

Exclusion Bars Coverage for Settlement of Liability Assumed Under Contract

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The Supreme Court of Texas has held that a contractual liability exclusion in a CGL policy precludes coverage where the only basis for the insured's liability is that it contractually agreed to be responsible for certain liabilities. *Gilbert Texas Constr., L.P. v. Underwriters at Lloyd's London*, 2010 WL 2219645 (Tex. June 4, 2010). The court also held that the insurer was not estopped from relying on the exclusion where the insurer provided notice that the alleged breach of contract potentially implicated the exclusion and that a potential conflict of interest existed between the insurer and the policyholder as a result.

The insured general contractor purchased an excess commercial general liability policy providing coverage for liabilities arising out of bodily injury or property damage. The contractual liability exclusion in the policy precluded coverage for "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." An exception to the exclusion applied to liabilities arising out of damages "that the insured would have in the absence of the contract or agreement."

In 1993, the insured contracted with the Dallas Area Rapid Transit Authority (DART) to construct a light rail system. The contract required the general contractor to protect the worksite and surrounding property and imposed a duty to repair any damage to third parties resulting from the "failure to comply with the requirements of [the] contract or failure to exercise reasonable care in performing the work." During the construction, unusually heavy rains resulted in water damage to a building adjacent to the construction site. The building's owner filed suit against DART, the insured and other entities involved in the construction, asserting various tort claims in addition to a claim for breach of contract as a third-party beneficiary of the construction contract. The primary insurer assumed the general contractor's defense and appointed defense counsel, who asserted the defense of governmental immunity in the original answer. On cross motions for summary judgment, the trial court granted the general contractor's motion on governmental immunity grounds for all of the counts save the breach of contract claim. The insured subsequently settled the breach of contract claim for \$6.175 million.

While the underlying suit was pending, the insurer issued a series of reservation of rights letters to the general contractor noting that its duty to indemnify would be determined by the judgment rendered and facts found in the suit, reserving its rights to deny coverage and alerting the general contractor to a potential conflict of interest because of the insurer's position that the damages claimed might not be covered. Coverage counsel

for the insurer, however, participated in the defense of the underlying claim pursuant to the policy's cooperation clause, and supported moving for summary judgment on the immunity issue. After the trial court's partial grant of summary judgment to the insured on that defense, the insurer issued an additional reservation of rights letter citing the contractual liability exclusion as a defense to coverage for the remaining breach of contract claim. Following the settlement, the insurer denied coverage based on that exclusion.

In the coverage litigation that followed, the state supreme court determined that, after the trial court's partial summary judgment ruling, the underlying claimant's only viable theory of recovery was breach of contract, which fell within the terms of the contractual liability exclusion. In doing so, the court considered and rejected the insured's argument that the exception to the exclusion for liabilities the insured would have had absent the contract should apply. According to the insured, it only prevailed on the tort claims due to the governmental immunity defense, which was applicable only due to the contract with DART. Absent that contract and the resulting immunity, the insured argued, it would have been liable in tort so the contractual liability exclusion should not apply. The court stated that the insured's hypothetical was irrelevant, as the exclusion had to be applied based on the actual facts, which had resulted in a judgment stemming from contractually liability, not tort.

The court also rejected the insured's argument that it had been prejudiced by the insurer's involvement with the defense in the underlying action, and thus that the carrier was estopped from denying coverage. Under the policy's cooperation clause, the insurer had a right to associate with the policyholder and the primary insurer in defending the underlying claim, even in the absence of a duty to defend. Independent counsel represented the general contractor in the underlying action and had the right to refuse to assert the immunity defense over the urging of the insurer's coverage counsel but did not do so and, in any event, defense counsel had previously raised the defense without any prompting from the insurer. The court also noted that the insurer's initial reservation of rights letters provided adequate and timely notice of both the likelihood of the lack of coverage for the breach of contract claim and the existence of a potential conflict of interest, negating any inference that the insurer waived any rights under its policy or was otherwise estopped from relying on the contractual liability exclusion.