150 F.3d 526 (5th Cir. 1998) (finding store employee's molestation of two children at different times constituted two occurrence because the store was exposed to new liability for each independent act of molestation, despite insured's argument that store's negligent supervision of employee was one occurrence); *State Farm Lloyds, Inc. v. Williams,* 960 S.W.2d 781 (Tex. App. – Dallas 1997, pet. dism'd by agreement) (holding that homeowner's shooting two people in same room constituted separate occurrences because the injuries resulted from two separate acts, each independently giving rise to liability).

In contrast, *Cullen/Frost Bank v. Commonwealth Lloyds* illustrates that more than one occurrence may result from a single wrongful act. 852 S.W.2d 252-258 (Tex. App.–Dallas 1993, writ denied with per curiam opinion 889 S.W.2d 266). In *Cullen/Frost*, the wrongful act was the bank's failure to remedy the defects after the Spring 1986 inspections revealed various property damage. Instead of focusing on the cause of the claimants' loss, the Dallas Court of Appeals' decision in *Cullen/Frost* seems to illustrate the focus upon the effect of the bank's alleged negligent act. Thus the Dallas Court of Appeals found more than one occurrence when the claimants alleged property damage to several condominium units, including drainage problems, floor displacement, warped and swollen windows and doors, rotten woodwork, and leaking and uneven floors. Somewhat conversely, in *Foust v. Ranger Ins. Co.*, 975 S.W.2d 329 (Tex. App.–San Antonio 1998, writ denied), the Court held that alleged chemical damage to a crop due to overside drift from an adjacent field constituted one occurrence. The Court found that the damage resulted from repeated exposure to the "same general conditions" and thus was the result of a "single occurrence" under the Crop Dusters Liability Policy, notwithstanding that the crop dusting plane made several passes and multiple landings to reload additional herbicide, and notwithstanding that conditions such as temperature, wind and altitude were constantly changing during the herbicide application process.

In *Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished) the court held that each claim for each home concerning the use of defective EIFS stucco was a separate occurrence. Lennar was not the manufacturer or designer of EIFS. Instead, Lennar's liability stemmed from the fact that it built and sold homes with EIFS. Thus, the court reasoned that Lennar's liability would not have occurred absent the application of the EIFS to each home. Furthermore, the court reasoned that there was not one entrapment of water that caused damage to all the homes, but instead the EIFS each home suffered its own water entrapment in the EIFS on that home. Therefore, the court concluded that Lennar was exposed to a new and separate liability for each home on which EIFS was applied. *Id.* citing *Stonewall Ins. Co. v. Asbestos Claims Mgnt. Corp.,* 73 F.3d 1178 (2nd Cir. 1995) (stating Texas law would apparently support finding that application of asbestos to numerous buildings constituted separate occurrences despite insured's argument that its course of manufacturing and selling asbestos products constituted one occurrence) and *Fina, Inc. v. Travelers Indem. Co.,* 184 F.Supp. 2d 547 (N.D. Tex. 2002) (finding that claims of numerous workers exposed to asbestos at Fina facilities constituted at least three occurrences because it was the exposure to asbestos which resulted in injuries and suit against Fina, and workers were exposed to asbestos at three Fina locations).

Though the apparent conflict in these decisions seems to invoke an air of uncertainty when determining the number of occurrences, it should be remembered that the *Pincoffs* decision is the seminal authority on this issue. Thus, one analyzing coverage for multiple property damage claims should focus upon the cause of these claims, rather than the effect of the insured's alleged negligent act when determining how many occurrences have taken place. As always, one analyzing

coverage should take into account the particular policy language as well. Depending on the provisions of the policy, the position taken and arguments made on the number of occurrences may vary for both the insured and the insurer according to the situation. In one context the insurer may want to limit the number of occurrences and in another it may want to have as many as possible. For instance if the policy provides for a per occurrence deductible which is substantially higher than the amount of money required to remedy each damage claim, it obviously is advantageous for the insurer to argue that multiple occurrences have taken place, rather than one occurrence which is typically what the insurer is arguing. *See Unigard Ins. Co. v. United States Fidelity & Guar. Co.*, 728 P.2d 780 (Idaho 1986) (Where insured's employee, using heavy equipment to clear snow from the front of garage doors in a mini-storage rental facility, injured 98 doors in a four-hour period and a per occurrence deductible was greater than the damage to any one door, the court rejected the liability insurer's argument that 98 occurrences had taken place, instead holding that only one occurrence took place.).

C. What Constitutes Property Damage

Equally important in the analysis of whether a CGL policy provides coverage for a particular occurrence, yet remarkably less defined, is the insuring agreement's requirement that the claimants have suffered "property damage." Once it is determined that a claimant seeks damages arising out of an occurrence, the next question is whether the damages sought qualify as property damage as defined by the policy. The form CGL definition for "property damage" incorporates a two-prong explanation. "Property damage" is defined as:

> a. Physical injury to tangible property, including all resulting loss of use of that property. All such loss of use shall be deemed to occur at the time of the physical injury that caused it; or
>
> b. Loss of use of tangible property that is not physically injured. All such loss of use shall be deemed to occur at the time of the "occurrence" that caused it.

Thus, when considering whether the damages qualify as "property damage," one must evaluate whether the property is tangible and whether the property has been physically injured. Further, one must evaluate whether, as a result of the occurrence, a claimant has suffered a loss of use of property connected with the project.

1. Physical Injury to Tangible Property

Coverage for a physical injury to tangible property sounds rather self-explanatory. It is evident this property damage requirement focuses upon the type of injury that is most-readily apparent after the discovery of a construction defect. Typically, this type of property damage is fairly easy to recognize and generally involves breaking, cracking, tearing, or other such injuries. *See e.g.*, *Cullen/Frost Bank v. Commonwealth Lloyds*, 852 S.W.2d 252, 256 (Tex. App.–Dallas 1993, writ denied with *per curiam* opinion 889 S.W.2d 266) (Drainage problems in floor of garage, excessive floor displacement, warped and swollen door and window frames, rotten woodwork on doors and windowsills, and warped and uneven floors constitute "physical damage to tangible property."); *Taylor-Morley--Simon, Inc. v. Michigan Mut. Ins. Co.*, 645 F. Supp. 596 (E.D. Mo. 1986), *aff'd*, 822 F.2d 1093 (8th Cir. 1987) (The cracking of walls, ceiling and floors, and the loosening of ducts in a house were covered as "physical damage to tangible property."). However, construction claims are rarely so cut and dry such that an identifiable defect is necessarily linked to an identifiable damage claim. Instead, claims are often made for damages that are invisible to the tangible world. For this reason, coverage for "physical injury to tangible property" is deceptively simple.

a. Physical Injury

When considering these types of damages, it is important to accurately interpret the terms "tangible" and "physical." First, the physical injury requirement was developed as a result of extensive litigation concerning the pre-1973 CGL form which incorporated a property damage definition of "injury to tangible property." Numerous jurisdictions interpreted this property damage definition to include claims for diminution of value occasioned by the installation by a contractor of faulty components, such as doors, roofs or heating systems which reduce the value of the overall structure. *See e.g.*, *Continental Cas. Co. v. Gilbane*

Bldg., 391 Mass. 143, 147 (1984); *Hauenstein v. St. Paul-Mercury Indem. Co.*, 242 Minn. 354, 65 N.W.2d 122 (Minn. 1954); *Eichler Homes, Inc. v. Underwriters at Lloyds London*, 47 Cal. Rptr. 843, 238 Cal. App. 2d 532 (1965); *Geddes & Smith, Inc. v. St. Paul-Mercury Indem. Co.*, 51 Cal. 2d 558, 334 P.2d 881 (1959); *Dakota Block Co. v. Western Cas. & Sur. Co.*, 81 S.D. 213, 218, 132 N.W.2d 826 (1965). The 1973 revision to the standard form CGL policy included the modern definition of "property damage" which incorporated a requirement that the injury be "physical." Some jurisdictions have considered this revision to deprive an insured of diminution in value coverage where an alleged faulty product has been incorporated into a product or building. *See e.g.*, *New Hampshire Ins. Co. v. Vieira*, 930 F.2d 696 (9th Cir. 1991) (Drywall subcontractor could not recover insurance for the diminution of value of an apartment complex as a result of contractor's defective drywall installation); *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751 (Minn. 1985) (Subcontractor could not obtain insurance for a claim where subcontractor's incorporation of defective concrete into grain elevator resulted in diminution of value of grain elevator.

However, claims for diminution of value under the post-1973 CGL form still may be available. To the extent that the mere incorporation of a defective product into a building causes "physical injury" to that building, this type of damage certainly equates to diminution in property value. *See Dayton Ind. School Dist. v. National Gypsum*, 682 F. Supp. 1403 (E.D. Tex. 1988) reversed on other grounds sub nom. In *W.R. Grace & Co. v. Continental Cas. Co.*, 896 F.2d 865 (5th Cir. 1990), Dayton ISD and 83 school districts located throughout the state of Texas brought suit against W.R. Grace & Co., the manufacturer of asbestos containing building materials that were utilized in the construction or renovation of approximately 600 school buildings. The school districts claimed that the presence and incorporation of Grace's asbestos containing products contaminated and damaged their school buildings because they continually released or threatened to release asbestos fibers into the buildings over extended periods of time. Grace turned to third-party defendants, Continental Casualty Company, which had issued primary and excess liability insurance policies to Grace between 1978 and 1985, for coverage in the underlying action. Although the Continental Casualty Company insurance policies defined "property damage" as "loss or direct damage to or destruction of tangible property (other than property owned by the named insured)," the underlying complaint clearly alleged that Grace's products, both by their presence in plaintiffs' buildings and by their gradual deterioration caused damage to plaintiffs' buildings, including physical injury. The court agreed that this constituted property damage under the terms of the liability policies based upon analogous situations in which the incorporation of allegedly-dangerous, defective or malfunctioning products or components in a building constituted property damage covered by insurance. *Id.* at 1408 (citations omitted).

On the other hand, in *General Mfg. Co. v. CNA Lloyds of Texas*, 806 S.W.2d 297 (Tex. App.—Dallas 1991, writ denied), the court denied that property damage had occurred based upon diminution of value of custom homes which had been fitted with defective windows. Rockwall Manufacturing, the insured, was the manufacturer of double-pane, insulated glass windows which it installed in custom homes. Immediately after they were installed, 10,027 windows cracked, thus obligating Rockwall to replace the windows at a cost of slightly more than $1.1 million. CNA denied the claim based on the business risk/products exclusion in the policy. Among the contentions asserted by Rockwall for coverage from CNA was Rockwall's argument that the claim involved third-party liability for diminution in value of the custom homes. However, the court stated that there was no evidence on the record of any claim against Rockwall for diminution of value and, further, that CNA's policy would not have covered Rockwall for such a claim for diminution in value of the custom homes.

Despite Texas' rejection of diminution in value claims under the post-1973 CGL form, a minority of jurisdictions continue to recognize diminution in value as property damage under this CGL form policy. *See e.g.*, *Missouri Terrazzo Co. v. Iowa National Mutual Ins. Co.*, 740 F.2d 647 (8th Cir. 1984)(defective tiling diminished value of building constituting property damage); *Marathon Plastics, Inc. v. Int'l Ins. Co.*, 514 N.E.2d 479 (Ill. App. 4th Dist. 1987)(Defective gaskets rendered underground pipe system useless and diminished its value); *Eljer Mfg. Inc. v. Liberty Mutual Ins. Co.*, 972 F.2d 805 (7th Cir. 1992) (Incorporation of defective plumbing system in buildings constitutes

property damage within meaning of policy), *cert. denied*, *Liberty Mutual Ins. Co. v. Eljer Mfg. Inc.*, 113 S. Ct. 1646 (1993). In fact, the controversial 7th Circuit decision in *Eljer Mfg. Inc. v. Liberty Mutual Ins. Co.* represents a significant departure from the majority position that diminution in value claims are not available under the post-1973 policy language. In *Eljer Mfg.*, the court reviewed the drafting history of the 1973 revision of the CGL policy and concluded that the "physical injury" requirement means that there must be some contact or physical linkage that causes the diminution in value. The court specifically rejected the notion that there must be a harmful, physical alteration in the injured property. Thus, under the Seventh Circuit's interpretation, so long as a defective product is physically attached or linked to the rest of the structure, the "physical injury" requirement is satisfied and diminution in value claims would be available for all non-physical harm resulting from the incorporation of the defective product.

Notwithstanding the Seventh Circuit's decision in *Eljer*, it is evident that the "physical injury" requirement dictates that the property which is damaged be somehow impaired, battered or broken such that replacement or maintenance of the property is required. However, one must take care to distinguish damage to a third-party's property as opposed to damage to the insured's work. As will be discussed in more detail below, there is no coverage for physical injury of the product of the insured's work. Specifically, the defectiveness of the insured's work itself is excluded by such exclusions as the business risk, faulty workmanship, your work, and your product exclusions. Thus, while coverage may be afforded for damage to a third-party's property as a result of the incorporation of the insured's work, there is no coverage afforded for the insured's work itself.

Consider, for example, a situation in which an HVAC contractor defectively installs an air-conditioning unit in a library. As a result of the defective installation of the air-conditioning unit and its duct work, the roof on the library begins to leak. After discovering the extent to which the leaking roof has caused damage to the interior walls, ceiling tiles, and book collections, the library makes a claim on the HVAC contractor for property damage resulting from the negligent installation of the air-conditioning unit. To remedy the problem, the library's walls would need to be reinforced and new sheetrock would need to be applied, the ceiling tiles would need to be replaced, the roof would need to be repaired, and the books would need to be refurbished. Furthermore the defective duct work and air-conditioning unit would need to be removed and replaced. In such a case, the HVAC contractor may make a claim upon its liability insurer for the physical injury visited upon the ceiling tiles, interior walls, roof, and book collections. However, the HVAC contractor would not be able to make a claim for the cost of replacing the air-conditioning and its duct work because of the operation of the CGL policy exclusions.

b. Tangible Property

Another consideration when construing the property damage definition is its requirement for the injury to be visited upon "tangible property." Tangible property has been defined as property that is capable of being handled or touched or which may be seen, weighed, measured or estimated by physical senses. *See Lay v. Aetna Ins. Co.*, 599 S.W.2d 684 (Tex. Civ. App.–Austin 1980, writ ref'd n.r.e.) (Where damages sought were limited to purchase price of assignment of drilling rights with attendant attorneys' fees and damages for loss of oil to adjacent wells during period in which company's drilling rights were being negotiated, no tangible property had been damaged); *Houston Petroleum Co. v. Highlands Ins. Co.*, 830 S.W.2d 153 (Tex. App.–Houston [1st Dist.], writ denied) (Where insured was sued by investors alleging loss of capital contributions, subscriptions, profits and other benefits due to insured's false representations, no tangible property had been injured). Conversely, intangible property is property that does not have intrinsic value, but rather merely is representative or evidence of value. *See e.g.*, *United States Fidelity & Guar. Co. v. Baron Indus., Inc.*, 809 F. Supp. 355, 360 (M.D. Pa. 1992) (Stock certificates, investments, copyrights, promissory notes, goodwill and reputation, profits, investment value, and productivity are all intangible interests and do not qualify as tangible property). Furthermore, Texas courts have interpreted this provision of the property damage definition to deprive an insured of coverage for claims alleging pure economic loss. *See State Farm Lloyds v. Kessler*, 932 S.W.2d 732 (Tex. App.–Fort Worth 1996, writ denied) (Costs incurred by homebuyers to restore property to condition which sellers represented property to be in prior to sale constituted economic loss which was not

covered as property damage); *Terra Int'l, Inc. v. Commonwealth Lloyds Ins. Co.*, 829 S.W.2d 270, 272 (Tex. App.–Dallas 1992, writ denied) (Alleged inclusion of tracts of land in county flood control district which resulted in substantial increase in ad valorem taxes constituted economic loss which was not covered as property damage); *Nutmeg Ins. Co. v. Pro-Line Co.*, 836 F. Supp. 385, 388-89 (N.D. Tex. 1993) (Lost product sales do not constitute property damage under general liability policies); *Gibson & Associates v. Home Ins. Co.*, 966 F. Supp. 468, 473-74 (N.D. Tex. 1997) (Liability for breach of construction contract cannot be characterized as property damage as it is pure economic loss).

In *Mid-Continent Cas. Co. v. JHP Development, Inc., et al,* ___ F.Supp. 2d ___ , 2005 WL 1123759 (W.D. 2005) the court held that "property damage" in the form of damage to tangible property was alleged where the claimant alleged "significant damage to contiguous building materials and interior finishes has resulted as a direct consequence of [JHP's] improper, defective and incomplete work. Defendant JHP further failed to properly water-seal exterior finishes and retaining walls, allowing water to penetrate through building materials and destroying the materials and finishes." The court noted that TRC alleged negligence, as well as breach of warranty and breach of contract.

Similarly, *Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished) the court held that water damage that resulted from the use of defective EIFS stucco, which included wood rot, damage to substrate, sheathing, framing, insulation, sheetrock, wallpaper, paint, carpet, carpet padding, wooden trim, and baseboards, mold damage and termite infestation, constituted physical injury to tangible property. Consequently, the cost to repair the water damage constituted "property damage". However, the court held that the cost to remove and replace the defective EIFS on the homes does not constitute "property damage" because the EIFS itself was not physically injured or changed from a satisfactory state to an unsatisfactory state after application to the homes. Rather, the EIFS was unsatisfactory when it was applied to the homes because its was inherently defective. Furthermore, the court held that the costs incurred in addressing the EIFS claims, such as overhead, inspection, personnel and attorneys fees, do not constitute "property damage" because Lennar was not legally obligated to pay these costs as required by the insuring agreement, though Lennar was legally obligated to incur the costs to repair the water damage in connection of settlement of claims.

2. Loss of Use

Both the first and second prongs of the CGL policy's property damage definition provide for recovery of damages sustained by a third party as a result of the loss of use of property occasioned by an occurrence. Complicating the fact that the "loss of use" language has not been thoroughly interpreted by the law, the CGL policy explicitly provides that coverage may be afforded for a loss of use of physically injured property or the loss of use of tangible property which is not physically injured. Nevertheless, a few decisions provide limited guidance in the interpretation of the "loss of use" standard.

For instance, *Cullen/Frost Bank v. Commonwealth Lloyds*, 852 S.w.2d 252 (Tex. App.–Dallas 1993, writ denied, see writ history on p. 17), demonstrates a situation in which a loss of use of tangible property which had not been physically injured or destroyed required coverage under a standard form CGL policy. In *Cullen/Frost*, a bank which had sold condominium units was sued by the condominium owners based upon the bank's alleged failure to correct known physical defects in condominiums. Among other defects with the condominium complex, the plaintiffs allege that repeated breakdown of the elevators and the bank's failure to correct the complained of conditions resulted in their loss of use of the property. The court agreed that the bank's failure to correct the repeated breakdown of the elevators constituted loss of use of tangible property which was not physically injured or destroyed. *Id.* at 256.

Further paving the way for loss of use damage claims in the absence of physical injury to tangible property is *Gibson & Associates, Inc. v. Home Ins. Co.*, 966 F. Supp. 468 (N.D. Tex. 1997). In *Gibson & Associates*, the City of Dallas was sued by Main Street storeowners as a result of a City contractor's allegedly-negligent construction plan which impeded access to the storeowners property. The storeowners sought to recover for financial losses created by the construction-imposed restrictions on access to their property which they argued constituted loss of use of tangible property

that is not physically injured. The Federal District Court recognized that no Texas court had adequately addressed this issue and cited several cases from jurisdictions outside Texas for the proposition that storeowners may make claims for loss of use of tangible property which is not physically injured where access is impeded due to construction outside of the store. The court cited *Geurin Contractors, Inc. v. Bituminous Cas. Corp.*, 5 Ark. App. 229, 636 S.W.2d 638 (1982) for its interpretation of loss of use to include a store's lost profits occasioned by the alleged negligent performance of a contract to pave a highway where the highway was closed, thus impeding access to the plaintiff's store. Similarly, the court cited *Sola Basic Ind., Inc. v. United States Fidelity & Guaranty Co.*, 90 Wis. 2d 641, 280 N.W.2d 211 (1979) where the Wisconsin Supreme Court's recognition that loss of access to a plaintiff's store due to a contractor's negligence represents loss of use property damage. Furthermore, the court recognized a Wisconsin Appellate Court's decision in *Western Casualty & Surety Co. v. Budrus*, 112 Wis. 2d 348, 332 N.W.2d 837, 839-40 (App. 1983) which held that a farmer's claim for loss of use of his field occasioned by the insured's sale of seeds that turned out to be useless qualified as a loss of use damage claim. Based on this out-of-state authority, along with the fact that the alleged negligence construction had impeded access to the Dallas storeowners' property, the Federal District Court concluded that the storeowners had suffered a loss of use of tangible property which was not physically injured under the terms of the CGL policy.

However, other Texas courts have been reluctant to extend the loss of use standard to claims which resemble coverage for economic loss. The courts recognize that more than mere economic loss is required to trigger coverage under a CGL insurance policy. *See Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 335 F.Supp. 2d 754 (W.D. Tex. 2004) (when the injury is only the economic loss to the subject of the contract itself, the action sounds in contract alone); *Houston Petroleum Co. v. Highlands Ins. Co.*, 830 S.W.2d 153, 156 (Tex. App.–Houston [1st Dist.] 1990, writ denied) (Holding that the plain meaning of insurance contract phrase "the loss of use of tangible property," does not include economic loss, i.e., the loss of initial investments, subscription funds and profits. The language used in the policy is based on the assumption that tangible property, unlike an economic loss, generally is subject to physical injury or destruction.); *Terra Int'l, Inc. v. Commonwealth Lloyds Ins. Co.*, 829 S.W.2d 270, 272 (Tex. App.–Dallas 1992, writ denied) (Inclusion of two tracts of land within county flood control district and resulting substantial increase in ad valorem taxes which resulted in land becoming virtually worthless and unsalable did not constitute loss of use of tangible property so as to impose a duty on the insurers to defend); *Nutmeg Ins. Co. v. Pro-Line Corp.*, 836 F. Supp. 385, 388-89 (N.D. Tex. 1993) (Buyer of hair care products attempts to cast loss of product sales as loss of use claim failed to establish coverage under CGL policy). Furthermore, courts in other jurisdictions sometimes make loss of use claims contingent upon whether the underlying physical injury would be covered by the policy. *See* Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, COVERAGE (Committee on Insurance Coverage Litigation Report), May/June 1997 at 22, *citing Thermex Corp. v. Firemen's Fund Ins. Co.*, 393 N.W.2d 15 (Minn. Ct. App. 1986); *T.E. Ibberson Co. v. American & Foreign Ins. Co.*, 346 N.W.2d 659 (Minn. Ct. App. 1984). However, other jurisdictions view the physical injury and loss of use damages as distinct forms of covered property damage. *Id.* Under this view, even if the underlying physical injury damages would be excluded, coverage still would be afforded for loss of use damages and consequential losses flowing from the loss of use. *Id.* citing *Federated Mut. Ins. Co. v. Concrete Units, Inc.*, 363 N.W.2d 751 (Minn. 1985).

Despite the lack of Texas jurisprudence interpreting the "loss of use" clause, construction defect litigation in other jurisdictions illustrates that this type of property damage may include a property owner's increased costs occasioned by its inability to utilize the property which is either damaged or destroyed by a construction contractor's negligence. *Id.* at 751 (Where delays occasioned by use of defective concrete, loss of use coverage afforded where damages included cost of piling bushels of corn, loss of use of storage space, and inability to dry corn); *World Ins. Co. v. H.D. Engineering Design & Erection*, 419 N.W.2d 630 (Minn. App. 1988) (Where placement of materials on partially-completed building caused structural collapse, loss of use coverage granted for additional costs of service and materials for erecting steel building under winter conditions). Thus, the absence of Texas jurisprudence on the loss of use clause leaves the door

open for potentially-far-reaching consequential damage interpretations.

3. Certified Question to Supreme Court

Recently, the Fifth Circuit certified the following question to the Texas Supreme Court:

> When a homebuyer sues his general contractor for construction defects and alleges only damage to or loss of use of the home itself, do such allegations allege "property damage" sufficient to trigger the duty to defend or indemnify under a CGL policy?

LamarHomes, Inc. v. Mid-Continent Cas. Co., 428 F.3d 193 (5th Cir. 2005).

4. Triggers of Coverage – Property Damage During the Policy Period

Not only is it important to accurately measure a particular event against the occurrence analysis, it also is important to take into account the timing of the occurrence. Because many CGL policies will be issued for concrete time periods of coverage, it is important to calculate when an event or its consequential injury took place. Ultimately this affects whether multiple coverage periods from the same carrier will be invoked and whether multiple carriers' policies will be invoked over a long period of time. Thus, beyond defining a particular event or injury as an occurrence, one must consider which policy or policies each occurrence "triggers."

The question of which policies are triggered by a particular occurrence has been litigated in jurisdictions throughout the United States with particular focus on mass tort and environmental litigation. Generally speaking, courts throughout the United States have adopted four trigger theories to determine when an occurrence takes place. The four major trigger theories are summarized as follows:

1. Manifestation or First Discovery Trigger

Some courts hold that the policy in effect at the time the property damage or bodily injury manifests itself or becomes apparent is the policy that is triggered by such an occurrence. In particular, Texas courts have particularly recognized the manifestation or first discovery trigger theory. *See Dorchester Development Corp. v. Safeco Ins.*, 737 S.W.2d 380 (Tex. App.–Dallas 1987, no writ) (discussed below); *American Home Assurance Co. v. Unitramp, Ltd.*, 91 F.3d 141 (5th Cir. 1996) (discussed below).

2. Exposure Trigger

Other jurisdictions hold that all policies in effect during the time that the claimant or property was exposed to the damaging events are triggered and must provide coverage. *Insurance Co. of N. America v. 48 Insulations, Inc.*, 633 F.2d 1212 (6th Cir. 1980) (Application of exposure theory in the context of asbestos claims); *LaFarge Corp. v. Hartford Cas. Ins. Co.*, 61 F.3d 389, 403-404 (5th Cir. 1995) (Application of *48 Insulations* exposure trigger theory in prorating CGL carrier's liability for harm caused by failure of protective pipe coating).

Guaranty Nat. Ins. Co. v. Azrock Industries, Inc., No. 98-21031, slip op. (5th Cir. April 28, 2000), the Fifth Circuit was required to decide what event triggers an insurer's duty to defend its insured against asbestos-related personal injury claims under a Commercial General Liability policy. The Court first noted that the terms "occurrence" and "bodily injury" in the insurance policy were ambiguous in the progressive disease context, noting that a progressive disease does not fit any of the disease or accident situations a liability policy was designed to cover. *Id*. at 3. The Court then analyzed the various theories of trigger that have evolved and been used by courts in the latent disease context: manifestation, exposure, continuous, and injury in fact. The Court noted that all of the cases relied on by the district court in applying the manifestation trigger involved non bodily-injury (property damage) claims. The Court then stated that it was not persuaded by any cases from Texas courts or from federal cases construing Texas law that there is any defensible reason to apply a different trigger of coverage theory for progressive disease cases governed by Texas law than the Court had previously adopted in construing Louisiana law. The Court then applied the exposure theory, noting that it was consistent with the rule announced in the seminal *48 Insulations* case. The Court determined that the exposure theory will likely trigger the duty to defend in such a case. *Id*. at 8. The Court also noted that the distinction between property damage and latent disease or damage is relevant. The

Court stated that the Federal district courts applying Texas law in the progressive disease context have distinguished between property damage cases, in which "manifestation" of injury triggers coverage, and bodily injury cases, in which coverage is triggered by exposure or injury-in-fact. *Id*. at 6; *See Clemtex, Inc. v. Southeastern Fidelity Co.*, 807 F.2d 1271, 1274-75 (5th Cir. 1987); *Mustang Tractor and Equip. Co. v. Liberty Mut. Ins. Co.*, 1993 WL 566032 (S.D. Tex. Oct. 8, 1993) (Rejecting manifestation trigger for bodily injury but declining to select between exposure or continuous trigger theories); *see also*, *National Standard Ins. Co. v. Continental Ins. Co.* CA3-81-1015-D (N.D. Tex. Oct. 4, 1984) (Applying exposure theory)

3. Continuous Coverage or Triple Trigger Theory

Other jurisdictions recognize that coverage is invoked from all policies in effect during the time that a claimant or property initially was exposed to a hazardous substance, or condition, continued its exposure to the hazardous substance, and finally when the claimant or property manifested symptoms or injuries related to the hazardous substance. *Keene Corp. v. Insurance Co. of N. America*, 667 F.2d 1034 (D.C. Cir. 1981), *cert. denied*, *Insurance Co. of N. America v. Keene Corp.*, 455 U.S. 1007 (1982) (Application of triple trigger theory in the context of coverage for asbestos claims); *Dayton Indep. School Dist. v. National Gypsum Co.*, 682 F. Supp. 1403 (E.D. Tex. 1988) (Asbestos damage to school property held to have caused damage from time of installation through time of removal and triggered all liability policies involved, reversed on other grounds by *W.R. Grace & Co. v. Continental Cas. Co.*, 896 F.2d 865 (5th Cir. 1990) (Specifically stating no Texas case to date applied either the injury in fact standard or a continuous trigger to the duty to indemnify in property damage cases).

The Fifth Circuit Court of Appeals declined to adopt the continuous trigger theory as the best Erie guess of what the highest Texas court would do if squarely faced with the issue. The insured argued, under the contra proferentum doctrine, that the Court should defer to the theory of continuous trigger proposed by it in a duty to defend case regarding asbestos-related personal injury claims under a Commercial General Liability policy. *Guaranty National Insurance Co. v. Azrock Industries, Inc*., No. 98-21031, slip op. (5th Cir. April 28, 2000). The Court acknowledged that Texas law requires it to construe ambiguous policy terms in favor of the insured, but clarified that it was not required blindly to adopt the interpretation proffered by the insured, especially if the Court perceived such an interpretation to be an unreasonable construction of the policy terms or to be unsupported in law. *Id.* at 7. Further, the Court noted that no Texas court has ever adopted or implicitly endorsed the continuous trigger theory. *Id*.

At least one Texas court, however, has adopted the continuous trigger theory requiring multiple policy periods to be invoked. *Cullen/Frost Bank of Dallas v. Commonwealth Lloyds Ins. Co.*, 852 S.W.2d 252 (Tex. App.–Dallas 1993 writ denied with per curiam opinion 889 S.W.2d 266). In *Cullen/Frost*, various condominium owners who had purchased their units from the Cullen/Frost Bank in 1984-85 brought suit against the bank alleging property damage to their condominiums. The bank notified their insurers of this lawsuit. The insurers responded that the allegations in the condominium owners' suit were not within the coverage of the policies. Among other things, the alleged property damage included drainage problems in the garage floor, excessive floor displacement, warped and swollen windows and doors, rotten woodwork, leaking in the roof, warped and uneven floors, and continual breakdown of the elevators. The insurers had issued various policies from 1983 through 1989. The bank sought coverage from several of these policies based upon the continued property damage. The insurers argued there could be no coverage under any policies issued after the spring of 1986, when an inspection revealed the defects complained about. They claimed that since the bank knew of the alleged property damage as of Spring 1986, the bank should be precluded from seeking coverage from multiple policies.

The court rejected this argument, holding that the complaints alleged continuing or multiple occurrences with continuous or repeated manifestations of property damage beginning in the spring of 1986. The court recognized that the condominium owners' petition stated that property damage began in Spring 1986, thus prompting the court to decide that under the definition of occurrence, there could be a new occurrence each time a condominium owner suffered property damage. The *Cullen/Frost* rationale is particularly threatening to

carriers who provide CGL coverage to construction contractors for large-scale projects. Thus, carriers who provide CGL coverage for the construction of apartment complexes, multi-story office towers, and large-scale housing developments could face liability for multiple policy periods if a particular construction defect slowly manifests in property damage over many policy intervals.

In sum, if the *Cullen/Frost* rationale for application of the continuous trigger theory is applied in a particular case, large-scale coverage for a construction defect during a single policy period would be insufficient should other tenants or property owners complain of previously unknown property damage in subsequent policy periods.

4. Injury in Fact Trigger Theory

Finally, some jurisdictions hold that coverage is invoked by the policies that are in effect when the bodily injury or property damage in fact occurs, regardless of whether the particular injury or damage has been discovered. *Jenoff Inc. v. New Hampshire Ins. Co.*, 1997 W.L. 40610 (Minn. Jan. 30, 1997) (Application of injury in fact trigger in construction case); *American Home Products Corp. v. Liberty Mutual Ins. Co.*, 565 F. Supp. 1485 (S.D. N.Y. 1983), *aff'd as modified*, 748 F.2d 760 (2d Cir. 1984).

In *Guaranty National Insurance Co. v. Azrock Industries, Inc*., No. 98-21031, slip op. (5th Cir. April 28, 2000), discussed above, the Court noted that the challenge in adopting the injury-in-fact approach is that, in each case of an individual suing a manufacturer, a "mini-trial" must be held to determine at what point the build-up of asbestos in the plaintiff's lungs resulted in the body's defenses being overwhelmed. *Id*. at 5. At that point, asbestosis could truly be said to "occur." *Id*.

5. The Effect of the Trigger Theory on Coverage

Application of the proper coverage trigger is essential in the determination of which CGL policy period is invoked and whether multiple policy periods can be invoked. The Texas Supreme Court declined to adopt a specific trigger theory for an "occurrence" policy in *American Physicians Insurance Exchange v. Garcia*, 876 S.W.2d 842, 853 n. 20 (Tex. 1994). Subsequently, Texas has followed two lines of trigger theories in recent cases: (1) the manifestation theory and (2) the exposure theory. The dominant line of Texas cases follows the manifestation theory, but the exposure theory has been utilized recently. The question also arises on how to handle the coverage issue if the complaint lacks sufficient facts to determine the coverage period at issue. Recent Texas decisions have addressed this very issue, with diverging results.

It is presumed that Texas follows the manifestation trigger theory, at least with respect to property damage. This "rule of Texas law" is based on the seminal case of *Dorchester Development v. Safeco Ins. Co.*, 737 S.W. 2d 380 (Tex. App.–Dallas 1987, no writ). In *Dorchester*, the insured, Dorchester, was a general contractor of an apartment complex in Dallas and was sued by B & L Sunflower because of alleged construction defects. Specifically, B & L complained that concrete flooring on the third floor was defective because it was prepared improperly, various gutters were improperly primed, and Dorchester failed to utilize concrete perimeter beams under certain patio slabs. Dorchester applied to Safeco for CGL coverage under the policy issued by Safeco during the construction of the apartment complex.

It was undisputed that the property damage had not manifested itself within Safeco's CGL policy period. In the absence of Texas authority, the Dallas Court of Appeals relied on decisions from Florida and Idaho in requiring that an identifiable damage or injury take place within the policy period for coverage to be afforded. *Id.* at 383 (citations omitted). This adoption of the manifestation theory under Texas law has been recognized in subsequent Fifth Circuit Court of Appeals' decisions involving claims for property damage. See *Snug Harbor, Ltd. v. Zurich Ins.*, 968 F.2d 538 (5th Cir. 1992) (Recognizing the adoption of manifestation theory per *Dorchester Development Corp. v. Safeco Ins.* in the context of negligent claims-handling where alleged underlying lawsuit petition was misplaced); *American Home Assurance Co. v. Unitramp, Ltd.*, 146 F.3d 311 (5th Cir. 1998) (Recognizing that "a claimant's damage may be identifiable but not identified" and that property damage manifests itself when "harm is reasonably detectible," especially where the property damage is difficult to perceive). There is no Texas Supreme Court decision involving the proper trigger of coverage under Texas law.

Application of the manifestation trigger theory is particularly important in drawing lines between different carrier's liability for consecutive policy periods. *See Carpenter Plastering Co. v. Puritan Insurance Co.*, Not Reported in F. Supp., may be found at 1988 WL 156829 (N.D. Tex. 1988). After wall panels constructed by Carpenter began leaking in the final stages of construction on the Texas Credit Union Building, Carpenter was sued for the damage caused by these defective wall panels. Carpenter sought coverage from liability carriers that insured the project both during and after the defects were discovered. USF & G and Ranger Insurance companies settled these lawsuits and then looked to Puritan, Old Republic, and Twin City Fire Insurance companies for reimbursement for the part of damages that occurred during those carrier's later policy periods. USF & G and Ranger argued that part of the leakage manifested during these later policy periods, thus obligating coverage from the other insurers. The Court rejected this argument, recognizing that by the time any of the Defendants' policies became effective, the risk of liability was no longer unknown, even though the extent of liability was uncertain. As the defective panels had already caused substantial damages by the time Puritan's, Old Republic's and Twin City Fire's policies became effective, there was no different source of occurrence that invoked these latter policies. Therefore, the initial manifestation of damages could trigger only the policies in effect at that time and subsequent identical damages did not trigger the subsequent policies.

In, *McKinney Builders II, Ltd. v. Nationwide Mut. Ins. Co.,* 1999 WL 608851 (N.D. Tex. August 11,1999), the Plaintiffs sought defense and indemnification from two insurance policies for complaints against them regarding their improper construction of two houses. In the underlying action, on July 20, 1989 Plaintiffs, McKinney Builders II, Ltd., ("McKinney") et al, sold a house located at 837 Forest Oaks Drive, Lot 10, Block 13, of Greenwood Addition No. 2, Phase II, City of Grand Prairie, Texas, to Alvis and Deloyce Green. On May 29, 1990, Plaintiff sold a house located at 833 Forest Oaks Drive, Lot 9, Block 13, of Greenwood Addition No. 2, Phase II, City of Grand Prairie, Texas, to Chrissa Juliette Cross. On or about April 25, 1994, the Greens and Cross were informed that their houses encroached on their neighboring lots. Specifically, the Greens' house encroached on Lot 11, which belonged to another homeowner, and the Cross's house encroached on Lot 10, owned by the Greens. In connection with the sale and financing of these houses, Plaintiffs gave the Greens and Cross a copy of an on-the-ground survey of their properties performed by a surveyor on May 23, 1990. The Greens and the Crosses sued the Plaintiffs in state court alleging, inter alia, negligence in misplacing the houses, negligence in hiring of surveyors who performed the survey upon which the Greens and Cross relied, misrepresentation and fraud. McKinney sought defense and/or indemnity from its two liability insurance policies and one commercial umbrella policy (all three effective January 10, 1989 through January 21, 1992) against the underlying litigation from the Greens' and Cross's claims. Defendants Nationwide Mut. Ins. Co, et al, refused both a defense and indemnity because they believed that the factual allegations against McKinney did not state a cause of action covered by the policies.

The insurance defendants argued that there was no "occurrence," "bodily injury," or "property damage" as defined by the policy. In an unpublished opinion, the Court disagreed with the insurance defendants and held that the McKinney Plaintiffs' construction of the houses in the wrong spots is not the natural and probable consequence of Plaintiff's reliance on a survey they believed to be correct. *Id*. at *5. In so ruling, the Court stated that, "It would be absurd to hold that there was no occurrence by concluding that the Plaintiffs expected or intended to place the houses in the wrong spots when they did not expect or intend such a result." *Id.* Thus, contrary to the arguments of the insurance defendants, the underlying petition filed by the homeowners constitutes an occurrence under the CGL and Umbrella policies. *Id*.

Additionally, the Court re-affirmed the rule set forth in *Dorchester Dev. Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380, 383, (Tex. App.–Dallas 1987, no writ), that "no liability exists on the part of the insurer unless the property damage manifests itself, or becomes apparent, during the policy period." The Court stated that it was clear that the homeowners purchased the properties from the McKinney Plaintiffs in July 1989. Thus, while the physical injury existed before July 1989, the homeowners actually suffered damages in July 1989, when they purchased the houses from Plaintiffs. *McKinney Builders* at *8. The Court ruled that the injury was identifiable upon purchase because

the Plaintiffs provided the homeowners with the survey, which was erroneous; so, the injury was identifiable when the homeowners purchased the houses. *Id*. In other words, the injury was "capable of being easily perceived, recognized and understood" when the homeowners purchased the houses. *Id*., *citing Unitramp*, 146 F.3d at 314.

In the same case, the insurance defendants argued that there was no coverage because there was no "property damage". The insurer argued that the allegations were based upon claims for diminution in value, which do not constitute property damage, and that the CGL and Umbrella policies specifically excluded coverage for loss of use. The Court found the insurance defendants' arguments unpersuasive and determined that while the underlying action alleged diminution in value, it also alleged loss of use, which, if there were no allegations of physical injury, is "property damage" covered by both the CGL and Umbrella policies. *Id*. at *7. The Court further ruled that the underlying petition alleged sufficient facts of physical injury because it alleged that the houses "encroached" on neighbors' lots, an allegation which is in and of itself an allegation of physical injury. *Id.*

In *Vanguard Underwriters Ins. Co. v. Forist*, 1999 WL 498200 (Tex. App.–San Antonio, July 14, 1999), Forist sought coverage for structural damage to their home caused in part by plumbing leaks near the joint between the original structure and an addition. In April 1992, Forist's son noticed a "heave" which he defined as a distinct difference in elevation between the slabs of the original construction and an addition. In mid-March 1993, Forist filed a notice of loss with her insurer. Importantly, the only policy in evidence was one in which the effective dates were May 1, 1992 to May 1, 1993. In an unpublished opinion, The Court re-affirmed the Texas common law rule that property loss occurs when the injury or damage manifests itself. *Id*. at *2; *State Farm Mut. Auto. Inc. Co. v. Kelly*, 945 S.W.2d 905, 910 (Tex. App.– Austin 1997, writ denied). It reasoned that property damage manifests itself when it becomes "apparent". *Id.*; *Dorchester Dev. Corp*., 737 S.W.2d at 383. "Apparent," like "manifest" means "capable of easy perception." *Id.*; *Unitramp*, 146 F.3d at 314. The Court ruled that the Forist's testimony revealed that all of the damage to the home occurred before April 23, 1992, when Forist contacted a contractor to install footings to support the rear side of the addition and garage of the home. This was at least eight days prior to the effective date of the policy in evidence; thus, the Court held that Forist failed to establish a loss that occurred during the policy period in question. *Id*. at *2.

An unpublished opinion from the Federal District Court for the Northern District of Texas, *Epina Prop., Ltd. v. Zurich American Ins. Co.*, 1998 WL 223737, CA 3:97-CV-0581-BC (N.D. Tex. April 28, 1998), also illustrates the manifestation trigger. In that case, Epina entered into a contract with Republic whereby Republic agreed to install a french drain and make other necessary repairs to a building owned by Epina. The work was substantially completed on or before November 30, 1989. In 1993, the tenant of the building noted that the floor was "heaving." Though Zurich Insurance provided coverage during the time the installation of the french drain occurred and up until April 15, 1990, when Zurich canceled its policy for non-payment of premiums, the parties maintained no Zurich coverage at the time the tenant notified Epina that the floor of the building was defective. Thus, because the damage did not become apparent until April 7, 1993, no occurrence had manifested itself within the policy period and Zurich was not obligated to provide coverage.

In *Aetna Cas.y and Surety Co. v. Naran*, 1999 WL 59782 (Tex. App. February 10, 1999), an unpublished opinion out of the Dallas Court of Appeals, the court held that fire damage to a home, garage and car caused by excessive heat from an improperly installed catalytic converter did not "manifest" itself during the policy period. The Court rejected Naran's arguments for application of either the exposure or injury-in-fact theories of trigger, distinguishing the personal injury context, in which those theories had been applied previously, from the property damage context. The Court held that, "[T]hose cases typically involve claimants suffering from continuous exposure to asbestos and pollutants or toxins causing environmental contamination which cause latent disease or damage and not the type of property damage involved in the present case." *Id.* at *4.

The Fifth Circuit agreed with the conclusions of the Dallas Court of Appeals in *Aetna Cas.y and Surety Co. v. Naran*. It too applied the exposure theory to asbestos related injuries in *Guaranty Nat'l Ins. Co. v. Azrock Indus., Inc.* 211 F.3d 239, 251-252 (5th Cir. 2000). In that case, the Fifth Circuit acknowledged that

its prior decisions had used the manifestation rule for property damage cases, however, and affirmed the trial court's application of the manifestation rule to the one underlying complaint alleging property damage. *Id.* at 245-248 citing *Snug Harbor, Ltd. v. Zurich Insurance,* 968 F.2d 538, 544 (5th Cir. 1992) and *American Home Assurance Co. v. Unitramp Ltd.*, 146 F.3d 311,313 (5th Cir. 1998).

Under the above-cited line of cases, it is readily apparent that the manifestation theory will be applied to trigger coverage in many construction defect cases. One who is interpreting coverage for a construction defect must look to whether property damage is reasonably detectible during the relevant policy period. Furthermore, CGL insurers whose policies are invoked for a particular time period may not turn to carriers who provided CGL coverage during the time period in which the work was performed unless the alleged property damage also manifested itself during that time period.

However, the exposure theory has been applied to a property damage claim. The exposure theory arose in a Houston Court of Appeals case involving both personal injury and property damage claims. In *Pilgrim Enterprises, inc. v. Maryland Cas. Co.*, 24 S.W.3d 488 (Tex.App.–Houston [14th Dist.] 2000, no pet.), Pilgrim sued Maryland and other insurers for coverage for personal injuries and property damage allegedly caused by long term exposure to a chemical known as perchloroethyelne ("PCE") and other hazardous substances released from Pilgrim's facilities. The Houston Court of Appeals held that because the Texas Supreme Court in *American Physicians*, *supra*, expressly declined to adopt any of the tests enumerated within the opinion or to fashion a new test, it was not bound by any of the theories discussed in analyzing the meaning of an occurrence under the Maryland policies. The Maryland policies were occurrence based policies that included continuous or repeated exposure to conditions. The Houston Court of Appeals reasoned as follows:

Each policy's definition of "occurrence" contemplates that covered injury or damage can arise from accidents of "continuous or repeated exposure" to chemicals, and each policy defines "bodily injury" or property damage" as "bodily injury, sickness, or disease" or "physical injury to or destruction of tangible property" occurring during the policy period. Thus, the policies contemplate that harm caused by continuous exposure during a policy period will be covered by that policy. *Pilgrim Enterprises, Inc*., 24 S.W.3d at 497. The Court held that because the Maryland policy definition of occurrence applied to both bodily injury and property damage, the Fifth Circuit's analysis in *Azrock*, *supra*, would apply to both.

6. When the Allegations Fail to Provide a Basis for Any Trigger Theories

Some petitions fail to provide sufficient allegations to determine whether a policy is triggered. Two recent cases, *Allstate Ins. Co. v. Hicks*, 134 S.W.3d 304 (Tex.App.–Amarillo 2003, no pet.), and *Gehan Homes, Ltd v. Employers Mut. Cas. Co.*, 146 S.W.3d 833 (Tex.App.–Dallas 2004), petition for review filed January 5, 2005, address the situation that arises when the pleadings fail to provide a trigger point; however, these opinions took completely opposite views on how to resolve this issue. The question also arises as to whether Texas courts will look outside the pleadings to determine whether a policy is triggered. The courts will not read facts into the pleadings; however, some may turn to extrinsic evidence.

In *Allstate Ins. Co. v. Hicks*, the Amarillo Court of Appeals faced whether alleged bodily injury and property damage caused by exposure to mold in a residence occurred during the policy period for purposes of triggering the duty to defend under a homeowner's liability policy. In 1991, Hicks contracted with a general contractor to custom-build a residence, and construction was completed in March 1992. At that point, Hicks moved into the house. During construction, pursuant to his agreement with the general contractor, Hicks provided some of the construction materials, including the fill dirt and the concrete. Hicks undertook to sell the house in 1995. In September 1996, he gave written disclosures to prospective purchasers Michael and Lynnette Dudding (the "Duddings"), and a sales contract was executed. The closing occurred on December 10, 1996. The Duddings subsequently alleged the house contained defects not disclosed by Hicks. In November 1997, the Duddings obtained an engineering report detailing defects in design and construction of the house.

The Duddings filed suit against Hicks in December 1997, but it was not until their third amended petition, filed in March 2000, that claims were asserted

for property damage and personal injury resulting from exposure to mold, which they alleged arose due to faulty plumbing. At this point, Hicks tendered defense of the claims against him to Allstate under the liability coverage in his homeowners insurance policy in effect at the time of the sale of the house to the Duddings. Allstate denied that the policy covered the Duddings' claims and in July 2000 filed a declaratory judgment action.

On appeal, the Amarillo Court of Appeals analyzed both the manifestation and exposure trigger theories adopted in Texas. Ultimately, the court held that under application of either trigger theory, Allstate did not have a duty to defend because there were no specific allegations of when the bodily injury or property damage actually occurred. The Duddings' petitions did not allege when their bodily injuries or property damages from mold manifested themselves. Their petition had alleged that the Duddings did not determine the residence was contaminated with mold until February 2000. To show the Duddings were put on notice of a bodily injury during the policy period, Hicks relied on the allegation that Mr. Dudding, was in the basement the day before the closing on December 10, 1996, when there was water damage present. The policy had terminated three months after this. However, the Court rejected Hicks' argument and held:

> Hicks' attempt to link the allegation that Mike Dudding was present in the basement of the house on the day before closing to the Duddings' claims of bodily injury seeks to have us read facts into the pleadings and "imagine factual scenarios which might trigger coverage," but were never alleged in the petition, in violations of the admonitions in *National Union*, 939 S.W.2d at 142, and *St. Paul Insurance*, 999 S.W.2d at 885.

The Court distinguished *Pilgrim*, *supra*, on the basis that the plaintiffs in *Pilgrim* specifically alleged exposure to perchloroethylene during the time the dry cleaning business was in operation, which happened to be during the relevant policy period. Unlike *Pilgrim*, the Duddings failed to allege that the residence was contaminated with mold when they purchased the house, nor did they assert when the mold formed. Their loss of use claim pertained to the period after the mold discovery in February 2000, which was well after the 1997 policy expired. There were no allegations to trigger the policy period, thus the Court determined Allstate did not have a duty to defend Hicks.

A recent case has created a split in the authority over whether coverage is triggered or not if there are no allegations establishing an injury or property damage during the policy period. In *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833 (Tex.App.–Dallas 2004), petition for review filed January 5, 2005, the petition did not contain a specific date pertaining to manifestation of the damage. Instead, it only alleged the damage occurred sometime in the "past". Instead of following the approach taken in *Hicks*, *supra*, The Dallas Court of Appeals held that the allegations were sufficient to trigger all policies in effect prior to the date the lawsuit was filed. The Court applied the strictest application of the complaint allegations rule by holding that where the petition is silent, the duty to defend is triggered, without consideration of extrinsic evidence.

In *Hicks* and *Gehan*, the courts examined the allegations in the pleadings, but other courts may diverge from both cases and consider extrinsic evidence when the pleadings lack sufficient allegations to determine when the alleged property damage was manifested or first discovered. *See Southwest Tank and Treater Mfg. Co. v. Mid-Continent Cas. Co.*, 243 F.Supp.2d 597, 602 (E.D.Tex. 2003); *Matagorda Ventures, Inc. v. Travelers Lloyds Ins. Co.*, 203 F.Supp.2d 704, 714 (S.D.Tex. 2000) (citing *State Farm Fire & Cas. Co. v. Wade*, 827 S.W.2d 448, 452 (Tex.App.–Corpus Christi 1992, writ denied) ("When the petition in the underlying lawsuit does not allege facts sufficient for a determination of whether those facts, even if true, are covered by the policy, the evidenced adduced at the trial in a declaratory judgment action may be considered along with the allegations in the underlying petition."); *John Deere Ins. Co. v. Truckin' U.S.A.*, 122 F.3d 270, 272 (5th Cir. 1997) (Extrinsic evidence may be considered in determining the existence of a duty to defend where complaint allegations were insufficient to determine coverage under the policy.); *Gonzales v. Am States Ins. Co. of Tex.*, 628 S.W.2d 184, 187 (Tex.App.–Corpus Christi 1982, no writ).

However, in a recent Fifth Circuit case, use of extrinsic evidence was not allowed. In *Northfield Insurance Company v. Loving Home Care, Inc.*, 363 F.3d 523 (5th Cir. 2004), the Court refused to allow the use of extrinsic to determine the insurer's duty to defend. The dispute involved whether Northfield had a duty to defend its insured, Loving Home Care ("LHC"), in a lawsuit arising out of the death of an infant cared for by one of LHC's nannies. Northfield claimed no duty to defend arose on the basis of several exclusions, including criminal acts and physical exclusions.

The Fifth Circuit held that the Texas Supreme Court has never recognized any exception to the strict eight corners rule that would allow courts to examine extrinsic evidence when determining the insurer's right to defend. However, several Texas appellate cases applied the extrinsic evidence exception to the eight corners rule. From its analysis of these cases, the Fifth Circuit concluded that "extrinsic evidence is admissible in deciding the duty to defend where fundamental coverage questions can be resolved by readily determined facts that do not engage the truth or falsity of the allegations in the underlying petition, or overlap with the merits of the underlying suit." *Id.* Those coverage issues have been defined to include (1) whether the person sued has been specifically excluded by name or description from any coverage, (2) whether the property in question is included in or has been expressly excluded from any coverage, and (3) whether the policy exists. *Id. See also Fielder Road Baptist Church v. Guideone Elite Ins. Co.,* 139 S.W.3d 384, 388 (Tex. App. – Fort Worth 2004, pet. granted).[1] On this basis, the Court refused to allow extrinsic evidence on the criminal acts and physical abuse because the allegations included at least one covered claim, negligent training, hiring and supervision by LHC. *Id.*

[1] The Houston First Court of Appeals has rejected the application of these exceptions to the complaint allegations rule. *Chapman v. Nat'l Union Fire Ins. Co.,* 171 S.W.3d 222 (Tex. App. – Houston [1st Dist.] 2005, no pet.); *Landmark Chevrolet Corp. v. Universal Underwriters Ins. Co.,* 121 S.W.3d 886, 890 (Tex. App. – Houston [1st Dist.] 2003, no pet.); *Tri-Coastal Contractors, Inc. v. Hartford Underwriters Ins. Co.,* 981 S.W.2d 861, 862-64 (Tex. App. – Houston [1st Dist.] 1998, pet. denied) (noting the limited use of extrinsic evidence).

However, in *Tucker v. Allstate Texas Lloyds Ins. Co.,* ___ S.W.3d ___, 2005 WL 3283658 (Tex. App. – Texarkana 2005, no pet. h.) the court allowed extrinsic evidence to determine the duty to defrnd based on the "aircraft exclusion". Mr. Hartless was injured when he assisted Mr. Tucker in moving Tucker's home-built airplane. Hartless made a claim against Tucker, who then sought coverage under his homeowner's policy issued by Allstate. Allstate argued the claim was excluded because it arose out of the ownership, maintenance, operation and/or use of the airplane. The court considered the evidence extrinsic to Hartless' pleadings, to wit: the ownership of the plane, whether the injury arose out of the maintenance of the plane, and/or the operation of the plane. The court also considered whether the injury arose out of the "use" of the plane. The court relied upon this various indicia of evidence relating to these elements of the "aircraft" exclusion and concluded that the exclusion did not apply because there was no evidence that the injury arose out of the ownership, maintenance, operation or use of the plane. Thus, the court ruled that Allstate had a duty to defend.

The Texas Supreme Court recently addressed the use of extrinsic evidence in determining whether an insurer has a duty to defend. In *Allstate v. Hallman*, 159 S.W.3d 640 (Tex. 2005), the Supreme Court examined only the allegations in the pleadings and the insurance policy's language to determine Allstate did not have a duty to defend Hallman in the litigation. In that case, Hallman leased property to Norton Crushing, Inc. for mining. The neighboring landowners sued alleging the blasting damaged their home, and Hallman sought a defense and indemnity from Allstate under her homeowner's policy. Allstate determined the claim was not covered due to the mining operations falling under the policy's business pursuit exclusion. A two-part standard for determining whether a claim is excluded from coverage under the business pursuits is necessary: (1) continuity or regularity of the activity, and (2) a profit motive, usually as a means of livelihood, gainful employment, earning a living, procuring subsistence or financial gain, a commercial transaction or engagement. Plaintiff argued that Allstate relied on extrinsic evidence, the plaintiff's deposition, in determining that the lease arose out of a commercial transaction and that plaintiff admitted to a profit motive regarding the lease to meet the elements required under the business pursuit exclusion. The Court of Appeals held the petition did not allege continuity of activity as it only referred to

one lease agreement executed 10 years prior and did not refer to any profit motive requirements.

The Texas Supreme Court held the business pursuits exclusion applied and barred coverage. The Court found that the pleadings established the continuity requirement of the business pursuits exclusion, finding that until the one lease expired Hallman was engaged in a continuous act of leasing her property. A profit motive was inferred from the nature of the activity, even though the pleadings contain no reference to Hallman's pecuniary interest in the lease nor refer to her motive for leasing the property. The Court did not create any exceptions to the strict eight corners rule. However, they ventured a good bit from the pleadings in inferring certain things.

The issue of whether the alleged damages occurred during the policy period is arguably more akin to a "fundamental" issue of coverage that warrants the consideration of extrinsic evidence. Allowing evidence of when the alleged damages were actually discovered or manifested does not touch on the issue of the insured's potential liability because evidence of when the damages actually occurred or were discovered in no way implicates that the insured is liable for those damages. Further, the Texas Supreme Court did not address these exceptions to the eight corners rule in its *Hallman* decision, leaving open the possibility for the use of extrinsic evidence. Thus, it is quite possible that a Texas court may consider extrinsic evidence to determine when alleged damage occurred for purposes of determining whether a duty to defend exists. If Texas courts do decide to allow extrinsic evidence to determine the duty to defend, it is possible that they could restrict its use to the three circumstances or "exceptions" mentioned above. When property damage manifested itself is not one of those exceptions, but could arguably fall within the second category, whether the property in question is included in or has been expressly excluded from any coverage.

III. EXCLUSIONS UNDER THE FORM CGL POLICY

A commercial general liability policy is designed to grant a broad scope of coverage in the insuring agreement. The insuring agreement requires only that there be an "occurrence" resulting in "property damage." If such a claim can be established, the next consideration is whether the nature of the property damage claim is one "to which this insurance applies." That inquiry is answered and the broad scope of coverage is significantly curtailed by the various standard form policy exclusions included in the commercial general liability policy. Simple reference to the exclusion's introductory language, "[T]his insurance does not apply to...," makes it clear that the broad scope of coverage painted by the insuring agreement does not provide the ultimate test for coverage of a particular claim.

Construction defect claims invoke several standard exclusions in the CGL policy form. However, just as additional coverage may be added through endorsement, additional exclusions often are added to policies by endorsement as well. Hence, each form CGL policy may be customized for a policy holder utilizing endorsements, requiring claims handlers to pay close attention to each individual policy. With regard to the form CGL, construction defect claims most frequently invoke exclusions focusing on the care, custody or control of premises, faulty workmanship, business risk (including "your work" and "your product"), and impaired property.

The rationale for this curtailment of the broad grant of coverage in the insuring agreement relates back to the fact that a CGL policy is not designed to address certain risks inherent in construction industry practices. Liability insurance is designed to cover liability for property damage incurred by third parties as a result of the contractor's work or operations. It is not intended to act as a performance bond to ensure that a contractor renders proper performance of a construction contract. Thus, most significant among the exclusions are those that narrow coverage for faulty workmanship or business risks. Additionally, exclusions generally removed from coverage are risks that: (1) are intended to be covered by other policies (e.g., workmen's compensation, first party property damage, professional liability, etc.); (2) are more efficiently and accurately priced separately; or (3) insurers do not want to insure or are prohibited by law or by public policy from insuring (e.g., nuclear accidents, intentional or criminal harm). *See* Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997 at 23, citing *Thermex Corp. v. Firemen's Fund Ins. Co.*, 393 N.W.2d 15 (Minn. Ct. App. 1986). Furthermore,

particular care must be applied in distinguishing occurrences that take place during the course of construction (operations claims) and occurrences that arise after the work is completed and fall within the "products-completed operations hazard". *Id.*

A. Insured's Property or Property in Insured's Care, Custody, or Control – Exclusion j(1)-(4)

Exclusion (j), excluding coverage for damage to property in certain circumstances in which the property is owned, rented, or occupied by the contractor or in the care, custody or control of the contractor, also targets for exclusion from coverage the insured's work while the insured is performing work on it. Specifically, Exclusion j. states:

> j. Damage to Property
>
> "Property damage" to:
>
> (1) Property you own, rent, or occupy:
>
> (2) Premises you sell, give away or abandon, if the "property damage" arises out of any part of those premises:
>
> (3) Property loaned to you:
>
> (4) Personal property in the care, custody or control of the insured:
>
> (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 (2) of this exclusion does not apply if the premises are "your work" and were never occupied, rented or held for rental by you.
>
> Paragraphs (3), (4), (5) and (6) of this exclusion do not apply to liability assumed under a side-track agreement.
>
> Paragraph (6) of this exclusion does not apply to "property damage" included in the "products-completed operations hazard."

Of particular importance in Exclusion (j), the restrictions in coverage for "property in the care, custody or control of the insured" and "property that must be restored, repaired or replaced because 'your work' was incorrectly performed on it" provide significant guidance in the reduction of construction claim coverage.

1. Property Insured Owns, Rents, or Occupies

The standard form CGL policy is not meant to be property insurance. For this reason, real property which is owned, rented or otherwise occupied by the insured is not meant to be within the scope of CGL coverage. Ownership and tenancy are concrete concepts: either an insured holds title to the property or the insured holds a lease interest to the property for purposes of determining the application of this exclusion. However, whether a construction contractor "occupies" a piece of property under the terms of this exclusion is a separate and less certain consideration.

Some guidance is provided with reference to the CGL form's exclusion for damages incurred from pollution by the insured's occupation of real property. *See Tri-County Service Co., Inc. v. Nationwide Mutual Ins. Co.*, 873 S.W.2d 719 (Tex. App.–San Antonio 1993, writ denied). In *Tri-County Service*, the insured paving contractor brought an action to recover under commercial general liability insurance for damage caused when oil sprayed on a parking lot as base material at a construction site washed into and polluted a nearby creek. The owners of the property, HEB, removed the oil from the creek and docked Tri-County for the cost of cleanup. Tri-County claimed this loss

under both its general and umbrella policies with Nationwide, which denied coverage based upon the CGL's pollution exclusion. In particular, the court's consideration of coverage in this matter centered upon whether Tri-County "occupied" the construction site. Tri-County argued that it never "occupied" the parking lot because it held no property interest in the site. The Court of Appeals rejected this interpretation holding that the plain, ordinary meaning of "occupied" did not necessarily mean ownership and was broad enough to encompass Tri-County's operations on the parking lot. *Id.* at 721. Thus, *Tri-County Service Co., Inc. v. Nationwide Mutual Ins. Co.* stands for the proposition that a contractor or sub-contractor can be deemed to "occupy" a piece of property if it merely maintains a temporary presence at the site, no matter how short.

The Texas Supreme Court nevertheless rejected this restrictive interpretation of the term "occupied" in *Kelley-Coppedge, Inc. v. Highlands Ins. Co.*, 980 S.W.2d 462 (Tex. 1998). In this case, KCI, an oil and gas pipeline contractor, inadvertently struck a Mobil Oil pipeline causing the release of 1,600 barrels of crude oil. The spill damaged a third party's land and KCI sought coverage under its CGL policy issued by Highlands Insurance Company. Highlands eventually paid to repair the Mobil pipeline and for the lost oil. However, it denied the claim for clean-up costs based upon the CGL pollution exclusion. Highlands argued, and the lower Court of Appeals agreed, that because KCI had the right to be on the easement to perform operations, it "occupied" the easement for purposes of the insurance policy. The Supreme Court rejected this interpretation, holding that to follow the reasoning of *Tri-County Service Co., Inc. v. Nationwide Mutual Ins. Co.*, a contractor's presence, no matter how transitory, would constitute occupancy under the pollution exclusion, therefore rendering the pollution exclusion meaningless. Instead, the Texas Supreme Court agreed that "occupy" means "to hold or keep for use," thus implying a longer, more substantial presence at a site before an entity is deemed to have "occupied" the property.

By analogy, each of these cases is enlightening in the interpretation of the term "occupy" in determining the scope of coverage negated by exclusion (j). As applied to construction contractors and sub-contractors, *Kelley-Coppedge, Inc. v. Highlands Ins. Co.* illustrates that a contractor or sub-contractor must establish a firm presence at a construction site and not merely provide temporary services for the contractor or sub-contractor to be deemed to have "occupied" the site.

2. Property in the Insured's Care, Custody or Control

Because the standard form CGL policy is focused upon liability to third-party claims, any property which is still under the insured's care, custody or control does not qualify as third-party property which may be damaged. A CGL policy is not first-party insurance, nor is it a performance bond and is not designed to insure against property damage or loss of use for property where the insured has the right to exercise dominion or control over the property.

For instance, where a contractor has not "turned over" a partly-completed project to the property owner, all materials used in constructing that project are within the care, custody and control of the construction contractor and are not covered. *McCord Condron & McDonald, Inc. v. Twin City Fire Ins. Co.*, 607 S.W.2d 956, 957 (Tex. Civ. App.–Dallas 1973, writ ref'd n.r.e.). In *McCord*, a subcontractor was setting a pre-cast "tee" on a cafetorium of a junior high school building when something caused the "tee" and other beams which previously had been set by the contractor to fall and damage the walls of the building and door frames stored on the ground of the cafetorium. Although the school district had paid McCord for the exterior walls, the door frames, beams and for all but three of the "tees" prior to the accident, the court determined that there was no evidence that McCord had "turned over" the partly-completed property to the school district. Thus, it was apparent from the record that the general contractor was in possession of and occupied the building until the general contract was completed and the property damage exclusion applied to prohibit coverage for the damaged walls, door frames, beams and "tees."

Other authority makes it clear that where a repair contractor takes charge of and subsequently damages a property owner's machine parts, no coverage is afforded by virtue of this same exclusion. *AIU Ins. Co. v. Mallay Corp.*, 938 F. Supp. 407 (S.D. Tex. 1996), *aff'd*, 116 F.3d 1478 (5th Cir. 1997). In this case, Mallay, a machine tool company, received a turbine from Dow Chemical so that Mallay could burnish the turbine so that it would meet precise specifications. In the process

of burnishing the turbine, the turbine rolled and fell out of the lathe jaws that held it. The turbine fell 3-4 inches and was damaged so that it could not be used without significant further repairs. Dow claimed it suffered economic losses of $2.9 million as a result of the damage to the turbine and looked to Mallay for payment of these economic losses, as well as for reimbursement of the costs of repairing the turbine. Mallay sought coverage from its CGL policy issued by AIU. AIU denied coverage in part because the turbine was in the care, custody and control of Mallay at the time it was damaged. Mallay argued that the exclusion did not apply because the damage to the turbine was not directly attributable to operations or work being performed on the turbine because at the precise time of damage the burnishing lathe was not turned on. Rather, the turbine merely was loaded into the lathe which would not qualify as being worked on. Nevertheless, the court was persuaded by AIU's policy language because the turbine belonged to Dow and at the time it was damaged, it was in the care, custody and control of Mallay. Therefore, under the policy exclusion, no coverage was afforded.

The *McCord* and *AIU* cases demonstrate that the contractor is liable for damage to all property for which it controls, despite the fact that the property has been sold to or already is owned by a third party. If the construction contractor is in charge of this property, the property effectively becomes the property of the insured such that any damage to that property would be treated as a first party claim, outside the bounds of CGL coverage. Furthermore, the decision in *AIU Inc. Co. v. Mallay Corp.* demonstrates that an analysis of whether property is in the care, custody or control of the insured does not take into account whether the insured contractor actually is working on that property at the time it is damaged.

B. Faulty Workmanship Exclusions

1. Damage to that Particular Part of Real Property on Which Contractors or Sub-Contractors are Performing Operations - Exclusion j(5)

Clause (5) of Exclusion (j) applies primarily to the construction industry but focuses on the particular part of the property on which the insured is working or a sub-contractor is working on the insured's behalf. Most often Exclusion (j)(5) is used in conjunction with the faulty workmanship exclusion found in Exclusion (j)(6) to cast a restriction of coverage focused on limiting risks that are typically covered by business risk insurance. Very few courts have interpreted Exclusion (j)(5) but several important issues are invoked by the language set forth in this exclusion. Initially it is important to recognize that the exclusion covers both work the insured performs and work that a sub-contractor performs on the insured's behalf. This stands in direct contrast to the "your work" exclusion which excepts out of the exclusion damaged work performed on the insured's behalf by a sub-contractor.

Also, the use of the present tense in the exclusion indicates that Exclusion j(5) applies only to damage arising while the insured is currently working on the project, i.e., ongoing operations. *Mid- Continent Cas. Co. v. JHP Development, Inc. and TRC Condominiums, Ltd.,* ___ F.Supp. 2d ___ , 2005 WL 1123759 (W.D. Tex. 2005); *Malone,* 147 F. Supp. 2d 628 (holding exclusion j(5) barred coverage for construction defects and noting, when discussing another exclusion, that insured's work could not be deemed completed); *Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished); *Main Street Homes, Inc.,* 79 S.W.3d at 696 (holding exclusion j(5) did not preclude coverage for foundation defects because the petition indicated that the insured had completed construction and sold the homes before the damage resulted); cf. *Houston Bldg. Serv., Inc. v. Am. Gen. Fire & Cas. Co.,* 799 S.W.2d 308 (Tex. App. – Houston [1st Dist.] 1990, writ denied) (finding exclusion j(5) precluded coverage for damage occurring while insured janitorial company was cleaning building because operations had not been completed).

The most contested elements of Exclusion (j)(5)'s language center upon the interpretations of "a particular part" and "performing operations." Generally, the "particular part" language is interpreted narrowly, thus constricting the application of this exclusion. However, the "performing operations" language is interpreted broadly thus expanding the area for which this exclusion applies.

The "particular part of real property on which [the insured] is performing operations" has been interpreted to deny coverage for only the exact portion of the

property on which the insured was working at the instant of the occurrence of damage. *See Columbia Mut. Ins. Co. v. Schauf*, 967 S.W.2d 74 (Mo. 1998). In *Schauf*, the housing contractor entered into a subcontract with Schauf to paint, stain or lacquer all interior and exterior surfaces of a new home. After Schauf completed applying lacquer to the kitchen cabinets he began cleaning his spray equipment inside the house which consequently started a fire causing extensive damage throughout the house and required replacement of several parts of the house. The housing contractor looked to Schauf to recover the expenses incurred from this fire and Schauf looked to his CGL insurer for coverage. Columbia Mutual denied coverage arguing that Schauf was not performing operations on real property within the meaning of the exclusion. The court rejected this argument and further defined the scope of Exclusion (j)(5) in finding that the "particular part" language was to be interpreted narrowly. In an attempt to expand the effect of Exclusion (j)(5), Columbia Mutual contended that the entire area of real property on which Schauf was scheduled to work was the "particular part" of the property intended to be excluded from coverage. The court rejected this argument and held the "particular part" language was meant to deny coverage for business risks but allow coverage for accidental and consequential damage to other property which is not considered a business risk. Therefore, the court held that Exclusion (j)(5) denied coverage only for the fire damage to the kitchen cabinets but did not apply to property damage to the rest of the house.

Courts of other jurisdictions have agreed with this result as well. As is obvious from this authority from other jurisdictions, the "particular part" clause of the exclusion has been derived from the predecessor "care, custody or control" clause which the "particular part" exclusion was designed too narrow. *See Glen Falls Ins. v. Don Mac Golf Shaping*, 203 Ga. App. 508, 417 S.E.2d 197, 200 (1992)("[P]articular part" exclusion" is one of the exclusions "designed to exclude coverage for defective workmanship by the insured causing damage to the project itself," but not designed to exclude tort liability for damage to other property); *Royal Indem. Co. v. Smith*, 121 Ga. App. 272, 173 S.E.2d 738, 740-41 (1970) (Exclusion would apply to walls of tank being painted, but not to other property in the tank); *Connie's Constr. Co. v. Fireman's Fund Ins. Co.*, 227 N.W.2d 207, 211-12 (Iowa 1975) (Applying "care, custody or control" clause to steel being hoisted by crane, but not to completed work damaged when steel fell).

However, some courts have recognized the limits of a narrowed application of Exclusion (j)(5)'s "particular part" language. *See Vinsant Electrical Contractors v. Aetna Cas. & Surety Co.*, 530 S.W.2d 76 (Tenn. 1975). In *Vinsant*, an electrical contractor was engaged to install two 100 amp circuit breakers in a switchboard located at a shopping center. During the course of its work, one of the contractor's workmen inadvertently deposited or dropped a socket wrench which produced a shortage causing the entire switchboard to burn and blow up. The electrical contractor sought coverage for this damage from Aetna Casualty and Surety Company, its CGL insurer. Vinsant attempted to argue that because its worker was only working on the two 100 amp circuit breakers that only property damage to those circuit breakers should be excluded as "that particular part of any property . . . upon which operations are being performed." The court refused to construe the provision as to limit the exclusion to the precise and isolated spot upon which work was being done.

> "Such a construction would lead to illogical and absurd results and would completely nullify the intent of the endorsement. An exclusion so limited could well result in being, in practical effect, no exclusion at all."

Id. at 78. Instead, the court held that the entire switchboard was that particular part on which operations were being performed such that fire damage to the entire switchboard was not covered by the CGL policy. *See also William Crawford, Inc. v. Travellers Ins. Co.*, 838 F. Supp. 157, 158-59 (S.D. N.Y. 1993)(Holding that "particular part" exclusion barred coverage for damage to entire apartment insured was renovating even though insured was working only on one part of apartment at time of damage); *Jet Line Serv. v. American Employers Ins. Co.*, 404 Mass. 706, 537 N.E.2d 107, 111 (1989) (Stating that location of insured at time of damage in one area or another of property on which the insured has agreed to perform operations is not significant to coverage).

Another controversial aspect of this exclusion is the "operations being performed" which purports to

broaden the scope of the exclusion. The "operations" language has been interpreted to include not only the actual work for which the insured contracted but also all preparatory and finalizing operations immediately before or after the work. For instance, in *Columbia Mut. Ins. Co. v. Schauf*, 967 S.W.2d 74 (Mo. 1998), the court found that Schauf was performing operations on real property within the meaning of this exclusion when he was cleaning his paint spraying equipment that he had used to apply lacquer to the kitchen cabinets thirty minutes earlier. Schauf previously stated that cleaning the lacquer from his equipment to be part of the job and that he included the time for cleaning equipment in his bid. The fire which damaged the house in the instant case, was caused by these cleaning operations. Consequently, the court held that Schauf's cleaning operations fell within the meaning of "performing operations on real property" such that Exclusion (j)(5) would apply.

Further supporting the broad scope of "performing operations" a Texas court has held that where an ongoing contract is being performed, property damage which results from work performed by the contractor and within the contract period is included within Exclusion (j)(5). *Houston Bldg. Serv. v. American Gen.*, 799 S.W.2d 308 (Tex. App.–Houston [1st Dist.] 1990, writ denied). Houston Building Services, Inc. ("HBS") provided janitorial services to commercial buildings when in May 1988, HBS employees negligently applied linseed oil to wooden doors and door frames while cleaning a building in Houston. After the oil was applied, the occupant of the premises complained that the linseed oil caused discoloration of the doors and frames and that the doors were sticky. HBS sought coverage from American General Fire and Casualty Company ("American General"), its CGL insurer, for the repair of the damaged doors. American General denied coverage relying in part on Exclusion (j)(5). In response, HBS argued the exclusion language "are performing" indicated that the provision only applied if the damage was simultaneous with the work. The court rejected this argument ruling that the exclusion applied because the work the insured was hired to perform was under an ongoing service contract. Thus, property damage need not result simultaneously with the insured's performance of operations and may occur so long as the insured is contracted to work on the site.

2. Damage to that Particular Part of Any Property that Must be Restored, Repaired or Replaced - Exclusion j(6)

Like the clause negating coverage for property in the insured's care, custody and control, the faulty workmanship clause in subpart (6) of Exclusion (j) prohibits an insured from transforming a CGL policy into a performance bond. It excludes property damage to that particular part of any property that must be restored, repaired or replaced because the insured's work has been incorrectly performed on it. The exclusion then excepts from its application property damage falling within the "products completed operations hazard." The faulty workmanship clause is targeted at excluding coverage for work performed by the insured which has been characterized as defective and damaging to the construction project as a whole. Put simply, absent allegations of third-party property damage, an insured may not receive coverage for damages caused by the insured's defective performance of a contract.

Underlying the decision in *McCord Condron & McDonald, Inc. v. Twin City Fire Ins. Co.*, the court's holding that the door frames, beams and "tees" which had not been turned over to the school district constituted property in the care, custody and control of the insured was the court's assumption that no coverage existed for the contractor's defective performance of the installation of beams and "tees." *McCord Condron & McDonald, Inc. v. Twin City Fire Ins. Co.*, 607 S.W.2d 956 (958) (Tex. Civ. App.–Fort Worth 1980, ref'd n.r.e.). In *McCord*, the court held that a general contractor's negligent installation of beams and "tees" resulted in the damage to the other materials which still were in the custody and control of the contractor. Based on this defective performance, the court denied coverage under the custody and control clause, as well as the faulty workmanship clause.

In *Dorchester Development Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380 (Tex. App.–Dallas 1987), the court took a similar approach in excluding coverage for damages to the insured's property based upon the insured's defective workmanship. In this case, Dorchester, as general contractor of an apartment complex in Dallas, was sued based upon allegations that concrete flooring was prepared improperly, that Dorchester had failed to use concrete perimeter beams under certain patio slabs, and that the gutters attached to

the apartments were improperly primed and stained. The Dallas Court of Appeals held that the policy specifically excluded coverage for faulty workmanship, where faulty workmanship did not cause damage to other property. As there was no complaint in the petition that any *other* property was damaged as a result of the insured's defective workmanship, the only complaint was for the failure of Dorchester, the insured contractor, to repair or remedy the defective workmanship in the construction of the apartment complex. Thus, no coverage was available to repair or restore the concrete flooring, the concrete pillars, and the defective gutters.

Further, this clause applies to situations in which a contractor fails to follow job specifications and damage results as a result of this failure. *Gar-Tex Const. v. Employers Cas. Co.*, 771 S.W.2d 639 (Tex. App.–Dallas 1989, writ denied). In *Gar-Tex*, the City of Ennis had contracted with Red River Construction Company for the construction of an addition to the Ennis Water Treatment Plant, which was to include the construction of a clear well. Red River entered into a subcontract with Gar-Tex for Gar-Tex to provide labor and equipment for the construction of the clear well. Gar-Tex's responsibilities included the construction of the concrete slab, walls, and ceiling for the clear well, and formulation of methods to prevent water damage to the clear well during its construction. One weekend, significant rainfall fell that resulted in surface water run-off that entered into the clear well excavation site and caused structural damage to the clear well. As a result, the clear well was damaged and ultimately Gar-Tex sought coverage under a liability policy issued by Employer's Casualty Company. Employer's denied coverage and the court agreed that Gar-Tex's failure to follow job specifications to keep the excavation site dry until the clear well was complete constituted faulty workmanship. Under this rationale, coverage was negated by the faulty workmanship exclusion.

This clause of the damage to property exclusion, along with the authority interpreting this clause, make it clear that an insured contractor will not be able to prove coverage under a form CGL policy where it is the insured contractor's defective work or failure to follow job specifications that has rendered that portion of the project in need of restoration, repair or replacement. However, each of the above-cited cases makes it clear that if the underlying petitions had made claims for property other than that particular contractor's work, coverage would nevertheless be afforded for the other property. Thus, it is imperative that when evaluating a particular claim, one keeps in mind for which property the claim is being made.

Additionally, Exclusion (j) provides for an exception to clause (6). Under the terms of the exception, clause (6) does not apply to "property damage" included in the "products completed operations hazard." The "products completed operations hazard" is defined in the definition section as:

> 14. a. "Products--completed operations hazard" includes all "bodily injury" and "property damage" occurring away from premises you own or rent and arising out of "your product" or "your work" except:
> (1)products that are still in your physical possession; or
> (2) work that has not yet been completed or abandoned.

The products-completed operations hazard exception generally has been construed not to grant a distinct line of coverage in commercial general liability insurance policies. *See Paradigm Ins. Co. v. Texas Richmond Corp.*, 942 S.W.2d 645 (Tex. App.–Houston [14th Dist.] 1997, pet. denied) (liquor liability exclusion endorsement applied to products completed operations liability). Instead, this exception is meant to apply where the contractor has completely left the construction site after a contractor has fully completed its work and no longer exercises dominion or control over the property. Specifically, this exception is not applicable where the insured, by its continued ownership of part of the subject property, has not relinquished possession or control of the entire property. See *Cullen/Frost Bank of Dallas v. Commonwealth Lloyds Ins. Co.*, 852 S.W.2d 252 (Tex. App.–Dallas 1993, writ denied) (Where bank continued ownership of one condominium and thereby common areas of property, the bank had not relinquished possession or control of the common areas, and since not all property damage had occurred away from the premises owned by the bank, the products completed operations hazard exception was not applicable). Thus, this exception will not exempt the contractor from the

operation of exclusion (j) unless and until the contractor has fully performed its contract and fully withdrawn from the construction site relinquishing all control of the property.

C. Property Damage to "Your Product" - Exclusion (k)

The "your product" exclusion is the first of two exclusions dealing with risks that typically are insured under a business risk policy. As a CGL policy is not meant to be a performance bond, this exclusion establishes that a CGL policy cannot be utilized to reimburse the contractor for costs that are more appropriately controlled by basic quality control. In pertinent part, exclusion (k) prohibits coverage for "property damage" to "your product" arising out of it or any part of it. Furthermore, "your product" is defined as follows:

> a. Any good or products other than real property, manufactured, sold, handled, distributed, or disposed of by:
>
> (1) you;
>
> (2) others trading under your name; or
>
> (3) a person or organization whose business or assets you have acquired; and
>
> b Containers (other than vehicles), materials, parts or equipment furnished in connection with such goods or products.
>
> "Your product" includes:
>
> a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your product"; and
>
> b. The providing of or failure to provide warnings or instructions.
>
> "Your product" does not include vending machines or other property rented to or located for the use of others, but not sold.

The purpose of the "your product" exclusion is to take away coverage for situations in which a manufacturer or contractor sells a defective product, incorporates that product into a construction site, and then seeks coverage for the loss sustained by virtue of the defectiveness of the product. The basic principle is that such damage is more appropriately addressed in business risk lines of insurance because this risk is inherently the insured's as part of its quality control program. See Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997 at 22, citing *Thermex Corp. v. Firemen's Fund Ins. Co.*, 393 N.W.2d 15 (Minn. Ct. App. 1986). Furthermore, this exclusion focuses upon the damages visited on the particular product, but not damages to other property as a result of the defectiveness of this product.

For instance, in *General Manufacturing Company v. CNA Lloyd's of Texas*, 806 S.W.2d 297 (Tex. App.–Dallas 1991, writ denied), the manufacturer of double-paned insulated glass windows incorporated into custom homes in the Dallas/Ft. Worth area sought coverage from its CGL insurer, CNA, based upon the cost of replacement of over 10,000 windows. It was undisputed that 10,027 windows began cracking after they were installed into Dallas/Ft. Worth custom homes. The manufacturer argued that the incorporation of a defective product into a building causes a diminution in the building's value requiring coverage. CNA rejected Rockwall's argument and denied coverage based upon a similar policy exclusion prohibiting coverage for "property damage...arising out of the work or any portion thereof, or out of materials, parts or equipment furnished in connection therewith; ...." The court found that the CGL policy provided coverage for the insured's liability for damages to other property resulting from the defective condition, but that the policy specifically excluded damage to the product itself. *Id.* at 300 (citations omitted). The court agreed that no coverage

existed for the loss incurred by virtue of the manufacturer's replacement of the defective windows at a cost of slightly more than $1.1 million. *General Mfg. Co. v. CNA Lloyd's of Texas* provides a classic example of an instance where coverage is not proper for a loss sustained by virtue of the defectiveness of a component part in the construction of a building. However, there has been some controversy as to whether a building itself can qualify as a product falling within the bounds of the "your product" exclusion.

Some courts view a completed structure to be a product of a construction contractor's work. For example, in *Employer's Cas. Co. v. Brown McGee, Inc.*, 430 S.W.2d 21 (Tex. Civ. App.–Tyler 1968, writ ref'd n.r.e.), the court considered whether a defectively-constructed grain elevator constituted a product which could be excluded from liability coverage under an exclusion similar to the "your product" exclusion currently utilized. The court recognized the fact that liability coverage was not intended to provide builder's risk insurance for the defectiveness of the grain elevator. Further, the court considered other states' authority for the position that a completed building or house constituted a product falling within a business risk-type exclusion. Ultimately, the court determined that the underlying petition sought damages for lost storage revenue which, in effect, was for the loss of use of the elevator. The grain elevator was then considered to be the product of the insured's work falling within the business risk-type of exclusion.

On the other hand, more recent authority has established that the "your product" exclusion does not exclude damage claims arising out of construction services provided by general contractors. *Mid-United Contractors, Inc. v. Providence Lloyd's Ins. Co.*, 754 S.W.2d 824 (Tex. App.–Ft. Worth 1988, writ denied). In *Mid-United Contractors,*, a third-party, Trail Creek, alleged a cause of action against Mid-United Contractors for damages resulting from defects in an office building that Mid-United, as general contractor, had constructed for Trail Creek. Mid-United turned to its CGL insurer for a defense of this lawsuit. Trail Creek's pleadings alleged that it entered into a contract with Mid-United for the construction of a professional building and, after completion and acceptance of the building, a number of defects were discovered. In attempting to avoid coverage, Providence Lloyd's argued that the building constructed by Mid-United for Trail Creek was Mid-United's product. The court rejected this argument, holding that the "your product" exclusion is not applicable to construction defect cases. Specifically, a building did not qualify as "goods or products manufactured, sold, handled or distributed by the named insured or others trading under his name...." Focusing specifically on the ordinary language contained in the exclusion, the court found that buildings are constructed or erected instead of manufactured. *Id.* at 826 (citations omitted). Furthermore, the court recognized that Texas law reflected a distinction between improvements of realty which are constructed or erected and the process of manufacturing. *Id.* citing TEX. REV. CIV. STAT. art. 249 (Vernon 1973); TEX. CIV. PRAC. & REM. CODE ANN. § 130.001 (Vernon Supp. 1988). Additionally, the court cited Texas Supreme Court and United State Supreme Court holdings distinguishing the construction of buildings and the erection of bridges from the manufacturing process. *Id.* (citations omitted). Because any ambiguity in policy language must be construed against the insurer and in favor of the insured, the "your product" exclusion could not be applied to restrict coverage in this case.

The question is whether a manufactured home will be considered a “product.” Two Texas appellate decisions hold that the definition of "your product" does not apply to a building and its components. *CU Lloyd’s of Texas v. Main Street Homes, Inc.,* 79 S.W.3d at 697 (Buildings are not the named insured's "product" within the meaning of a CGL policy exclusion of coverage for property damage to the named insured's product arising out of it or any part of it; buildings are constructed or erected, not manufactured, and any ambiguity in the policy language must be construed against the insurer and in favor of the insured); *Mid-United Contractors, Inc. v. Providence Lloyds Insurance Co.,* 754 S.W.2d 824, 826 (Tex.App.-Fort Worth 1988, writ denied) (Interpreted the term as "not apply[ing] to the construction of [a] building because in ordinary language buildings are constructed or erected, not manufactured, and because any ambiguity in the policy language must be construed against the insurer and in favor of the insured.”).

Mobile homes are considered “products” or “goods” that are subject to the implied warranty of the Uniform Commercial Code as codified in Texas Business & Commerce Code sections 2.314 and 2.315.

See Nobility Homes of Texas, Inc. v. Shivers, 557 S.W.2d 77 (Tex. 1977) (Where the Texas Supreme Court held that a manufacturer of a mobile home is a seller of goods under Texas Business & Commerce Code §2.103(4) when it sells or contracts to sell mobile homes. Whether a manufacturer or a dealer, the insured is a seller of goods under the UCC as codified in the Texas statutes. "It is therefore our opinion that the exclusion for property damage to 'your product' will apply in this case where any property damage has occurred because the South Fort's product is the manufactured home where the damages involve only damages to the manufactured home.")

Given the more recent effect of *Mid-United Contractors, Inc. v. Providence Lloyd's Ins. Co.*, it most likely is the case that insurers will not be able to rely upon the "your products" exclusion to curtail coverage for damages to an entire building or structure. Instead, reliance upon the "your work" exclusion is more appropriate.

D. Property Damage Occasioned by "Your Work" - Exclusion (l)

The second and equally important business risk exclusion is the subtraction of coverage for property damage visited upon the work of the contractor. Like the rationale underlying the "your product" exclusion, the "your work" exclusion was created to eliminate coverage for costs that are more appropriately controlled through everyday quality control. Quality control is a cost inherent in the construction industry and is thus an expected loss. *See Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788, 791 (1979). Since insurance is designed to protect against unforeseen hazards, a lack of quality control precautions that naturally leads to a defect in the contractor's work should not be compensated by a liability policy.

The "your work" exclusion has gone through several iterations, presently existing in a form that is much narrower than its original language. The basic 1973 CGL form incorporated a "your work" exclusion that cut coverage for all work performed "by or on behalf of" the named insured. See Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997, at 29. Significantly, this encompassed liability for the work of both the named insured and any subcontractor that performed the work for the insured-contractor. *See Weedo v. Stone-E-Brick, Inc.*, 81 N.J. 233, 405 A.2d 788, 791 (1979)(interpreting 1973 CGL Form Exclusion "o" to exclude coverage for both named insured contractor and all subcontractors because the named insured is in the best position to ensure the control of quality of the goods and services supplied).

In its second iteration, the "your work" exclusion could be narrowed through the purchase of the Broad Form Property Damage Endorsement (BFPD) beginning in 1973. See Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997, at 29. This endorsement broadened the coverage by narrowing certain exclusions included in the 1973 CGL form. *Id.* Specifically, the BFPD restricted the application of the "your work" exclusion to work performed by the named insured only. *Id. at 29-30*, *citing Fireguard Sprinkler Systems v. Scottsdale Ins. Co.*, 864 F.2d 648, 649 (9th Cir. 1988); *Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824, 827 (Tex. App.–Fort Worth 1988, writ denied).

In 1986, the "your work" exclusion currently utilized by the CGL form incorporated the narrowed language set forth in the Broad Form Property Damage endorsement into the main part of the policy. In pertinent part, the current "your work" exclusion and its accompanying definition states:

> 1. "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.
>
> "Your work" means:
>
> a. Work or operations performed by you or on your behalf; and

> b. Materials, parts or equipment furnished in connection with such work or operations.
>
> "Your work" includes:
>
> a. Warranties or representations made at any time with respect to the fitness, quality, durability, performance or use of "your work"; and
>
> b. The providing of or failure to provide warnings or instructions.

Courts construing this exclusion have uniformly upheld its intended curtailment of coverage for deficiencies in the insured's work where the work is completed. For instance, a similar exclusion was interpreted by one Texas court to exclude coverage for the collapse of a building as a result of a contractor's utilization of defective steel supports that failed to conform to specifications. *Eulich v. Home Indemnity Co.*, 503 S.W.2d 846 (Tex. Civ. App.–Dallas 1973, ref'd n.r.e). In *Eulich*, the owner of the collapsed building sued the insurer based upon the contractor's admitted liability for the defective steel supports. The Court ruled that a "your work" type of exclusion does not insure the contractor against his own failure to perform his contract, but does insure him against liability for damages other than to the building itself as the result of his performance, whether defective or otherwise. Furthermore, liability for damage to the building resulting from the use of an inadequate steel member that did not comply with the specifications is exactly the type of liability which the language of the policy was evidently intended to exclude.

Similarly, the Court in *T.C. Bateson Const. v. Lumbermens Mut. Cas.*, 784 S.W.2d 692 (Tex. App.–Houston [14th Dist.] 1989, writ denied) declared that the "your work" exclusion eliminated coverage for costs incurred as a result of a general contractor's defective work. As part of its construction of the University of Texas LBJ Library, the general contractor in *Bateson* subcontracted the installation of marble slabs to the exterior of the library. Because the subcontractor used a mix of mortar that incorporated gypsum, the slabs cracked, causing damage to the library and destruction of the slabs. Bateson requested coverage for a lawsuit brought by the University of Texas based on the damage to the marble slabs and the library. Lumbermens Mutual denied coverage based upon the 1973 CGL form "your work" exclusion because the defective installation of marble had been performed *on behalf* of Bateson. Bateson argued that the exclusion was ambiguous and did not curtail coverage for the non-defective sections of the library that had been injured. The Court rejected this argument, finding no ambiguity in the policy language and reading the exclusion to apply to the defective work performed by Bateson's subcontractor. Further, the Court distinguished cases that held the "your work" exclusion focused upon the actual work performed by the insured or its subcontractor, thereby upholding coverage for the non-defective work injured by the defective work. As Bateson had contracted to build the entire library and marble was affixed to the entire structure, the defective mix of mortar resulted in damage to the structure as a whole, thus negating coverage for the entire project. *See also Taylor v. Travelers Ins. Co.*, 40 F.3d 79 (5th Cir. 1994)(excluding coverage under a "your work" type exclusion where insured defectively performed contract to restore automobile finishes); *Sarabia v. Aetna Cas. and Sur. Co.*, 749 S.W.2d 157 (Tex. App.–El Paso 1988, no writ) (Insured mechanic could not recover costs of re-repair of engine that was damaged by mechanic's failure to include certain parts during first repair).

Other courts have nonetheless recognized a distinction between damage to the insured's work and the remainder of the project. This distinction is important because it sets forth the boundaries of coverage between first party business risk and liability to third parties for damages resulting from the defective work. Unquestionably, the former is meant to be excluded by the "your work" clause. *See T.C. Bateson Const. v. Lumbermen's Mut. Cas.*, 784 S.W.2d 692, 694-95 (Tex. App.–Houston [14th Dist.] 1989, writ denied). The latter is more appropriately the subject of CGL coverage. Hence, several courts have recognized this distinction and afforded coverage for the third party claims. *See Travelers Ins. Co. v. Volentine*, 578 S.W.2d 501 (Tex. Civ. App.–Texarkana 1979, no writ) (Where insured's defective valve job resulted in the destruction of the entire engine, coverage was granted to cover all parts of the damaged engine except the valves as the rest of the engine constituted "other property" outside the application of the "your work" exclusion); *Hartford*

Casualty Co. v. Cruse, 938 F.2d 601, 603 (5th Cir. 1991) (Defective performance of foundation work invoked "your work" exclusion to negate coverage for foundation, but damages visited upon the rest of the house by virtue of the faulty foundation were recoverable; as stated by the court, a contractor "cannot recover from the insurer for his own failure to perform his contract, but can recover for damage *other than to his own work* whether or not that work is defective.") *But see T.C. Bateson Const.*, 784 S.W.2d at 697 (Distinguishing *Travelers Ins. Co. v. Volentine* and refusing to grant coverage to the rest of the structure that was damaged by insured's defective work because work was performed on the entire library).

Also important to recognize in the current "your work" exclusion is the narrowed application to work of the insured only. Under this narrowed approach, the result in *T.C. Bateson* would most likely be different, as it was Bateson's subcontractor that had caused the defect in the construction. In a similar case, the Court found that a general contractor would not be liable for the defective performance of a subcontractor's work. *Mid-United Contractors, Inc. v. Providence Lloyds*, 754 S.W.2d 824 (Tex. App.–Fort Worth 1988, writ denied). The issue before the Court was whether or not the broad form Comprehensive General Liability Endorsement to its Comprehensive General Liability Insurance policy created a duty on the part of Providence Lloyd's Insurance Co. to defend Mid-United, which duty would not have existed under the basic policy, absent the endorsement. The Court determined that the language of the endorsement, by replacing exclusions in the basic policy with more restrictive exclusions, extended the policy coverage and obliged Providence to defend the suit. Although the basic Comprehensive General Liability policy would not provide coverage for property damage caused by the acts of a subcontractor, the endorsement replaced some of the exclusions contained in the basic policy and extended coverage to property damage resulting from the actions of the subcontractors. The endorsement narrowed the application of the two exclusions to the particular part of the property with which the insured or its subcontractor had contact in causing the loss. In short, although Mid-United Contractors would have no insurance coverage for damage to its own work arising out of its work, it was covered for damages arising out of the subcontractor's work.

In sum, the "your work" exclusion goes a long way in curtailing a contractor's ability to make claims for damages that are business risks. Under the above-cited cases, it is obvious that a contractor may not seek reimbursement for costs related to the insured's defective work, but may in certain circumstances recover for the remainder of the structure that is injured by virtue of the defect in the insured's work. Furthermore, under the present language in the "your work" exclusion, an exception exists which allows recovery for that part of the work that is attributable to the defective performance by a subcontractor acting on behalf of the insured.

E. Impaired Property Damage - Exclusion (m)

This exclusion addresses damages occasioned by a loss of use of property either as a result of the insured's failure to fully perform a contract or as a result of the inclusion of a defective component part into the property. In relevant part, the exclusion states:

> m. "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.

Further, the term "impaired property" is defined as follows:

> "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:

> a. The repair, replacement, adjustment or removal of "your product" or "your work"; or
>
> b. Your fulfilling the terms of the contract or agreement.

This exclusion is specifically targeted to the portion of the form CGL's property damage definition that grants coverage for the loss of use of property that has not been physically injured. The "impaired property" exclusion refers to instances where an insured has incorporated defective materials in a project that reduce the levels of performance, quality, or durability of the constructed property. See Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997, at 31; *See also Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished) (exclusion m might arguably apply to the replacement of EIFS on homes, but does not apply to the costs incurred by the insured to repair physical injured caused by water damage to the homes); *T. C. Bateson Constr. Co. v. Lumbermen's Mut. Casualty Co.*, 784 S.W.2d 692 (Tex. App.–Houston [14th Dist.] 1989, writ denied) (Holding "impaired property" exclusion was unambiguous and applied to exclude the cost of repair and replacement of marble slabs that were attached to a building in a defective manner).

Very few courts have construed this clause, but what little jurisprudence that exists points to the fact that the "impaired property" exclusion is not meant to exclude coverage for loss of use which is accompanied by physical injury. *See e.g., Unifoil Corp. v. CNA Ins. Co.*, 218 N.J. Super 461, 528 A.2d 47 (1987); *Sentry Ins. Co. v. S&L Home Heating Co.*, 91 Ill. App. 3rd. 687, 414 N.E.2d 1218, 1221 (Ill. 1980). Instead the exclusion is supposed to reflect a "clear an unambiguous desire by the insurer to exclude coverage damages arising from a breach of representations or warranties made by the named insured as a level of performance of its products." Joseph G. Blute, *Analyzing Liability Insurance Coverage for Construction Industry Property Damage Claims*, Coverage (Committee on Insurance Coverage Litigation Report), May/June 1997, at 31, *citing Willets Point Contracting Corp. v. Hartford Ins. Group*, 429 N.Y.S.2d 230, 233 (N.Y. App. Div. 1980), *aff'd*, 53 N.Y.2d 879, 440 N.Y.S.2d 619 (1981). The property must also be able to be restored to use by the repair of the insured's defective work in order to constitute "impaired property." In *Federated Mut. Ins. Co. v. Grapevine Excavation, Inc.*, 197 F.3d 720 (5th Cir. 1999), the Court refused to apply the impaired property exclusion because the defect could not be cured without removing or destroying the other work that was alleged to be the "impaired property." In that case, the top layer of the asphalt parking lot, which was alleged to be the "impaired property," could not be restored to use by the repair, replacement, adjustment or removal of the insured's work, which constituted the select fill material underlying the asphalt, without tearing up the parking lot. The Court therefore held that the impaired property exclusion did not apply.

IV. OTHER ISSUES IN CONSTRUCTION DEFECT CASES

Typically there are a number of issues that arise in a construction defect dispute. In addition to the insured, there are often several other parties who are involved in the dispute in one way or another, either as a contractor, subcontractor, owner, or otherwise. These parties may have suffered some damage as a result of the defect at issue or they may have some liability for the damage that has occurred or both. The coverages available to these other parties often come into play in the context of a construction defect coverage dispute and the availability and applicability of those other coverages can often have an impact on the coverage provided under the policy to the named insured. Additionally, some of those other parties, and particularly other contractors, may have a claim for coverage under the policy issued to the named insured, usually as an additional insured under the policy.

A. Contractor as an Additional Insured

Typically, the party who is claiming coverage as an additional insured under the policy is a contractor on the project on which the named insured is working. As part of the contract with the named insured, the contractor has required that the named insured name it as an additional insured under the named insured's insurance policy. Generally, most CGL policies contain

provisions which allow the party who is the named insured under the policy to add a contracting party as an "additional insured" under the named insured's CGL policy. Today, a great number of contracts contain agreements to procure insurance for additional parties. Therefore, most insurance policies contain one of several standard endorsements to comply with these types of agreements.

(1) Additional Insured - Owners, Lessees, or Contractors (Form A) (CG 2009); and

(2) Additional Insured - Owners, Lessees, or Contractors (Form B) (CG 2010).

CG 2009 was designed for inclusion in CGL policies when the insured did not purchase contractual liability insurance. *See* D. MALECKI & J. GIBSON, THE ADDITIONAL INSURED BOOK, p. 185 (2nd Ed. 1995). Once contractual liability coverage was incorporated directly into the CGL form in the 1980s, the CG 2009 form became unnecessary. Because form CG 2010 is more commonly found in general liability policies and therefore, more often at issue, we will limit the discussion to legal authority and interpretation thereof.[1]

The most recent version of CG 2010 reads:

ADDITIONAL INSURED - OWNERS, LESSEES OR CONTRACTORS (Form B)

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE PART

SCHEDULE

Name of Person or Organization:

(If no entry appears above, information required to complete this endorsement will be shown in the Declarations as applicable to this endorsement.)

WHO IS AN INSURED (Section II) is amended to include as an insured the person or organization shown in the Schedule, but only with respect to liability arising out of your ongoing operations performed for that insured.

This version of CG 2010 was substantially changed from the prior versions. The 1985 version broadly included coverage for the additional insured's "liability arising out of 'your work'" for the named insured. The 1997 version was narrower, extending coverage to the designated additional insured only for "liability arising out of your ongoing operations." Then, the 2001 version was modified to delineate between the "work" and the "ongoing operations" of the named insured to make more explicit the intention that such additional insured coverage was not to include "completed operations" coverage for occurrences arising after completion of the named insured's work. *See Mid-Continent Cas. Co. v. Chevron,* 205 F.3d 222 (5th Cir. 2000), and *Pardee Const. Co. v. Ins. Co. of the West,* 92 Cal. Rptr. 443 (2000), where both courts concluded that "your work" included completed operations coverage, but in dictum concluded that "your ongoing operations" language in the later versions of the endorsement did not. *See also* D. HENDRICK, INSURANCE LAW: UNDERSTANDING THE BASICS REGARDING 'ADDITIONAL INSUREDS,' Insurance Law 2003: Understanding the ABC's, Practicing Law Institute, p. 619 (2003) (including the terms "ongoing operations" in additional insured endorsements clarified the intention that such additional insured coverage was not to include "completed operations" coverage for occurrences arising after completion of the named insured's work).

The narrowed coverage under the 2001 versions of CG 2010 is intended to correspond with another additional insured ISO endorsement form issued in 2001, CG 2037, which specifically affords only completed operations coverage to an additional insured to the extent included in the "products-completed operations hazard" coverage.

There is also a broad form additional insured endorsement which provides additional insured

1 *See Columbia Casualty Co. v. City of Des Moines, Iowa*, 487 N.W.2d 663 (Iowa 1992) for a judicial analysis of form CG2009.

coverage to any party that the named insured contracts with. The following is an example of the broad form additional insured endorsement:

ADDITIONAL INSURED - WORK CONTRACT

This endorsement modifies insurance provided under the following:

COMMERCIAL GENERAL LIABILITY COVERAGE FORM
WHO IS AN INSURED (Section II) is amended as follows:

5. Any person or organization other than an architect, engineer, or surveyor, which requires in a "work contract" that such person or organization be made a protected entity under this policy. However, such person or organization shall be an insured only with respect to covered "bodily injury" or "property damage, personal injury" and "advertising injury" which results from work done by you or on your behalf under that "work contract."

   The coverage afforded to such person or organization shall continue only for a period of thirty (30) days after the effective date of the applicable "work contract" or until the end of the policy term, whichever is earlier. However, if you report to us within this period the name of the person or organization, as well as the nature of the "work contract" involved, the coverage afforded under this endorsement to such person or organization shall continue until the expiration of this policy.

DEFINITIONS (Section IV) is amended to add the following definition:

"Work contract" means an agreement into which you enter for work to be performed by you or on your behalf.

AN EXTENSION OF COVERAGE GRANTED BY THIS ENDORSEMENT SHALL NOT CONTINUE BEYOND THE EXPIRATION DATE OF THIS POLICY.

The additional insured endorsement has been the center of various judicial decisions. One of the primary issues is the scope of coverage available to the additional insured under such an endorsement. Specifically, the question in many cases has been whether the endorsement affords coverage for the additional insured only for vicarious liability or whether the CG 2010 endorsement or the broad form additional insured endorsement insures the additional insured for its own negligence. Another issue is the scope of the terms "arising out of" and "resulting from" and the effect those terms have on the availability of coverage to the additional insured.

1. Minority View: Negligence on Part of the Named Insured Only

Historically, Texas has been in the minority of jurisdictions and has followed the interpretation that precludes coverage for an additional insured unless there has been negligence on the part of the named insured. In *Granite Constr. Co., Inc. v. Bituminous Ins. Co.,* 832 S.W.2d 427 (Tex. App.–Amarillo 1992, no writ), the court was confronted with an additional insured endorsement similar to the additional insured endorsement referenced above. Granite was a contractor who contracted with Joe Brown company to haul asphalt materials from its construction site. Pursuant to this contract, Brown agreed to and did carry liability and property damage insurance, which had been issued to Brown by Bituminous in the form of general and excess liability policies. Granite was named as an additional insured under the general liability insurance policy by way of an endorsement which read as follows:

1. The "Persons Insured" provision is amended to include as an insured the person or organization named below [Granite Construction Company] but only with respect to liability arising out of operations performed for such insured

> [Granite] by or on behalf of the named insured [Brown].

Id. at 428. Brown's employee, Valchar, brought a negligence action against Granite alleging that Granite negligently loaded his truck with dirt in such a manner that it overturned and injured him. Thereafter, Granite requested Bituminous to defend it against Valchar's action. Bituminous refused, stating that the acts of Granite were not covered by Brown's policy and, therefore, there was no duty to defend. Granite brought a declaratory judgment action seeking a determination that Bituminous had a duty to defend and a duty to indemnify.

Granite argued that since Valchar alleged that his claim against Granite stemmed from operations performed pursuant to the Granite/Brown contract, Bituminous was liable under the general liability insurance policy endorsement because Valchar's claim clearly arose "out of operations performed [namely, hauling] for such insured [Granite] by or on behalf of the named insured [Brown]." *Id.* at 429. The Court found that:

> . . . Valchar's claim against Granite was for its negligent loading of his truck. Under the Granite/ Brown contract, the loading operation was the sole obligation of Granite, and Brown was not responsible for that operation. Measuring the policy coverage provided Granite by the allegations in Valchar's petition, it is at once obvious that Valchar's claim of Granite's liability arose out of the loading operations performed by Granite; it was not a claim "arising out of operations performed for [Granite] by or on behalf of [Brown]," the only operations for which Granite was insured.

It follows that the endorsement is susceptible of only one reasonable interpretation: Granite is not afforded coverage for its own loading operations upon which Valchar's suit is predicated. Accordingly, the trial court correctly determined as a matter of law that Bituminous had no duty to defend Granite against Valchar's suit. *Id.* at 430. The *Granite* court focused specifically on the exact activity that gave rise to Valchar's claim and then reviewed each parties' contractual obligations. Thus, it can be argued that the *Granite* decision is limited solely to the factual scenario presented to the court and that is that the sole cause of the injury was caused by an activity performed only by Granite, the additional insured.

The only other case interpreting Texas law on this issue for a number of years was a federal case out of the Northern District of Texas which dealt directly with this issue but failed to provide any real guidance. In *Northern Ins. Co. of N.Y. v. Austin Commercial, Inc. and Am. Airlines, Inc.,* 908 F. Supp. 436 (N.D. Tex. 1995), Judge Maloney relied upon *Granite Constr. v. Bituminous Ins. Co.,* in holding that when the third party's claims involve direct negligence on the part of the named insured, then the insurance company is obligated to defend those claims on behalf of the additional insureds. This case involved Northern's additional insured endorsement extending coverage for "liability arising out of 'your work'." In the *Northern Ins. Co.* case, the court recognized that the lawsuit against the additional insured did not involve the direct negligence of the named insured. In fact, the named insured was not named as a defendant in the state court actions. There were no allegations that the injuries were caused by the named insured. Instead, the injured parties sought recovery directly from the additional insured on the basis of its own negligence. Austin Commercial claimed contributory negligence against the injured claimant worker in the underlying state court action. However, the federal court held such allegations have no bearing on whether the injury arose out of the named insured's [Process Piping's] liability for its employee's claims against Austin Commercial.

The *Granite* and *Northern Insurance* decisions raise several questions about the true purpose of the additional insured endorsement, especially given the common circumstances under which parties seek such coverage. For example, an employee of the named insured is injured while working on the owner's project. The employee recovers under the named insured's worker's compensation policy and is thereafter barred from raising a claim against a named insured. Even if the employee asserts a claim against the named insured, there is no coverage under a general liability policy due to the employee's bodily injury and worker's compensation exclusion.

So, the employee sues the owner for its own negligence. Arguably, the owner is not entitled to the status of additional insured under the *Granite* and *Northern Insurance* decisions. However, the only equitable defense available to the owner is the benefit of the worker's compensation bar. Thus, one justification for limiting the scope of the additional insured endorsement is that the general liability policy is not designed to cover employee injuries, whether the claim is brought against the named insured or the additional insured. Instead, the policy is designed to cover bodily injury and/or property damage suffered by a third party. *See Gates v. James River Corp. of Nev.,* 602 S.2d 1119 (La. App. 1992) (Court recognized that owner obtained additional insured endorsement for two reasons: (1) proof of insurance from contractors for their own liability, and (2) an additional layer of insurance for the owner's own coverage in the event of its liability arising from the fault of the named insured).

2. Majority View: Coverage for Additional Insured's Direct Negligence

The second interpretation of the term "additional insured" is broader in that the endorsement applies to trigger the insurer's duty to defend and/or indemnify the additional insured even when the named insured is not negligent. A majority of jurisdictions across the country have adopted this view. In *Consolidated Edison Co. v. N.Y., Inc. v. Hartford Ins. Co.,* 203 A.D.2d 83, 610 N.Y.S.2d 219 (N.Y.A.D. 1994) the New York Court of Appeals interpreted the "additional insured" endorsement broadly. The endorsement at issue reads as follows:

> The "persons insured" provided is amended to include as an insured *[Con Edison]* but only with respect to liability arising out of operations performed for such insured by or on behalf of the named insured *[Tara].*

The court held that the endorsement did not focus upon the precise cause of the accident, as *Hartford* urged, but instead focused upon the general nature of the operation in the course of which the injury was sustained. *Id.* at 21. In *Consolidated Edison,* the injured party was an employee of a subcontractor hired by Tara who was working in furtherance of his duties under Tara's contract with Con Edison. The New York Court held that the fact that the cause of the injury may have been Con Edison's fault or due to Con Edison's negligence, is immaterial. *Id.*

Hartford argued that the endorsement served as an exclusion. The court disagreed and held that the endorsement is an addition to coverage and that the "but only" qualification does not change the meaning of the latter portion of the clause. Also, the court reasoned that the language in the endorsement is neither clear, nor unmistakable and therefore should not be considered an exclusion of coverage. Finally, the court held the insurance company's feet to the fire with the argument that if the parties intended to exclude coverage arising out of the negligence of Con Edison, the additional insured, such language could easily have been added into the subject endorsement. *Id.*

In *McIntosh v. Scottsdale Ins. Co.,* 992 F.2d 251 (10th Cir. 1993), the federal court of appeals held that under Kansas law an additional insured endorsement in a general liability policy did not limit the policy's coverage to cases where the additional insured is held vicariously liable for the named insured's negligence. In this case, the subject endorsement read the same as in the *Consolidated Edison* case discussed above. Applying principles of contract construction, the court held that "at best, the phrase 'but only with respect to liability arising out of [Festival's] operations' is ambiguous as to whose negligence is covered and whose negligence is excluded from coverage." *Id.*

One of the more recent cases interpreting additional insured endorsements is *Endre v. Niagara Fire Ins. Co.*, 675 A.2d 511 (Ma. 1996). In *Endre*, Endre, d/b/a Sunrise Gas, was a licensed dealer of Foster, a propane gas and equipment dealer. Foster agreed to name all its dealers as additional insureds on its general liability policy through Niagra. Both the vendors endorsement and the additional insured endorsement were added to Foster's liability policy for that purpose.

A lawsuit arose against Endre when Endre installed Foster propane equipment to a water heater, which resulted in a fire in September of 1991 at the Travis' home. Travis' homeowner's insurer filed a complaint as subrogee of its insureds, against Endre and Foster, alleging that the fire was caused by Endre's improper and negligent installation and/or servicing of

[the used] propane heater and its attachments, and that Endre's negligence was attributable to Foster as its duly authorized principal. *Id.* at 512-13. Endre brought the present lawsuit seeking a declaration that Niagra owed to Endre defense and indemnity against the Travis' complaint.

Niagra argued that because the used propane heater was not a Foster product and the work done by Endre for the Travises was not "by or for" Foster, Niagra had neither a duty to indemnify nor defend Endre. The court of appeals disagreed and held that Niagra had a duty to defend and indemnify Endre in the Travis lawsuit. The court reasoned that based on the allegations in the complaint, there may be facts developed at trial that would result in a fact finder determining the cause of the fire to be either (1) Endre's negligence in servicing the heater subsequent to its installation or (2) Endre's negligence in installing or servicing the "attachments" to the used heater (i.e., the Foster cylinders, aluminum hood, or gas regulators). *Id.* at 513. The court reasoned that in either case of negligence, Endre's actions could come within the policy's definition of "your work."

Recall that the definition of "your work" includes (a) work or operations performed by you or on your behalf; and (b) materials, parts or equipment furnished in connection with such work or operations. Apparently, the Maine Court placed significance upon the fact that Endre used Foster parts in servicing the used heater. The logic that Endre is performing work on behalf of Foster simply because it chose to use Foster parts is tenuous at best. Possibly, the court assumed Foster's products were defective. However, there were no allegations to that affect. More likely, the court may have recognized Foster's intent to protect its dealers from exposure as a means of maintaining exclusivity in representation of the Foster product.

Though the opinion is somewhat convoluted, the result certainly follows the majority interpretation of the additional insured endorsement. It is unclear whether the court would have ruled similarly had the Travises failed to allege that Endre's negligence was attributable to Foster as principal.

In *Transamerica Ins. Group v. Turner Constr. Co.*, 601 N.E.2d 473 (Mass. App. 1992), Turner was the general contractor for the construction of a large office building in Boston. Turner subcontracted with Blaesing to complete the fabrication and installation of the exterior granite of the building. While a Blaesing crew was aligning a panel on the 31st floor, the panel broke and a chunk of granite fell into the 28th floor where Davis, a Blaesing employee, was working. Davis brought a negligence action against Turner but not Blaesing.

The Turner/Blaesing subcontract required Blaesing to obtain contractual liability insurance for liability Blaesing had assumed under an indemnity agreement within the subcontract. Transamerica, Blaesing's insurer, argued that the additional insured endorsement on Blaesing's policy, which named Turner as an insured on the Boston construction job "but only with respect to liability arising out of 'your [Blaesing's] work'" for the insured [Turner] by or for you," did not apply to the Davis accident. *Id.* at 476. Transamerica argued that the words "arising out of" presupposed that Blaesing was the proximate cause of the accident; however, it was Turner which was the proximate, if not the sole cause of the accident when Turner failed to take responsibility for general safety on the job. *Id.*

The court found that argument "breathtakingly unpersuasive." *Id.* The court recognized that it was Blaesing which lost control of the granite which fell on Davis. *Id.* While the court found in favor of Turner on what appeared to be an issue of proximate cause, the Court made the following comment:

> That the general contractor, because of its over-all supervisory role, would be a target for a claim of negligence <u>*as well*</u> is precisely the purpose of having the subcontractor's insurance name the general contractor as an additional insured.

Id. (emphasis added). This language suggests that the additional insured endorsement could be intended to apply only when both the additional insured and named insured are allegedly negligent.

The Tenth Circuit construed the endorsement broadly and in favor of the additional insured after finding that it was ambiguous and that it purported to limit coverage. *Id. See also Saavedra v. Murphy Oil U.S.A., Inc.*, 930 F.2d 1104, 1109-10 (5th Cir. 1991) (Court held that clause providing coverage to additional

insured "as required by contract" and "with respect to operations performed by or for the named insured" covered additional insured for its own negligence); *Hartford Accident & Indem. Co. v. United States Natural Resources, Inc.*, 897 F. Supp. 466 (D. Ore. 1995) (Additional insured status limited to "operations performed by or on behalf of 'named insured'" was not limited to vicarious liability of additional insured, but afforded additional insured same coverage as named insured where injury occurred to named insured's employee, using named insured equipment and while working on project under contract between named insured and additional insured"); *Philadelphia Elec. Co. v. Nationwide Mut. Ins. Co.*, 721 F. Supp. 740 742 (E.D. Penn. 1989) (Holding that clause adding additional insureds "for any work performed by [the named insured] on their behalf" covered additional insureds for their own negligence in relation to work of the named insured); *Casualty Ins. Co. v. Northbrook Prop. & Cas. Ins. Co.,* 501 N.E.2d 812, 815 (Ill. App. 1986) (Holding that phrase "arising out of operations performed for the additional insured by the named insured" covered additional insured for its own negligence); *Dayton Beach Park No. 1 Corp. v. National Union Fire Ins. Co.,* 175 A.D.2d 854 (N.Y.A.D. 1991), *appeal denied*, 586 N.E.2d 62 (1991) (Holding that phrase "arising out of . . . operations performed for the additional insured . . . by the named insured" covered additional insured for its own negligence); *Charter Oak Fire Ins. Co. v. The Trustees of Columbia Univ.*, 198 A.D.2d 134, 604 N.Y.S.2d 55 (N.Y.A.D. 1993) (Additional insured endorsement not limited in scope to those situations in which defendant is only vicariously liable); *Florida Power & Light Co. v. Penn Am. Ins. Co.*, 654 So.2d 276 (Fla. Ct. App. 1995) (Additional insured endorsement held ambiguous where clause did not require fault on behalf of insured before additional insured could be considered for coverage); *Township of Springfield v. Ersek*, 660 A.2d 672 (Pa. Com. Ct. 1995) (Person named as additional insured "with respect to liability arising out of operations performed by the named insured" entitled to coverage regardless of whether negligence arises from named insured or additional insured's conduct).

3. No Coverage for Additional Insured's Sole Negligence

The 2002 version of the ISO GL2033 solves this dilemma of the scope of coverage by limiting coverage for the additional insured to the sole negligence of the named insured. The endorsement reads:

> **A. Section II – Who Is An Insured** is amended to include as an insured any person or organization for whom you are performing operations when you and such person or organization have agreed in writing in a contract or agreement that such person or organization be added as an additional insured on your policy. **But regardless of the terms and provisions of such contract or agreement or other provisions of this policy, such person or organization is an additional insured only with respect to liability directly related to your sole negligence and directly related to your ongoing operations performed for that additional insured under such contract or agreement.** A person's or organization's status as an additional insured under this endorsement ends when your operations for that additional insured are completed.

This particular endorsement limits coverage to the additional insured in several respects. First, the additional insured coverage is limited to the additional insured's liability directly related to the named insured's sole negligence. This means that the additional insured's coverage is only for vicarious liability, not direct negligence, of the additional insured. Second, the additional insured's coverage is limited to ongoing operations of the insured under contract or agreement. There is no coverage for the additional insured for liability for damages that occur after the operations of the named insured are complete.

Most courts that have analyzed this type of exclusion to additional insured coverage recognize that the application of the exclusion cannot be determined until there is final adjudication in the matter of liability. For example, the court *in Employers Ins. Co. of Wausau v. General Star Nat. Ins. Co.*, 2004 WL 1555143, *2 (S.D.N.Y.,2004) addressed an additional insured endorsement in a liability policy issued by General Star that provided that the policy will cover:

> [A]ny person or organization *whom you have agreed, by written contract* prior to an 'occurrence' or offense, to include as additional insured, but only for liability arising out of your premises and operations and *not for liability arising out of the sole negligence* of the aforementioned person or organization.

General Star contended that any determination of whether it has a duty to defend and indemnify the additional insured, 75 West Construction, should be stayed pending the outcome of the Underlying Action. According to General Star, until it is determined whether Kandic's injuries were the result of 75 West Construction's "sole negligence," it is impossible to know whether 75 West Construction can recover under the General Star Policy. Under New York law, "an insurer's duty to defend is 'exceedingly broad' and is separate from and more expansive than the duty to indemnify." *Id.* citing *Commercial Union Assurance Co., PLC v. Oak Park Marina, Inc.,* 198 F.3d 55, 59 (2d Cir.1999) (citation omitted); *see also International Business Machines Corp. v. Liberty Mut. Fire Ins. Co.,* 303 F.3d 419, 424 (2d Cir.2002) (*"IBM Corp."*). The complaint in the underlying action alleges that Kandic suffered "bodily injury" while working for R & J at the Job Site pursuant to its Subcontract with 75 West Construction. The court held that the allegations in the complaint do not preclude a finding at trial that Kandic's injuries were caused by the contributory negligence of others, such as R & J, or Kandic himself. *Employers Ins. Co. of Wausau.*, 2004 WL 1555143, *4. Thus, the court held that there was a possibility in the underlying action that 75 West Construction could be found liable based on something other than its sole negligence. Accordingly, the court held that the complaint in the underlying action raised the possibility of coverage sufficient to trigger General Star's duty to defend 75 West Construction. The court held that it was premature, however, to decide whether General Star has a duty to indemnify 75 West Construction. The court interpreted the General Star Policy to provide that it will not indemnify an additional insured for an injury caused by its sole negligence, even though the additional insured coverage also included defense benefits. It appears that there were other defendants in the *General Star* matter besides 75 West Construction. Also, even if not, the court took note that Kandic's own contributory negligence could relieve 75 West Construction of sole negligence, even though Kandic's pleadings obviously did not assert his own contributory negligence.

In *Shaffer v. Stewart Const. Co., Inc.*, 865 So.2d 213, 223 (La.App. 5 Cir.,2004) the court considered the "sole negligence" exclusion. The court held it was not an issue of apportionment of fault, as the matter had already been settled, but only an issue of whether a rational trier of fact have found that the additional insured was solely negligent or was there evidence of fault on the part of others. After thorough review of the record, the court found that the trial court did not err in finding that a rational trier of fact would have concluded that the additional insured was not solely negligent in causing the injuries where the evidence clearly supported the finding of some fault on the other parties, including other employees and/or plaintiff himself. *See also Department of Social Services v. Aetna Cas. & Sur. Co.*, 177 Mich. App. 440, 443 N.W.2d 420 (Mich.App.,1989) (Additional insured under liability policy was entitled to indemnity for judgment entered against it in underlying negligence action arising from slip and fall injuries; insurer was unable to prove that insured was solely negligent in causing injury, so as to bring claim within exclusion precluding coverage for injuries resulting from the "sole negligence" of the additional insured).

However, in *Transport International Pool, Inc. D/B/A GE Capital Modular Space v. The Continental Ins. Co., et al,* 166 S.W.3d 781 (Tex. App. – Fort Worth 2005, no pet.) policy provided that the additional insured endorsement "does not apply to 'bodily injury'…arising out of the sole negligence of such…organization." GE argued that additional insured coverage was not negated because Vratsinas was responsible for the duties that gave rise to Plaintiff's alleged injuries. However, the court noted that in the underlying lawsuit against GE, the plaintiff alleged that GE "furnished and set up" the trailer and "negligently and carelessly failed to property anchor and tie the trailer down…" The court held that giving the pleadings the most liberal interpretation, these allegations do not suggest anything other than the conclusion that Plaintiff's injuries resulted from GE's failure to property secure the trailer. The Plaintiff did not allege any other acts of negligence or omissions from any other persons or organizations. The court

refused to consider the matters of Vratsinas duties under the lease agreement with GE because they were outside the policy and the pleadings. Because Doolin, Plaintiff, only alleged that GE's conduct led to his injuries, and because the court looked only to the policy and the pleadings, the court concluded that coverage under the additional insured endorsement did not apply because the policy excluded coverage for GE's sole negligence.

4. "Arising Out of" Versus "Resulting From"

Additional insured endorsements often contain either the terms "arising out of" or "resulting from" in referring to the limitations placed on the coverage provided by the additional insured endorsement, noting that the bodily injury or property damage in question must "arise out of" or "result from" the work performed by the named insured. Cases in many jurisdictions have recognized a clear distinction between the use of the terms "arising out of" as opposed to the terms "resulting from" and have indicated that the scope of coverage provided may be different depending on which terms are used. *State Farm Fire and Cas. Co. v. Thomas*, 1986 WL 9001 (Tenn. App. Aug. 21, 1986) (unpublished opinion), expressly distinguishes between "resulting from" and "arising out of" language in insurance policies. In *State Farm*, the insured, Thomas, was involved in an auto accident in which another car collided with his car while he was towing his boat on a trailer attached to his car. The driver of the other car died as a result of the accident. Thomas sought coverage from State Farm under the "watercraft liability" provision of his "boatowners" policy. Under that provision, coverage was available for "damages because of bodily injury or property damage resulting from the ownership maintenance or use" of Thomas' boat. *Id.* at *1. State Farm contended that the injuries to the other driver did not result from use of the Thomas boat. *Id.* In evaluating this argument, the court commented on the difference between the terms "resulting from" and "arising out of":

> The courts make a distinction between "resulting from" and "arising out of" cases. The net result being the "resulting from" policies require proximate causation analogous to tort cases.

Id.

On the other hand, courts have held that phrases such as "arising from" or "arising out of" have a broad meaning, implying a broad grant of coverage. *Redball Motor Freight, Inc. v. Employers Mut. Liab. Ins. of Wis.*, 189 F.2d 374, 378 (5th Cir. 1951). "Arising from" is ordinarily understood to mean "originating from," "having its origin in," "growing out of," or "following from." *Bluebird Body Co. v. Ryder Truck Rental*, 583 F.2d 716, 717 (5th Cir. 1978). In other words, for an event to "arise out of" or "arise from" a particular activity, there must be some causal relationship between the activity and the event. *See, e.g.*, *Schmidt v. Utilities, Inc.*, 353 Mo. 313, 182 S.W.2d 1818 (1944). It is not necessary that the event be directly or proximately caused by the activity in question. *See Sports Mart, Inc. v. Daisy Mfg. Co.*, 645 N.E.2d 360 (Ill. App. 1994); *Manufacturers Cas. Inc. Co. v. Goodville Mut. Cas. Co.*, 403 Penn. 603, 170 A.2d 571 (1961); *Eastern Transp. Co. v. Liberty Mut. Ins. Co.*, 101 N.H. 407, 144 A.2d 111 (1958); *see generally*, Annot. 89 A.L.R. 2d 150, 154 (1963) for a discussion of cases interpreting the words "arising out of" as used in the ownership, maintenance or use clause of an automobile liability insurance policy. "Arising out of" has also been defined as causally connected with, not proximately caused by. *State Farm Mutual Auto. Ins. Co. v. Davis*, 937 F.2d 1415 (9th Cir. 1991); *McCabe v. Old Republic Ins. Co.*, 425 Pa. 221, 228 A.2d 901 (1967). A cause and result relationship has been enough to fall within the term "arising out of. *Aetna Cas. & Surety Co. v. Ocean Accident & Guar. Corp.*, 386 F.2d 413 (3rd Cir. 1967).

Texas courts hold that the phrase "arising out of" is a broad phrase which means that there is simply some "causal connection" amount to a "but-for" cause. It does not require causation to the extent of a proximate cause standard. *See Utica National Ins. Co. v. American Indemnity Co.,* 141 S.W.3d 18 (Tex. 2004); *General Agents Ins. Co. v. Arredondo*, 52 S.W.3d 762, 767 (Tex.App.-San Antonio 2001, pet. denied) (For injuries to "arise out of" a contractor's or subcontractor's operations, they need not be caused by an act of the contractor or subcontractor; all that is required is a causal connection); *Admiral Ins. Co. v. Trident NGL, Inc.,* 988 S.W.2d 451, 454-55 (Tex. App.--Houston [1st Dist.] 1999, pet. denied) (Holding "arising out of" in the context of an "additional insured" *endorsement* does not

require that named insured's act caused accident). The Fifth Circuit has recognized that the phrase "arising out of" is "understood to mean 'originating from,' 'having its origin in,' 'growing out of,' or 'flowing from.'" *American States Ins. Co. v. Bailey,* 133 F.3d 363, 370 (5th Cir.1998) (quoting *Red Ball Motor Freight, Inc. v. Employers Mut. Liab. Ins. Co.,* 189 F.2d 374, 378 (5th Cir.1951)). Thus, "a claim need only bear an 'incidental relationship' to the excluded injury for the policy's exclusion to apply." *Cf. Mid-Century Ins. Co. v. Lindsey,* 997 S.W.2d 153, 156-57 (Tex.1999) ("For liability to 'arise out of' the use of a motor vehicle, a causal connection or relation must exist between the accident or injury and the use of the motor vehicle.").

Despite the occasional interchangeable use of the two terms by some courts, distinctions do exist, at least in the view of certain courts. Policies requiring liability that "results from" the named insured's work rather than liability that "arises out of" the named insured's work typically require a greater proximate cause. Some courts, however, see no real distinction between the terms "arises out of" and "results from." *See Maryland Cas. Co. v. Regis Ins. Co. and Ran Holding Corp.*, 1997 WL 164268 (E.D. Pa. 1997). Neither the *Granite* nor *Austin Commercial* opinions place any real significance on the difference between the two terms. In fact, both cases dealt with the broader "arising out of" language and still came up with a rather narrow interpretation of the coverage provided under the additional insured endorsement.

5. Recent Changes Under Texas Law

After several years of having no Texas cases interpreting the additional insured endorsement other than *Granite Construction* and *Austin Commercial*, the courts have issued several decisions in this area over the last few years. We now have a whole body of case law in this area. There have been a number of cases in recent years that have come out on the issue of the scope of coverage provided by an additional insured endorsement under Texas law. As a result, Texas law on the issue of coverage pursuant to an additional insured endorsement has changed and is more in line with the majority view.

The first of those cases, *Assicurazioni Generali Spa v. Crown Central Petroleum Corp.*, 1998 WL 476462 (S.D. Tex. 1998), is an unpublished federal case out of the Southern District of Texas. In *Assicurazioni*, Crown Central Petroleum Corporation ("Crown Central") sought coverage as an additional insured under a policy issued by Assicurazioni Generali Spa ("Generali") to Reactor Services International, Inc. ("RSI"). Crown Central had apparently been named as an additional insured under RSI's policy as part of the contract relating to the work being performed by RSI on Crown Central's reactor. The underlying facts involved an explosion at the reactor and there was of course a personal injury lawsuit that followed. RSI had been hired by Crown Central to perform work on Crown Central's reactor. During RSI's efforts to vacuum out spent catalysts from the failed reactor, the catalysts remaining in the reactor reached high temperatures. RSI ceased vacuuming and to cool the remaining catalysts, RSI connected a rubber hose to the reactor and pumped nitrogen into it from a nearby Crown Central nitrogen system header. In addition to the nitrogen, the nitrogen hose apparently released hydrocarbons into the reactor. After resuming the vacuuming, RSI removed the nitrogen hose and an explosion occurred when RSI attempted to clear a blockage in the vacuum hose and adjust the vacuum. The explosion was caused when oxygen, released from the RSI vacuum, combusted with hydrocarbons, released from the nitrogen hose, within the reactor. The jury therefore found that the accident had a direct relationship to the work done by RSI's employees and that the accident was proximately caused by the negligence of RSI's employees. Crown Central sought coverage for the claims brought against it as an additional insured under the policy issued by Generali to RSI. The policy issued to RSI contained a "Blanket Additional Assured" endorsement which provided as follows:

> "Coverage includes additional assured as required by contract but only in respect of work performed by or on behalf of the assured."

The underlying lawsuit pertained only to the negligence of Crown Central and did not allege any negligence by RSI. As previously stated, this is not at all unusual because the plaintiff/employee is often barred from suing his own employer by the workers' compensation bar. The carrier argued that since the underlying lawsuit pertained only to the negligence of the additional insured and did not allege any negligence on the part of the named insured that there was no

coverage provided by the additional insured endorsement because the claim was not "in respect of work performed by or on behalf of" the named insured. Essentially, the carrier was arguing that the additional insured endorsement only provided coverage for vicarious liability and, since the allegations were limited to the sole negligence of the additional insured, then the coverage provided by the additional insured endorsement did not apply. The carrier was arguing the minority Texas rule expressed in *Granite* and *Northern*.

The Court, however, refused to accept the carrier's argument and instead distinguished the *Granite* and *Northern* cases. Interestingly, the Court noted that the *Granite* and *Northern* cases involved additional insured endorsements limiting coverage to liability arising out of operations performed by the named insured and the endorsement in the Generali policy referred to liability with respect to operations performed by the named insured. The language of the *Generali* endorsement is actually different than the "resulting from" language in the cases mentioned above. Noting the difference in the language of the respective endorsements, the Court declined to follow *Granite* and *Northern* and chose instead to follow the case of *Saavedra v. Murphy Oil USA, Inc.*, 930 F.2d 1104 (5th Cir. 1991) which construed an endorsement with similar language providing coverage "with respect to" work performed by or on behalf of the named insured. *Saavedra* did not limit the additional insured endorsement to claims in the underlying lawsuit alleging that the named insured was negligent but instead found that the clause applied where the underlying lawsuit alleged that the cause of the injury was "directly related" to the named insured's work. Referring to the facts before it, the Court in *Assicurazioni* held that the injury in question was clearly "directly related" to the named insured's work and therefore found that coverage was available to Crown Central as an additional insured under the additional insured endorsement.

The next case on the issue, and the first Texas case addressing the additional insured endorsement since *Granite Construction*, was *Admiral Ins. Co. v. Trident NGL, Inc.*, 988 S.W.2d 451 (Tex. App.–Houston [1st Dist.] 1999, pet. denied). In *Admiral*, a company by the name of K.D. Oilfield ("K.D.") was in the business of providing crews and equipment to service oil and gas facilities. Trident NGL, Inc. ("Trident") and K.D. entered into an agreement whereby K.D. would service certain facilities owned by Trident. K.D. was insured by Admiral under a policy naming Trident as an additional insured for liability "arising out of" K.D.'s operations. The additional insured endorsement actually provided as follows:

> In consideration of the premium charged, the persons or entities insured provision is amended to include as an insured the organizations designated below, but only with respect to liability arising out of the named insured's operations.

Santos was a K.D. employee who was assigned to assist Trident in performing maintenance on a compressor. Santos was unloading Trident's tools from Trident's truck when the compressor exploded and Santos was seriously injured. Neither Santos nor any other K.D. employee performed any act or failed to perform any act that caused the compressor to explode. Admiral argued that the liability arose out of Trident's operations, not K.D.'s operations, such that the additional insured endorsement did not apply. Admiral further argued that absent an affirmative act by K.D. causing or contributing to the explosion, the additional insured endorsement would not provide coverage.

The Court relied on the majority view of out-of-state cases and held that for liability to arise out of the operations of a named insured it is not necessary that the named insured's acts have caused the accident. Rather, the Court held that it is sufficient that the named insured's employee was injured while present at the scene in connection with performing the named insured's business, even if the cause of the injury was the negligence of the additional insured. The Court added that, giving Admiral every benefit of the doubt, the policy was at best ambiguous and held that a construction that afforded coverage to Trident must be adopted. Since the accident occurred to a K.D. employee while the employee was on Trident's premises for the purpose of performing preventive maintenance on the compressor that exploded, in accordance with the agreement between K.D. and Trident, the alleged liability for the employee's injuries therefore "arose out of K.D.'s operations" and fell within the coverage provided to Trident as an additional insured under the policy.

The Opinion in *Admiral* was a split decision. The majority justices, Mirabal and Wilson, did not even bother to address the *Granite* and *Northern* cases. Justice Taft in his Dissent, however, addressed the *Granite Construction* case and noted that it was the only Texas case on point. He also noted the similarities between the additional insured endorsement and the facts before the Court in both the *Granite* and *Admiral* cases. Justice Taft then stated that "the purpose of obtaining the coverage here is to protect the additional insured from acts of the named insured who has entered into a contract to provide a service to the additional insured." He then pointed out that the liability in the case before him arose from the operations of the main company, noting that "the operations of the servicing company that placed its agent in harm's way were not a cause of the harm." Justice Taft further stated:

> "To extend coverage to acts of the main company that harmed the agent of the servicing company upsets the delicate balance between the cost of this insurance policy and the coverage it provides. The result the majority achieves gives the main company, the tort feasor in this case, an alternative source of coverage for its own negligence, at the expense of the named insured, the servicing company. To uphold this result as an application of the rule requiring ambiguous policy provisions to be construed in favor of the insured is particularly inappropriate here because the servicing company paid for the policy.
>
> I would, therefore, follow the only Texas authority on point. I see no need to seek guidance from foreign jurisdictions in the absence of any more persuasive rationale than that those foreign jurisdictions comprise the "majority view."

Id. at 10. Justice Tafts' Dissent, however, did not carry the day and the Opinion in *Admiral* may signal a rather significant change in Texas law as it relates to coverage provided under the additional insured endorsement.

Since *Admiral*, there has been another Texas Court of Appeals' case, as well as two Fifth Circuit opinions, that have addressed the issue of coverage under an additional insured endorsement. The Texas case is *McCarthy Bros. Co. v. Continental Lloyds Ins. Co.*, 7 S.W.3d 725 (Tex. App.–Austin 1999, n.w.h.). In that case, the Austin Court of Appeals addressed again, and perhaps even more directly, the question of whether the "arising out of" language in the additional insured endorsement was limited only to vicarious liability or whether it was broad enough to require coverage when there was no liability on the part of the named insured. In that case, McCarthy was the general contractor and hired Crouch/Fisk Electric Company to provide electrical services on a construction project. Wilson was an electrical foreman for Crouch and he was injured when he slipped and fell at the construction site. Wilson claimed that the electricians on the site were required to traverse a fifty-five to sixty foot incline to retrieve electrical equipment that was necessary for their work and that he fell on the muddy, slippery surface of the incline when he was descending it. Wilson claimed that the incline was unreasonably dangerous, that McCarthy should have known of its conditions, and that he and his supervisors had requested that McCarthy place stairs in the area. While the case doesn't specifically address it, Wilson no doubt did not sue Crouch because of the Workers' Compensation bar.

The insurance companies made the same arguments against coverage that had been made before and granted in the previous cases. They claimed that the allegations in the suit alleged negligence only on the part of McCarthy and not on the part of Crouch and therefore claimed that the liability did not arise out of Crouch's work for McCarthy. The Court began its analysis by noting that the Texas Supreme Court has recently given a broad construction to the phrase "arising out of" in a case in the context of an automobile policy. That case, *Mid-Century Ins. Co. v. Lindsey*, 997 S.W.2d 153, 156 (Tex. 1999) involved a claim in which a man was accidently shot when a boy climbed into his parents' truck through a sliding rear window and touched a loaded shotgun on a gun rack which fired and shot the plaintiff who was sitting in an adjacent parked car. The Supreme Court noted that while the direct cause of the plaintiff's injuries stemmed from the boy's conduct in touching the shotgun, the injury "arose out of" the use of the truck because the

injury producing act and its purpose were an integral part of the use of the vehicle.

The Court in *McCarthy* then went on to address the *Admiral* opinion. The *McCarthy* court noted, as the court in *Admiral* did, that for liability to "arise out of operations" of the named insured it was not necessary for the named insured's act to have caused the accident. It was sufficient that the named insured's employee was injured while present on the scene in connection with his performing the named insured' business, even if the cause of the injury was the negligence of the additional insured. The Court further noted that this construction was consistent with the interpretations of the phrase "arising out of" given by a number of other jurisdictions and noted that "arising out of" is broader than the concept of proximate causation in tort law and denotes a nexus between proximate and actual causation. The Court held that the allegations in walking down the incline to get tools to perform his job was an integral part of Crouch's work for McCarthy. The Court dismissed the insurance company's argument that the liability must stem directly from the additional insured's negligence and found that such a restrictive interpretation was no longer reasonable in Texas after *Lindsey*. In a footnote, the Court criticized the *Granite* opinion. It noted that the Court in *Granite* had violated the eight-corners rule by looking outside the policy and pleadings, reviewing the contract defining the scope of the additional insured's work and finding that the operation in question was solely the additional insured's responsibility. The Court further dismissed *Granite* as no longer good law because it had been decided before *Lindsey's* analysis of the meaning of the terms "arising out of."

There have also been two fairly recent Fifth Circuit opinions addressing the additional insured endorsement. The first, *Mid-Continent Cas. Co. v. Chevron Pipeline Co.*, 205 F.3d 222 (5th Cir. 2000), involved a claim by an employee of the named insured, Power Machinery, Inc. ("PMI"), against the additional insured, Chevron, after he was injured while removing a valve in a vessel storage area. The Court noted that PMI was immune from suit under the Workers' Comp Act and that the plaintiff had therefore sued Chevron claiming its negligence had caused the injury. PMI was performing work for Chevron pursuant to a labor services contract under which it agreed to indemnify and hold Chevron harmless from any claims for injury or death resulting from PMI's performance and to name Chevron as an additional insured under its policy. The additional insured endorsement under the PMI policy was identical to the endorsement in *McCarthy*. The Court noted this similarity and also noted the difference between the additional insured endorsement before it and the ones in *Granite* and *Admiral*. The Court noted that the endorsement before it provided coverage for liability arising out of the named insured's work, whereas, the endorsements in *Granite* and *Admiral* provided coverage for liability arising out of operations performed by or on behalf of the named insured. The Court noted that "your work" was defined in the PMI policy as work or operations and found that that indicated that broader coverage was intended. The Court also found that the underlying services contract did not divide responsibilities between the additional insured and the named insured and finally, the Court looked to the findings in the underlying trial between the named insured's employee and the additional insured, which found that the named insured controlled the employee's work for the additional insured. The Court therefore found that the injury at least in part "arose out of" the named insured's work for the additional insured. The Court also noted that its opinion was consistent with *Admiral* in that the named insured was in the business of supplying workers and, like the named insured in *Admiral*, the named insured's worker was injured on the additional insured's premises while performing the work for which he had been hired.

Another case concerning the additional insured endorsement was also out of the Fifth Circuit. That case, *Mid-Continent Cas. Co. v. Swift Energy Co.*, 206 F.3d 487 (5th Cir. 2000), also found coverage pursuant to the additional insured endorsement at issue in that action. *Swift* was a little different in that it involved an indemnity agreement between Air Equipment Rental, Inc. ("Air Equipment"), as the contractor, and Swift. Swift leased and operated an oil drilling site and hired Flournoy Drilling Company to drill a well. Flournoy hired Air Equipment to provide a casing crew to install casing at the site and entered into a master service contract with Air Equipment. Swift and Air Equipment subsequently entered into a master service agreement for the work. A supervisor employee for Air Equipment was injured at the drilling site when gas released from the well and ignited and exploded. The employee sued Swift and Flournoy claiming that their negligence caused his injuries. After initially providing

a defense to both Flourney and Swift, Air Equipment's insurer, Mid-Continent advised them both that it would no longer be providing a defense and indemnity because the Fifth Circuit had issued its decision in *Green's Pressure Testing & Reynolds, Inc. v. Flournoy Drilling Co.*, 113 F.3d 47 (5th Cir. 1997), which had held that indemnity language identical to that contained in the master service contract was unenforceable under the Texas Oilfield Anti-Indemnity Act ("TOAIA"). The additional insured provision of the policy provided coverage for any person or organization for whom the named insured had agreed by written "insured contract" to designate as an additional insured, but only with respect to "liability arising out of your ongoing operations performed for that insured." The policy further defined "insured contract" as any contract or agreement pertaining to your business "under which you assume the tort liability of another to pay for 'bodily injury' or 'property damage' to a third-person or organization."

Mid-Continent first argued that the master service agreement did not qualify as an insured contract because it was unenforceable under the TOAIA. The Court began by noting that the question was not whether Swift was entitled to indemnity under the indemnity provisions of the master service contract, but whether the master service contract qualified as an "insured contract." The Court noted that under Texas law indemnity agreements are strictly construed in favor of the indemnitor while insurance policies are strictly construed in favor of coverage. The Court then noted that it must construe the term "insured contract" broadly and concluded that the TOAIA does not preclude the master service contract from being an "insured contract" under the policy. The Court went on to note that the master service contract was probably enforceable under the TOAIA anyway because section 127.005 of the Texas Oilfield Anti-Indemnity Act provided an exception, allowing for enforcement of indemnity provisions that are supported by liability insurance satisfying section 127.005. The Court found that the master service contract satisfied those requirements and therefore found that its earlier decision in *Green's* was not controlling.

The Court then went on to analyze the additional insured endorsement itself. The Court noted that the endorsement was nearly identical to the ones in *Granite* and *Admiral*, providing coverage for liability arising out of the named insured's operations. The Court also cited *McCarthy* and found that the plaintiff's injuries "arose out of " the named insured's operations because the plaintiff was an employee of the named insured who was on the additional insured's premises in connection with the named insured' operations. Consistent with the recent opinions in *Admiral*, *McCarthy*, and the other recent cases interpreting coverage under an additional insured endorsement under Texas law, the Court held that there was a sufficient causal connection between the named insured's operations and the injuries to afford coverage under the endorsement.

The Blanket Additional Insured endorsement extends coverage to an additional insured as long as there is a connection between the damage or injury and the insured's operation. The majority of courts, including Texas, interpret this "arising out of your [operations or work]" limitation to mean that negligence on the part of the named insured is not necessary for additional insured coverage, only that the injury to the claimant would not have occurred "but for" the operations of the named insured. *Highland Park Shopping Village v. Trinity Universal Ins. Co.,* 36 S.W.3d 916 (Tex. App. – Dallas 2001, no pet.); *McCarthy Bros. v. Continental Lloyds Ins. Co.,* 7 S.W.3d 725, 727 (Tex.App. – Austin 1999, no pet.)(citing collected cases); *St. Paul Ins. Co. v. Texas Dept. of Transp.*, 999 S.W.2d 881, 886 (Tex.App.-Austin 1999, pet. denied) (Additional insured endorsement provides coverage for damage that "results from" Abrams' work for TxDOT or TxDOT's supervision of that work; to be covered, the claim need only arise out of Abrams' work or TxDOT's supervision). Thus, under such clauses, the additional insured was held to be covered even for his own negligence, so long as the injury bore some connection to the named insured's work, whether the named insured was negligent or not. *See also, ATOFINA Petrochemicals, Inc. v. Evanston Ins. Co.,* 104 S.W.3d 247, 249 (Tex. App. – Beaumont 2003, pet. requested July 15, 2003); *Admiral Ins. Co. v. Trident NGL, Inc.,* 988 S.W.2d 451 (Tex.App. – Houston [10th Dist.] 1999, writ denied); *Mid Continent v. Swift Energy Co.,* 206 F.3d 487, 498 (5th Cir. 2000) (Tex. law); *Mid Continent Cas. Co. v. Chevron Pipeline,* 205 F.3d 222, 228 (5th Cir. 2000) (Tex. law). *Compare*, *Granite Const. Co. v. Bituminous Ins. Co.,* 832 S.W.2d 427 (Tex. App. – Amarillo, 1992) (Additional insured coverage limited to

vicarious liability for named insured's own negligent conduct).

Trident NGL involved a similar "additional insured endorsement" that restricted coverage for the additional insured to liability arising out of the named insured's operations. *Admiral Ins. Co. v. Trident NGL, Inc.,* 988 S.W.2d at 454. *Trident* involved an injury to an employee of the named insured occurring on "premises of the additional named insured." In *Trident,* the court followed the rule of a majority of courts around the country, that it was sufficient that the named insured's employee was injured while present at the scene in connection with performing the named insured's business, even if the cause of injury was the additional insured's negligence. *Id.* at 454-55.

In *Highland Park Shopping Village v. Trinity Universal Insurance Company,* 36 S.W.3d 916, 917-18 (Tex. App.-Dallas 2001, no pet.), the Dallas Court of Appeals held that an injury to the employee of a contractor, the named insured, as he returned to his car in a Man-Lift occurred while he was on premises to do the work of his employer and arose out of the named insured's work. Thus, the landowners were additional insureds, even though the employee alleged negligence only by the landowners.

The interesting aspect of about *Highland Park* is that the employee was not even actually working at the time he incurred an injury. He had completed his work and used the Man Lift to get to his car parked outside the garage so that he could leave the premises. These Texas cases demonstrate the court's willingness to interpret the terms "arising out of" broadly and with little actual causal connection between the named insured's work and the injury or damage.

Another decision from a Texas court is *ATOFINA Petrochemicals, Inc. v. Evanston Insurance Company,*104 S.W.3d 247 (Tex. App. – Beaumont 2003, no pet.), ATOFINA sought insurance coverage as an additional insured under a policy issued to Triple S by Evanston. The liability policy included as additional insured the following:

> 6. A person or organization for whom you have agreed to provide insurance as is afforded by the policy; but that person or organization is an insured only with respect to operations performed by you or on your behalf, or facilities owned or used by you.

The court rejected the argument that the subject injury did not arise out of Triple S' operations because the evidence showed that the death actually occurred while the Triple S employee was performing work for Triple S on the project for ATOFINA.

As a review of the above decisions indicates, the only connection required for additional insured coverage is that the injury would not have occurred "but for" the operations of the named insured. This places Texas law in line with the majority view.

B. Waiver and Estoppel's Effect on Coverage

In Texas, the doctrines of waiver and estoppel cannot be applied to create coverage where none exists under the terms of the policy. *Paradigm Ins. Co. v. Texas Richmond Corp.*, 942 S.W.2d 645, 652 (Tex.APp.–Houston [14th Dist.] 1997, writ denied); *Texas Farmers Ins. Co. v. McGuire*, 744 S.W.2d 601, 602-03 (Tex. 1998) (op. on reh'g). An exception to this rule has been recognized. *Id.* If an insurer has knowledge of facts indicating non-coverage of the claims against its insured, yet the insurer assumes or continues the defense of its insured without obtaining a reservation of rights or a non-waiver agreement, the insurer waives all policy defenses, including that of non-coverage, or it may be estopped from raising these defenses. *Farmers Texas County Mutual Ins. Co. v. Wilkinson*, 601 S.W.2d 520, 522 (Tex.App.–Austin 1980, writ ref'd n.r.e.); *State Farm Lloyds Inc. v. Williams*, 791 S.W.2d 542, 550 (Tex.App.–Dallas 1990, writ denied) (*"Williams I").* Nevertheless, to demonstrate that the exception applies, the insured must show that it was harmed, i.e. prejudiced, by the insurer's conduct and the insured must demonstrate that it suffered "clear and "unmistakable" harm caused by the insurer's actions. *Certain Underwriters at Lloyd's London v. Oryx Energy Co.*, 142 F.3d 255, 257 n. 2 (5th Cir. 1998); *Pennsylvania Nat. Mut. Cas. Ins. Co. v. Kitty Hawk Airways, Inc.*, 964 F.2d 478, 479 (5th Cir. 1992); *Nutmeg Ins. Co. v. Clear Lake City Water Authority*, 229 F.Supp.2d 668, 694-695 (S.D.Tex 2002); *Katerndahl v. State Farm Fire and Cas. Co.*, 961 S.W.2d 518, 524 (Tex.App.–San Antonio 1997, no writ); *Williams I*, 791 S.W.2d at 550; *State Farm Lloyds v. Williams*, 960 S.W.2d 781,785 (Tex.App.–Dallad

1997, writ dism'd by agr'mt) (*"Williams II"*); *Paradigm Ins. Co. v. Texas Richmond Corp.*, 942 S.W.2d 645, 652-53 (Tex.App.–Houston [14th Dist.] 1997, writ denied).

In *Pennsylvania Nat. Mut. Cas. Ins. Co. v. Kitty Hawk Airways, Inc.*, 964 F.2d 478 (5th Cir. 1992), the Fifth Circuit addressed whether Pennsylvania National was estopped from raising a defense of non-coverage by its assumption and continuation of Kitty Hawk's defense for over one year before it tendered a reservation of rights. Fiding that the doctrines of estoppel and waiver did not apply, the Fifth Circuit found in favor of Pennsylvania National's non-coverage claim. The Court found that Pennsylvania National, the drafter of the exclusion upon which it relied to extend the reservation of rights, had satisfied the first two requirements of the *Wilkinson* exception when it possessed sufficient knowledge to challenge its coverage of Kitty Hawk but assumed and continued Kitty Hawk's defense for more than a year before it obtained an effective reservation of rights. However, the Fifth Circuit analyzed whether there was prejudice as follows:

> [T]he facts of this case do no support a conclusion that Pennsylvania National's defense of Kitty Hawk resulted in a "clear and unmistakable" conflict of interest or harm, or that Kitty Hawk had demonstrated that it suffered actual harm or prejudice. Kitty Hawk has produced no evidence that the attorneys provided by Pennsylvania National acted in any manner, during the course of the defense, that was prejudicial to Kitty Hawk. Kitty Hawk points to no evidence that Pennsylvania National in its defense of Kitty Hawk manipulated the defense of its insured to better its future claim of non-coverage. Indeed, Pennsylvania National does not base its non-coverage defense on an issue that was material to the underlying suit: Exclusion (c), on which Pennsylvania National premises its non-coverage defense, withdraws coverage for defamatory statements that relate directly or indirectly to the employment of the defamed person, and this issue of employment relatedness was not contested in the underlying suit. In fact, the defamatory letter specifically refers to Pollard's employment-related conduct. Kitty Hawk points to no evidence reflecting that Pennsylvania Mutual had an opportunity to manipulate the facts on this matter to bolster its non-coverage defense.

Id. at 482. (In this case the reservation, though timely, was still set two years before trial and the insured never sought to hire its own counsel.)

In *Nutmeg Ins. Co. v. Clear Lake City Water Authority*, 299 F.Supp.2d 668, 694-695 (S.D.Tex. 2002), the Court held that the insured was not prejudiced by Nutmeg's alleged failure to provide it with a timely and sufficient reservation of rights letter. The letter was sent within one month of receipt of the claim and clearly notified Clear Lake that it would be investigating the bases of the claims subject to a reservation of rights and that there were coverage issues, without specifying the policy terms upon which the coverage issues were based. The Court held that the letter was sufficient even though it did not specifically identify the coverage defenses. Significant to the Court was the fact that Clear Lake is a large governmental entity with the benefit of counsel and operating on equal footing with Nutmeg. Moreover, Nutmeg paid for and allowed Clear Lake to select its counsel for its representation in the underlying suit and permitted Clear Lake to direct that defense. On these facts, the Court found there was no prejudice to the insured. *Id.* at 695.

C. Contractual Risk Transfers

1. Coverage for Contractual Liability under Indemnity Agreements

Another issue that often arises in these construction disputes is the issue of coverage for liability assumed by the insured under a contract. This typically arises in the context of a hold harmless or indemnity agreement that the insured has entered into with another contractor or contractors on the site. The indemnity agreement itself raises a whole myriad of issues that are beyond the scope of this paper. Whether

the indemnity agreement is even valid and enforceable is the first thing that must be determined. If the contractual obligation is enforceable, however, the question becomes whether such an obligation is covered under the liability policy issued to the party who has assumed the obligation.

The issue involves a two-step analysis that begins with the contractual liability exclusion. The exception to the exclusion then gives back a good bit of the coverage taken away by the exclusion. The contractual liability exclusion, Exclusion b, generally provides as follows:

> This insurance does not apply to: (b) "Bodily injury" or "property damage" for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement. This exclusion does not apply to liability for damages:
>
> (1) That the insured would have in the absence of the contract or agreement; or
>
> (2) Assumed in any contract or agreement that is an "insured contract," provided that the "bodily injury" or "property damage" occurs subsequent to the execution of the contract or agreement. Solely for the purpose of liability assumed in an "insured contract," reasonable attorneys's fees and necessary litigation expenses incurred by or for a party other than insured are deemed to be damages because of "bodily injury" or "property damage," provided:
>
> (a) liability to such party for, or for the cost of, that party's defense has also been assumed in the same "insured contract"; and
>
> (b) such attorneys' fees and litigation expenses are for defense of that party against a civil or alternative dispute resolution proceeding in which damages to which this insurance applies are alleged.
>
> * * *
>
> Definition:
>
> "Insured contract" means:
>
> * * *
>
> (f) That part of any other contract or agreement pertaining to your business (including an indemnification of a municipality in connection with work performed for a municipality) under which you assume the tort liability of another to pay for "bodily injury" for "property damage" to a third person or organization. Tort liability means the liability that would be imposed by law in the absence of the any contract or agreement.

The contractual liability exclusion typically cannot be used to preclude coverage for liability assumed by the insured under a contract at least in the context of construction defect cases. That is because much of the coverage that is excluded by the exclusion is given back in the exception to the exclusion. An indemnity agreement under which the named insured assumes the tort liability of another to pay for property damage to a third party or organization qualifies as an "insured contract" under the policy and is therefore excepted from the exclusion. Coverage is therefore provided for such an indemnity agreement. There has not been a great deal of Texas case law in this area. Case law from other jurisdictions has held that coverage is afforded for typical indemnity agreements. *See Olympic, Inc. v. Providence Washington Ins. Co.*, 684 P.2d 1008, 1011 (Alaska 1982) ("Liability assumed by the insured under any contract refers to liability incurred when one promises to indemnify or hold harmless another, and does not refer to liability that results from breach of contract").

One recent case interpreting Texas law, however, has directly addressed this issue and clearly indicates how coverage for liability assumed under a contract can be construed and construed quite broadly. In *Gibson & Assoc., Inc. v. Home Ins. Co.*, 966 F. Supp. 468 (N.D. Tex. 1997), the court addressed a fairly typical construction defect case. After reviewing the facts under a straight coverage analysis, the court concluded that the claims were not covered because they did not constitute an occurrence, finding essentially that claims for breach of contract for failing to perform as obligated under a construction contract were not covered. After making such a finding, however, the court completely reversed field and found coverage for the claims as claims for indemnity under an indemnification agreement. The court found that the indemnification agreement constituted an "insured contract" (an exception to the contractual liability exclusion) for which coverage was provided.

As previously discussed, the facts of *Gibson* revolved around construction being performed on Main Street in downtown Dallas. Same business owners on Main Street sued the City for losses they had allegedly incurred as a result of the construction and the impact of that construction on their business. The City in turn brought a claim against the contractor for breach of contract and indemnity arising out of the financial losses claimed by the business owners. The indemnity claim was based upon an allegation by the City "that the contractor `contracted and agreed to indemnify and save harmless the defendant, City of Dallas, from and against any and all claims, lawsuits or any other harm for which recovery of damages is sought, that arise out of a breach of any term of the contract by third party defendant [the contractor].'" The policy contained the standard contractual liability exclusion with the exception to the exclusion for liabilities assumed under an "insured contract." The carrier argued that there was no coverage for the indemnity obligation because it was based in contract. The court disagreed and, citing a Louisiana case, noted that liability assumed under a contract is triggered by contractual performance, while breach of contract is triggered by contractual breach. The court then focused on the claims made against the third party seeking indemnity, stating as follows:

> "The claims asserted against it [Gibson, the contractor] by the Shop Owners, however, sought to hold the City liable not for breach of contract, but rather for negligence and unconstitutional deprivations of property. [footnote omitted.] Clearly, the mere fact that the City's indemnification action against Gibson arose from the parties' contractual relationship does not convert the Shop Owners' tort based causes of action against the City into breach of contract claims.
>
> * * *
>
> Consequently, as the Shop Owners' actions do in fact include causes of action that sound in tort, and as the City's third party complaints allege that Gibson agreed to assume all such liability if it was caused by a breach of contract on Gibson's part, the Court finds that the indemnification clause constitutes an `insured contract' not exempted from coverage by Exclusion (b)."

Id. at 479. The Court makes clear that the focus when analyzing whether a claim is excluded by the contractual liability exclusion is on the allegations made against the third party seeking indemnity, not the contractual indemnity claim of the indemnitee against the insured. The *Gibson* case is a good example of how a case that appears to be a straight forward breach of contract case for which there would be no coverage under a commercial general liability policy can nevertheless involve coverage depending upon the various contractual obligations of the parties involved.

2. A Valid Transfer of the Insured's Liability Pursuant to an Indemnity Agreement

In order for this indemnity agreement to be a valid assumption of tort liability under Texas law, the indemnity agreement must meet the fair notice rules. A party who attempts to indemnify itself from its own negligence must satisfy two fair-notice requirements: (1) the express negligence test and (2) a conspicuousness requirement. *Dresser Indus., Inc. v. Page Petroleum, Inc.,* 853 S.W.2d 505, 508 (Tex.1993). The express negligence test was adopted by the Texas

Supreme Court in *Ethyl Corp. v. Daniel Construction Co.,* 725 S.W.2d 705, 708 (Tex.1987). The court stated, "The express negligence doctrine provides that parties seeking to indemnify the indemnitee from the consequences of its own negligence must express that intent in specific terms." *Id.* The contract at issue in *Ethyl* provided:

> Contractor shall indemnify and hold Owner harmless against any loss or damage to persons or property as a result of operations growing out of the performance of this contract and caused by the negligence or carelessness of Contractor, Contractor's employees, Subcontractors, and agents or licensees.

Id. at 707. The court determined that this indemnity clause did not meet the express negligence test, finding that the phrases "any loss" and "as a result of operations" did not show an intent on Ethyl's part to cover its own negligence. *Id.*

a. The Express Negligence Rule

Numerous Texas opinions are available to demonstrate language satisfying the express negligence rule. In *B-F-W Const. Co., Inc. v. Garza,* 748 S.W.2d 611, 612 -613 (Tex.App.-Fort Worth,1988, no writ) the court held the following indemnity provision met the express negligence rule:

> (a) Subcontractor shall fully protect, indemnify and defend Contractor and hold it harmless from and against any and all claims, demands, liens, damages, causes of action and liabilities of any and every nature whatsoever arising in any manner, directly or indirectly, out of or in connection with or in the course of or incidental to any of Subcontractor's work or operations hereunder or in connection herewith (regardless of cause or of any concurrent or contributing fault or negligence of Contractor) or any breach of or failure to comply with any of the provisions of this Subcontract or the Contract Documents by Subcontractor. (Emphasis added.)

The court held that the language "regardless of any cause or of any concurrent or contributing fault or negligence of Contractor" meets the express negligence test because it expressly states the intent of the parties that the subcontractor would indemnify the contractor for the contractor's own negligence. *Id.* at 613.

In *Permian Corp. v. Union Tex. Petroleum Corp.,* 770 S.W.2d 928, 929-30 (Tex.App.-El Paso 1989, no writ), the following language was held to satisfy the express negligence doctrine:

> Contractor [Appellant] hereby indemnifies and agrees to protect, hold and save Union Texas [Appellee] ... harmless from and against all claims, ... including but not limited to injuries to employees of Contractor, ... on account of, arising from or resulting, directly or indirectly, from the work and/or services performed by Contractor ... and whether the same is caused or contributed to by the negligence of Union Texas, its agent or employees. (Emphasis added.)

In *Banner Sign & Barricade, Inc. v. Price Const., Inc.,* 94 S.W.3d 692, 695 (Tex.App.-San Antonio 2002, pet. denied) the indemnification provision at issue reads:

> (b) To fully and unconditionally protect, indemnify and defend [Price], its officers, agents and employees, and hold it harmless from and against any and all costs, expenses, reasonable attorney fees, claims, suits, losses or liability for injuries to property, injuries to persons (including subcontractor's employees), including death, and from any other costs, expenses, reasonable attorney fees, claims, suits, losses or liabilities of any and

> every nature whatsoever arising in any manner, directly or indirectly, out of or in connection with or in the course of or incidental to, any of subcontractor's work or operations hereunder or in connection herewith, regardless of cause or of the sole, joint, comparative or concurrent negligence or gross negligence of [Price], its officers, agents or employees.

Id. (emphasis added). The court held that the express negligence doctrine was satisfied in this case by the inclusion of the following phrase in the contract's indemnification provision, "regardless of cause or of the sole, joint, comparative or concurrent negligence or gross negligence of [Price], its officers, agents or employees." *Id.* at 697.

Recently, in *AABB Kraftwerke Aktiengesellschaft v. Brownsville Barge & Crane, Inc.*, 115 S.W.3d 287 (Tex.App.-Corpus Christi 2003, pet. denied), the Corpus Christi Court of Appeals interpreted a similar indemnity agreement that read:

> ABB and or C.H. Robinson Company shall release, defend, indemnify and hold Brownsville Barge & Crane, Inc., its directors, officers, employees, agents and subcontractors (Contractor Group) harmless from and against all liability, claims and losses, damages, punitive damages, costs, expenses, attorney's fees, demands, suits, and causes of action of every kind (the "claims"), arising on account of personal injury or death or damage to property in any way incident to or in connection with or arising out of the "Lifting Services Agreement" dated March 22, 1999 between Schaefer Stevedoring, Inc. and Brownsville Barge & Crane, Inc. regardless of the sole, joint or concurrent negligence, negligence per se, gross negligence, statutory fault, or strict liability of any member of the Contractor Group or the unseaworthiness of any vessel owned operated or chartered by any member of the Owner Group without limit and without regard to the cause or causes thereof that may have caused or contributed to the claim, to the extent such indemnity obligations are not prohibited by applicable law.

Id. (emphasis added). The court held that this language sufficiently expressed the parties' intent that the subcontractor assumed liability for the contractor's own negligence as follows:

> By its very terms, the agreement purports to indemnify Brownsville Barge for liabilities resulting from its own future negligence. The agreement provides that ABB would "indemnify and hold harmless Brownsville Barge & Crane, Inc .... from and against all liability ... arising on account of personal injury or death ... arising out of the 'Lifting Services Agreement' ... regardless of the sole, joint or concurrent negligence" of Brownsville Barge employees. Brownsville Barge's intent as to what risk it intended to shift to ABB is clear from the four corners of the document. *See Atlantic Richfield Co. v. Petroleum Personnel, Inc.,* 768 S.W.2d 724, 726 (Tex.1989) (holding that language which sufficiently defines the parties' intent meets the requirements of the express negligence rule).

Id.

In contrast, the following language was found insufficient and invalid under the express negligence rule:

> Subcontractor specifically agrees to indemnify, save harmless and fully reimburse Contractor, its agents, officers and employees, from all suits, actions or claims of any character, type or description, brought or made for or on account of any injuries or damages received or sustained by any person or persons or property, arising out of or occasioned by, the acts of Subcontractor or Subcontractor's agents, officers or

> employees, in the execution and/or performance of this Contract. Subcontractor shall additionally reimburse Contractor for any and all expenditures or expenses associated with the defense of lawsuits arising out of any of the above described circumstances; provided, however, that Contractor shall have the option to compel Subcontractor to defend any and all causes of action brought against Contractor, based in whole or in part upon allegations of negligence on the part of Subcontractor or Subcontractor's employees, and Subcontractor shall pay any judgment rendered against Contractor from any such case and shall reimburse and fully indemnify Contractor for any expenditures or expenses made or incurred by Contractor for any reason of any such suit or suits notwithstanding Contractor's option to compel Subcontractor to defend said suits.

J.M. Krupar Const. Co., Inc. v. Rosenberg, 95 S.W.3d 322, 334 -335 (Tex.App.-Houston [1 Dist.] 2002, no pet.). The court held that nowhere in the indemnity clause does it expressly state that one party will indemnify the builder for expenses incurred in a claim resulting from the builders own negligence. Thus, according to the court, the clause does not meet the express negligence test. *Id.* at 335.

b. Conspicuous Requirement

Texas law further requires that a party seeking indemnity for the consequences of its own negligence must meet the fair notice requirement of conspicuousness. The Texas Supreme Court has stated that "a provision is ordinarily conspicuous when a reasonable person against whom it is to operate ought to have noticed it." *See Dresser Industries, Inc. v. Page Petroleum,* 853 S.W.2d at 511 (This conspicuousness standard is met by a heading printed in capital letters and by text printed in larger or other contrasting type).

Courts have ruled on this conspicuous requirement whereby a sufficiently conspicuous provision is one that is readily apparent to attract the attention of the reasonable person. The Amarillo court held that an indemnity agreement that was in larger type than the preceding paragraphs and titled "Indemnity" with capitalized and bold letters was conspicuous and met the fair notice requirement. *See Powerhouse Services, Inc. v. Bechtel Corp.*, 108 S.W.3d 322, 327 (Tex.App.-Amarillo 2002, writ denied). Another court held that an indemnity agreement labeled "RESPONSIBILITY FOR LOSS OR DAMAGE, INDEMNITY, RELEASE OF LIABILITY AND ALLOCATION OF RISK" in all capital letters would attract the attention of a reasonable person sufficient to meet the fair notice and conspicuous requirement. *See Tesoro Petroleum Corp. v. Nabors Drilling USA, Inc.,* 106 S.W.3d 118, 132 (Tex.App.-Houston [1 Dist.]2002, pet. requested July 30, 2003).

On the other hand, in *U.S. Rentals, Inc. v. Mundy Service Corp.*, 901 S.W.2d 789, 792 (Tex.App.-Houston [14 Dist. 1995, pet. denied) the court held the indemnity agreement was not sufficiently conspicuous where: (1) the indemnity provision was the seventh of fifteen unrelated provisions spanning the back of the rental contract; and (2) the headings and text of all fifteen were printed in the same respective sizes and types. The court held the indemnity provision was no more visible than any other provision on the back of the page. Furthermore, the court noted that neither the statements on the front of the contract nor the heading of the indemnity provision said anything to alert renters that they were entering into an indemnity agreement.

D. Late Notice Defense to Coverage

It is well settled by Texas case law applying notice requirements in liability policies that an insured must notify the insurer whenever a claim is made against the insured and forward any legal papers. *Harwell v. State Farm Mut. Auto. Ins. Co.,* 896 S.W.2d 170, 173-74 (Tex.1995); *Liberty Mut. Ins. Co. v. Cruz,* 883 S.W.2d 164, 165-66 (Tex.1993). Compliance with a notice provision is a condition precedent to an insurer's liability on the policy. *Id.* However, the insured's failure to notify the insurer does not absolve the insurer from the underlying judgment unless the lack of notice prejudices the insurer. *Id.* Today, Texas liability policies are endorsed so that the insurer cannot deny coverage for late notice of claim or suit unless the insurer can show it has been prejudiced by the late notice. The Texas Board of Insurance requires a showing of prejudice before allowing a late-notice

defense on a liability policy, at least with respect to claims involving bodily injury and property damage. *See Chiles v. Chubb Lloyds Ins. Co.,* 858 S.W.2d 633, 635 (Tex.App.--Houston [1st Dist.] 1993, writ denied).[2] Whether an insurer is prejudiced by its lack of notice is generally a question of fact. *See Struna v. Concord Ins. Services, Inc.,* 11 S.W.3d 355 (Tex. App. – Houston [1st Dist] 2000, no pet.)*; Duzich v. Marine Office of Am. Corp.,* 980 S.W.2d 857, 866 (Tex.App.--Corpus Christi 1998, pet. denied); *P.G. Bell Co. v. U.S.F.&G., Co.,* 853 S.W.2d 187, 191 (Tex. App. – Corpus Christi 1993, no writ); *Members Ins. Co. v. Branscum,* 803 S.W.2d 462, 464 (Tex. App. – Dallas, no writ). Courts have held that, generally, an insured's failure to notify the insurance company of a claim filed against it by a third party will not constitute prejudice unless that notice is given after a default judgment is taken against the insured. *See Kimble v. Aetna Cas. & Sur. Co.,* 767 S.W.2d 846, 849 (Tex.App.--Amarillo 1989, writ denied) (No notice was given until after the entry of judgment); *Filley v. Ohio Cas. Ins. Co.,* 805 S.W.2d 844, 847 (Tex.App.--Corpus Christi 1991, writ denied) (Court held carrier was prejudiced when it received notice of suit three years after date of occurrence where trial date was quickly approaching and carrier was not given adequate time to prepare for defense).

Texas law does not presume prejudice from a settlement without conset or lack of notice. *Hanson Prod. Co. v. Americas Ins. Co.,* 108 F.3d 627 (5th Cir. 1997); *Lennar Corp., et al v. Great American Ins. Co., et al.,* 2005 WL 1324833 (Tex. App. Houston [14th Dist.] 2005) (unpublished); *Comsys Info. Tech. Servs., Inc. v. Twin City Fire Ins. Co.,* 130 S.W.3d 181 (Tex. App. – Houston [14th Dist.] 2003, pet. denied) (recognizing mere fact that the insurer owes money it does not wish to pay does not constitute prejudice as a matter of law).

There are cases in Texas, however, where prejudice is determined as a matter of law. For example, in *Liberty Mutual Ins. Co. v. Cruz,* 883 S.W.2d 164 (Tex.1993) the Texas Supreme Court held that Liberty Mutual was prejudiced as a matter of law when it did not receive notice of the suit until July 2, 1987, 41 days after entry of the default judgment against its insured and after the deadline to appeal the default judgment had passed. It was questionable whether Liberty Mutual ever had actual knowledge of the claim, however, the court held that actual knowledge of a claim is not actual notice of a suit. *Id.* at 165. *See also Kimble v. Aetna Casualty and Sur. Co.,* 767 S.W.2d 846 (Tex.App.--Amarillo 1989, writ denied) (Where court held insurer was prejudiced where no notice was given and insurer had no knowledge of suit until after default judgment rendered, but before judgment became final); *Filley v. Ohio Casualty Ins. Co.,* 805 S.W.2d 844 (Tex.App.--Corpus Christi 1991, writ denied) (Where court held insurer was prejudiced when the insured notified the insurer of suit only a few days prior to trial, when insurer could not locate the insured and could not adequately prepare for trial).

V. CONCLUSION

Coverage in the context of a construction defect claim is often convoluted and murky. There are several general principles that serve as useful guides, such as the notion that there is typically no coverage for a breach of contract claim and the thought that damage to work or property other than the work or property that is the subject of the insured's work is generally covered. Nevertheless, coverage in each construction defect case necessarily depends upon the particular facts that are involved and the angle from which those facts are viewed. There are also other obligations and risk transfer provisions in the various contracts at issue that can provide coverage separate and apart from any coverage provided under the general coverage grant and which can provide additional and sometimes priority coverage for the insured. All of these various obligations and angles must be analyzed and evaluated in order to fully assess a construction defect claim.

[2] In 1973, the Texas State Board of Insurance passed Order No. 23080 which provided that the following endorsement be attached to all general liability policies issued or delivered in Texas:

> [a]s respects *bodily injury* liability coverage and *property damage* liability coverage, unless the company is prejudiced by the *insured's* failure to comply with the requirement, any provision of this policy requiring the *insured* to give notice of action, *occurrence,* or loss, or requiring the *insured* to forward demands, notice, summons or other legal process, shall not bar liability under this policy.