Insurance, Surety & Liens

A Newsletter of Division 7 of the ABA Forum on Construction

January 2013 Issue 2013-01

Message from the Chair

Happy New Year to Division 7 Members! Welcome to the Winter Edition of the Newsletter for Division 7, the ABA Forum on Construction's Division on "Insurance, Surety & Liens." On behalf of the Division 7 Steering Committee, I want to thank those members who contributed substantive articles for this Edition and encourage you, Division 7 members, to consider submitting proposed articles on important cases and emerging issues in the Insurance, Surety & Lien construction law practice areas for publication in future Editions.

Special thanks to Division 7's recent Hot Topic presenters Mary Licari and Marc Sanchez for their outstanding presentations. For those who were unable to attend the Division's November 2012 Hot Topic presentation, Mary Licari, with Bates, Carey, Nicolaides, LLP, spoke on the insurance coverage issues faced by additional insureds. Division 7's January 2013 Hot Topic presentation featured Marc Sanchez, with Frantz Ward in Cleveland, who discussed the

(Continued on page 3)

Welcome New Members

Division 7 would like to welcome the following new members who have joined the Division since October 1:

Kari Horner Ashcroft
Dingess Foster Luciana Davidson & Chleboski, LLP
Pittsburgh, PA

Gene W. Bailey, II
Charleston, WV

(Continued on page 3)

Fifth Circuit Certifies Questions To Texas Supreme Court on Contractual Liability Exclusion

By: Mark D. Shifton

Seiger Gfeller Laurie LLP

On June 15, 2012, the Fifth Circuit Court of Appeals issued a groundbreaking decision in an insurance coverage case which could have had far-reaching effects upon the construction industry. Employing a novel interpretation of a CGL policy's contractual liability exclusion, the Fifth Circuit held that an insurer had no duty to defend its insured subcontractor, as the policy's contractual liability exclusion operated to exclude coverage. *Ewing Construction Company v. Amerisure Insurance Company*, 684 F.3d 512 (5th Cir. 2012). Less than two months later, the Fifth Circuit withdrew its opinion and certified two questions to the Texas Supreme Court. 690 F.3d 628 (5th Cir. 2012). The Fifth Circuit's original opinion, which ran contrary to the vast majority of courts dealing with this issue, would have had significant effects on the state of insurance law in Texas and within the Fifth Circuit as a whole, and its repercussions might have

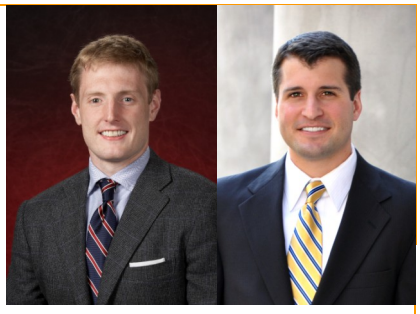
(Continued on page 6)

In This Issue

Division 7 Website:
www.americanbar.org/groups/construction_industry/divisions.html

Mechanics' Liens Go Viral: Lessons from Iowa and Utah

By Samuel E. Jones and Scott M. Wadding
Shuttleworth & Ingersoll, P.L.C.



Mechanics' liens are an important tool to secure payment for members of the construction industry. As a general matter, mechanics' liens are security interests that attach to the land where construction work is performed or where goods are to be installed. The requirements for filing and enforcing mechanics' liens vary from state to state. An increasing proportion of construction industry members prepare and file mechanics' liens without legal assistance. Iowa and Utah have responded to that trend by creating "State Construction Registries" intended to make the mechanics' lien program more transparent and widely accessible.

State construction registries innovate the way mechanics' liens are filed and managed. These registries are online "bulletin boards" where project participants can file various construction notices and mechanics' liens. These registries are designed to promote transparency by creating a forum in which property owners, contractors and providers of goods and services can access detailed project information.

Utah implemented its construction registry in 2005. The Utah registry applies to both commercial and residential construction projects. It is administered by a third party, Utah Interactive, and is overseen by the Division of Occupational and Professional Licensing. The Division of Occupational and Professional Licensing has taken a role in training industry professionals on using the program. A local government entity or contractor may file a notice of commencement, though contractors are charged a fee. Local government entities may post a notice of commencement directly to the registry or may email or fax the notice to Utah Interactive. Those who perform work on a construction project must submit a preliminary notice within twenty days of commencing work to retain lien rights. A notice of completion must then be filed at the conclusion of the project. The registry indexes the property by owner, contractor, name, lot or parcel number, address, entry number, and county. Non-governmental projects are also indexed by tax parcel identification number and building permit number. The registry can be accessed through traditional means or by mobile phone. In addition to basic information related to the project, the registry includes a list of all parties working on the project and the project start date.

In 2007 the Utah Legislative Auditor General performed a review of the registry. The ensuing report contains a number of concerns deserving the attention of other states considering implementing a construction registry. The report concluded local government entities failed to consistently file timely notices and transmit building permit information. The report also cited insufficient training for industry professionals as a major challenge. The report further observed administrative rules governing the registry were misleading and contradicted state law. As a result of its findings, the Legislative Auditor General recommended regular audits of local governments, enhanced training efforts, and a revision of various administrative rules.

Iowa joined Utah in implementing an online construction registry in January. The new Iowa registry is similar to Utah's, though there are some differences. Iowa's registry applies to residential construction and is administered by the Secretary of State. The registry is available to the general public through the Secretary of State's website. The Iowa registry is indexed by owner name, general contractor name, state construction registry number, property address, legal description, and tax parcel number. Notices and mechanics' liens may either be posted directly on the website or sent to the Secretary of State by mail or fax. The Secretary of State must post notices or mechanics' liens within three days of receipt.

Proponents of online registries boast the databases are inexpensive and efficient tools that make filing mechanics' liens easier and more affordable. Construction registries mitigate unknown risk by streamlining, standardizing and centralizing communication between property owners, contractors and government entities. Property owners benefit because they can find out who is working on their project with the click of the mouse. These registries ensure vital project information can be collected and shared with ease among all interested parties.

Despite broad-based support by industry professionals, some doubt the utility of internet-based construction registries. For example, in October 2008, the Indiana Commission on Courts convened to hear testimony related to the adoption of an online construction registry. Individuals involved in implementing the Utah registry testified about many of the advantages of the program, including efficiency and cost savings. A number of individuals and organizations spoke in opposition of the registry, however. Voices of opposition included the Association of Indiana Counties, Indiana Recorders Association, the Indiana Land Title Association, and the Heating and Air Conditioning Alliance. Many of these organizations were concerned that "mom and pop" operations in the state would not benefit. Opponents observed that many of these operations employ individuals who are untrained and inexperienced with the use of computers. The commission took no further action on the bill in light of the "unresolved issues" concerning the online registry.

(Continued on page 3)

(Continued from page 2)

Despite these concerns, the experiences in Utah and Iowa demonstrate how internet-based technology has the potential to simplify, streamline, and centralize the way in which mechanics' liens and notices are filed and managed. Recognizing this, a number of state legislatures, including Kansas, Indiana and Colorado, have or are considering implementing an online state construction registry. Although support for online registries is not universal, opposition is likely to wane. Internet use is on the rise, and states can implement measures to ensure those who seek training have access to it. Safety valves can also be put in place, namely, submission of notices and mechanics' liens by mail or fax as in Iowa and Utah. As digital government become the new normal and paper filing becomes more antiquated, states considering new ways to innovate and streamline government now have two examples to follow: Utah and Iowa.

Samuel E. Jones
sej@shuttleworthlaw.com
P: 319.731.2359
F: 319.365.8443

Scott M. Wadding
smw@shuttleworthlaw.com
P: 319.731.2398
F: 319.365.8564

Shuttleworth & Ingersoll, P.L.C.
115 3rd Street SE, Suite 500
PO Box 2107
Cedar Rapids, Iowa 52406-2107
www.shuttleworthlaw.com

***(Message from the Chair** - Continued from page 1)*

current split of authority on whether a bad faith claim can be asserted against a payment bond surety. Please be sure to join us for our next Hot Topic presentation which will be held on Thursday, March 7, 2013 at 1:00 p.m. E.S.T. Look for our email blast for more details.

I hope all of you who are able have made arrangements to attend the ABA Forum's upcoming Mid-Winter Meeting from January 31 through February 1, 2013 in Naples, Florida. This year's Mid-Winter Conference theme is "**Making Dollars and Sense of Construction Damages**."

As is our tradition, Division 7 will be hosting an informal Division Dinner on Thursday, January 31, 2013 at 8:00 p.m. Dan King, Division 7's Membership Chair, has arranged for a bus to pick up all who have RSVP'd from the ABA Reception at 7:30 p.m. and take us to Pincher's Crab Shack.

Division 7 will also be co-hosting a lunch-presentation with Division 9 (Specialty Trade Contractors & Suppliers) on Thursday, February 21, 2013 between 12:15 and 1:30 p.m. The title of this year's presentation is "It's Miller (Act) Time!" A panel of speakers including our own Sam Laurin and Michael Clark will be joining forces with Division 9's Dave Fine to provide an overview of the Miller Act; the types of damages recoverable thereunder; and the distinctions between a Miller Act bond, a "Little Miller Act" bond and a common bond, and much more.

Also, please make plans to attend the Forum's Annual Meeting, scheduled for April 25-27, at St. Regis Monarch Beach Resort, Dana Point, California. Our very own David Theising, immediate Past President of Division 7, is one of the co-chairs for that meeting.

Please remember, if you are unable to attend one of the Division Meetings or Hot Topic teleconference presentations, Division 7's Technology Chair, Sam Laurin, posts the meeting minutes, handouts and other updates to the Division 7 website, which you can access at: http://apps.americanbar.org/dch/committee.cfm?com=CI107000.

I would like to welcome all the new Division 7 members. All new members receive a welcoming package that includes the Division 7 Lapel Pin and copies of our most recent Newsletters. We encourage all members to wear their lapel pin at Forum events. If for some reason you have misplaced your lapel pin, please feel free to notify me or Dan King and we will get you a replacement pin.

Thanks again to all those who continue to volunteer their time and talents to make Division 7 the premiere membership organization for practitioners of Insurance, Surety and Liens in the Construction Industry. I hope to see you at one of the upcoming Forum events!

Warmest regards,
Pat

Patrick J. Poff
Trenam Kemker
101 E. Kennedy Boulevard, Suite 2700
Tampa, Florida 33602

pjpoff@trenam.com
http://www.trenam.com
P: 813.223.7474
F: 813.227.0481

***(Welcome New Members** - Continued from page 1)*

Jackson B. Boyd
Ober|Kaler
Baltimore, MD

Pat Coughlan
Raymond, ME

Tracy A. Davis
Beiging Shapiro & Barber
Denver, CO

Dean W. Farley
Riordan Fulkerson Hupert & Coleman
Chicago, IL

Christopher S. Dove
Warden Grier
Kansas City, MO

Rebecca McWilliams
McWilliams Law, LLP
Quincy, MA

Jason R. Potter
Wright, Constable & Skeen, LLP
Baltimore, MD

Out of the Woodwork: Dealing with an Increase in Latent Defect Claims Against Performance Bond Sureties

By: Jason T. Farley
Whitfield & Eddy, P.L.C.

Similar to the increase in defect claims following the construction boom of the 1990s and early 2000s, it is likely the current recovery in the construction industry will lead to an increase in latent defect claims against performance bonds.

In the mid-2000s, construction activity all but ceased and contractors began to struggle financially. Dissatisfied project owners in many cases were left to pursue defect claims for shoddy work against judgment-proof or defunct contractors. While such claims were properly remediable under contract theories, owners often brought them under tort theories. In the absence of a performance bond, the tort claim was a desperate litigation strategy hoping to trigger insurance defense and perhaps ultimately, payment from an economically viable party, the CGL insurer.

That was then, this is now, and a significant difference is an increase in bonded projects. Since 2008, public and private bonded projects have accounted for the acceleration in construction activity and fueled the current recovery in the industry. Many of those projects are complete and accepted with standard post-completion guarantees expired. However, years remain for owners to "discover" claimed defects allegedly unknown to them at the time of acceptance or during the warranty period. It seems inevitable: as contractors continue to struggle, dissatisfied owners of bonded projects will begin to bring latent defect claims against principle contractors and sureties seeking to obtain judgment against the viable party left holding the bag, the performance bond surety.

The performance bond surety guarantees the principal contractor's performance of its contractual obligations. If the contractor defaults, the surety is obligated to assume the duty to complete the construction work or to pay for labor and materials incorporated into the project." Absent defenses, the surety must either complete the contract or pay the penal sum of the bond.

The surety's potential liability in many cases does not end with project completion, owner acceptance, or expiration of the post-completion warranty period. While these events generally bar recovery on the performance bond for *patent defects*—defects that are known or discoverable by reasonable attention—they do not bar recovery for *latent defects*—defects that are hidden or concealed at the time of completion, acceptance, or during the warranty period and are undiscoverable by reasonable inspection. Generally speaking, a *defect* is an act or omission that renders a project (or any part of a project) non-compliant with plans, specifications or other contract provisions, building codes or ordinances, or industry standards that are applicable for the project. Owner acceptance and expiration of post-completion warranties generally do not bar recovery on the performance bond for latent defects. This is loosely premised on the legal principle that an unknown cannot be waived.

Performance bond surety liability for latent defects depends on the terms of the bond and the law of the jurisdiction in which the project is located. Many courts—if not the majority—recognize surety liability for latent defects claims. These courts hold that a surety may be liable for latent defects in its principal contractor's work, *regardless of whether the defects are discovered before or after the warranty period*, where a contractor fails to perform its obligations under the contract and the bond is conditioned upon the contractor's faithful performance of all of its obligations under the contract. The most common rationale for these holdings is the generalization that a surety's liability is coextensive with its principal's liability.

This prolonged exposure to liability for latent defects obviously causes great concern to sureties.

The surety's obligation to correct latent defects is often limited only by the applicable state statute of repose for improvements to real property, which can extend up to 15 years from project competition. Indeed, latent defects discovered after expiration of any post-completion warranty obligation have been coined the "biggest headache" faced by a performance bond surety. Nothing surprises a surety more than having to defend a large performance bond claim many years after a project is completed and retainage released, when project documents have disappeared, project participants are nowhere to be found, memories have faded, industry standards have changed, and the owner has long-occupied and (at least, theoretically) maintained the project.

In the face of this impending increase in latent defect claims, performance bond sureties must evaluate various defenses that may be available in the applicable jurisdiction. While surety defenses may require discovery and can become contested factual disputes in themselves, sureties should utilize defenses as early as possible in litigation to eliminate, as a matter of law, liability for latent defects. Some potential defenses include:

- Time. A surety's potential liability for latent defects does not extend forever. Contractual and bond time limitations, statutes of limitation, and statutes of repose are all relevant in determining when a surety's exposure for latent defects ends. Surety liability for defects is generally time-barred at the conclusion of the limitations period, as extended by the

(Continued on page 5)

(Continued from page 4)

discovery rule of accrual, or the repose period (if applicable), whichever is shorter. However, no bright line rule exists to establish when the surety's exposure for latent defects ends. The interplay between the relevant limitation periods has led to inconsistent results across the country.

- Default as condition of liability. Surety liability is often conditioned upon contractor default. When the underlying performance bond conditions the surety's liability upon the principal's default, an argument may be available that no post-competition breach of a bonded contract can trigger the surety's potential liability. This argument is premised on the distinction between breach and default, and the theory that no material breach of contract—and therefore no default—can occur after the bonded contract is completed.
- Release of principal. The surety is released from liability for latent defects if, at any time, the owner releases the contractor from liability for latent defects, unless the owner specifically reserves its rights as to other parties. In this regard, the terms of the contract and their operation are critical in determining whether a release of the contractor and release of the surety has occurred.
- Owner inspection. An owner may waive a potential latent defect claim when there is a requirement of regular inspections by the owner's agent or where the owner hires a consultant specifically for the purpose of inspection.

In the wake of the current recovery in the construction industry, sureties are well-advised to prepare for an increase in latent defect claims against performance bonds. Principal contractors and sureties both have exposure to latent defect claims, but sureties have defenses that may defeat claims against the performance bond independent of the defect claim against the contractor. It is critical for sureties to continue to advance these defenses as they develop into more widely acknowledged and consistently applied principles of law.

1. Some authorities have concluded "the mere showing of faulty work is sufficient to bring a claim for resulting damages (of whatever nature) within policy coverage." *Pursell Const., Inc. v. Hawkeye Security Ins. Co.*, 596 N.W.2d 67, 71 (Iowa 1999) (quoting United States Fidelity & Guarantee Corp. v. Advance Roofing & Supply Co., 788 P.2d 1227, 1233 (Ariz. Ct. App. 1989). In our opinion these authorities disregard the fundamental nature of a comprehensive general liability policy of the type involved in this litigation, and ignore the policy requirement that an occurrence be an accident. If the policy is construed as protecting a contractor against mere faulty or defective workmanship, the insurer becomes a guarantor of the insured's performance of the contract, and the policy takes on the attributes of a performance bond. We find these authorities unpersuasive. *Pursell Const., Inc.*, 596 N.W.2d at 71 (quoting *United States Fidelity*, 788 P.2d at 1233).
2. Jeffrey M. Chu and Shannon J. Briglia, American Bar Association Forum on Construction Law, *Liability of Contractors and Sureties for Latent Defects* 19 (2002), *available* at http://www.legalist.com/aba/sf/speakers/chu/ chu_briglia.pdf.
3. John S. Mrowiec, ENRMidwest, *Surety Company Bound to Honor Contractor's Warranty* 1 (2009).
4. *See, e.g., City of Osceola v. Gjellefald Const. Co.*, 279 NW. 590, 594 (Iowa 1938).
5. *See, e.g., Speight v. Walters Dev. Co., Ltd.*, 744 N.W.2d 108, 114 (Iowa 2008); *Estate of Vazquez v. Hepner*, 564 N.W.2d 426, 430 (Iowa 1997).
6. *See* Chu, *supra* note 2, at 10.
7. *Id.*; *see* Jarrod W. Stone, *When is it Over? Theories for Eliminating, or at Least Reducing, a Surety's Liability for Latent Defects that are Discovered After Final Competition and Acceptance of the Bonded Contract* 2 n.1 (2012), *available at* http://www.forcon.com/papers/ssfcc/2012/05.%20Stone.pdf.
8. Mrowiec, *supra* note 3. Whether a surety ultimately will be held liable under its performance bond for latent defects depends upon a variety of factors including: (1) whether the precise language of the bond affords coverage, (2) if the bond affords coverage, the amount of time which has passed between the end of the warranty period and the discovery of the latent defects, (3) the extent and nature of the defects, and (4) the case law of the relevant jurisdiction. Philip L. Bruner and Tracey L. Haley, American Bar Association, *Managing and Litigating the Complex The Complex Surety Case* 33 (2d. ed. 2007).
9. *See* Patrick R. Kingsley and Michelle K. Carson, Fidelity and Surety Law Committee Newsletter, *Latent Defect Claims Against Sureties—Practical Considerations* 9, 13 (2009), *available at* http://www.stradley.com/library/files/aba_-_fslc-winter09_kingsley_carson_authored_article.pdf; *see also* Steven Streck, *Surety Liability Under a Performance Bond for Post-Construction Guarantees* 1 (2009), *available at* http://axley.com/articles/surety-liability-092409.
10. *See* Streck, *supra* note 9.
11. Stone, *supra* note 7, at 2.
12. Shannon J. Briglia and Edward Etcheverry, *The Construction Defect Hot Potato: The Interplay Between the Performance Bond and CGL Policy—A Surety's Perspective*, 77 Def. Couns. J. 30, 32-33 (2010).
13. *See, e.g.*, Iowa Code § 614.1(11) (2011) (setting forth fifteen year statute of repose for improvements to real property).
14. Bruner & O'Conner on Construction Law, § 12:22, p. 490.
15. Scott Fitzsimmons, *Through the Looking Glass: Contract Terms from a Surety Perspective* (2008).
16. *See* Kingsley, *supra* note 9, at 10.
17. *See* Chu, *supra* note 2, at 28.
18. *See* Robert M. Wright & William F. Ryan, Jr., *Hazardous Waste Liability and the Surety Revisited*, 30 Tort & Ins. L.J. 739, 766 (1995) ("Many states now recognize claims on a performance bond for latent construction defects with the cause of action not accruing until the date of discovery of the latent defect.").
19. *See* Kingsley, *supra* note 9, at 10-11.
20. Chu, *supra* note 2, at 28.
21. *Id.*
22. *See* Stone, *supra* note 7, at 3.
23. *See id.*
24. Chu, *supra* note 2, at 34.
25. Kingsley, *supra* note 9, at 12.
26. Stone, *supra* note 7, at 11.

Jason T. Farley
Whitfield & Eddy, P.L.C.
3737 Woodland Avenue, Suite 400
West Des Moines, Iowa 50266

farley@whitfieldlaw.com
www.whitfieldlaw.com
P: 515.246.5516
F: 515.222.0318

Division 7 Member Spotlight

By: Lawrence Lerner

Levy Craig Law Firm

Lawrence Lerner is a shareholder with the Levy Craig Law Firm in Kansas City, Missouri, focusing on construction, fidelity and surety law. Larry is a highly skilled construction, fidelity and surety law attorney, and also a licensed professional engineer. Larry is recognized and well respected for his knowledge and extensive experience involving strategies to recover costs and complete construction projects, and resolve surety payment and performance bond claims, construction disputes, contract bond defaults, default terminations along with insurance coverage and bad faith issues. Larry has represented sureties, contractors, owners and design professionals in complex construction claims involving takeovers, relets, changes, changed conditions, modifications delays, interferences and design defects.

Larry is an active member of Division 7, Insurance, Surety and Liens, of the ABA Forum on the Construction Industry and has been published by Division 7 in articles relating to surety law.

Larry is a member of the National Society of Professional Engineers. He is an active member of the Missouri Bar and Kansas Bar and an inactive member of the State Bar of California, and has also been listed in Super Lawyers. Larry also is a member of the Kansas City Metropolitan Bar Association, as well as the American Bar Association, where he is a member of the Sections on Tort and Insurance Practice, Fidelity and Surety Law Committee; Litigation, Construction Litigation Committee; Public Contract Law and Forum on the Construction Industry. He is a current member of the National Bond Claims Association and the Surety and Fidelity Claims Institute. Larry is also a co-editor of the ABA, CGL/Builder's Risk Monograph, published by ABA-TIPS/FSLC in 2004 and the Performance Bond Manual of the 50 States, District of Columbia, Puerto Rico and Federal Jurisdictions, published by ABA-TIPS/FSLC in 2006. Larry has presented numerous times, authored and co-authored various publications including: Tying Together Termination for Convenience in Government Contracts, 7 Pepperdine L. Rev. 711, 721-22 (1980); Chapter 13, "Salvage Subrogation Considerations," Bond Default Manual, Second and Third Editions, published by ABA-TIPS/FSLC in 1995 and 2005; Chapter 15, "Worker Compensation Bonds," The Law of Commercial and Miscellaneous Surety Bonds, published by ABA-TIPS/FSLC in 2001 and 2012; and the soon to be published in 2013, by ABA-TIPS/FSLC, The Contract Bond Surety's Subrogation Rights, Chapter 9, "Surety v. Third-Party Beneficiaries under the Surety's Payment Bonds (Payment Bond Claimants)."

Larry is not only a well-respected construction, fidelity and surety law attorney, he is also known for his commitments to the community. He is a past-President and a member of the Board of Trustees of Congregation Beth Torah. Larry currently serves on the Executive Committee and Board of Directors of The Family Conservancy and on the Executive Committee and Board of Trustees of the Medical Missions Foundation of Kansas City and has participated in the Guatemala mission.

Larry resides in Overland Park, Kansas with his wife. His personal interests include yoga, reading and traveling.

Lawrence Lerner
Levy Craig Law Firm
1301 Oak Street
Kansas City, Missouri 64106

llerner@levycraig.com
www.levycraig.com
P: 816.460.1807
F: 816.382.6607

(Fifth Circuit Certifies Questions To Texas Supreme Court on Contractual Liability Exclusion - *Continued from page 1)*

eventually extended nationwide. Now, it will fall upon the Texas Supreme Court to clarify the current state of Texas law.

Ewing Construction Company contracted with a school district in Corpus Christi, Texas to construct tennis courts. After the tennis courts began cracking and flaking, allegedly rendering them unfit for use, the school district filed a construction defect action in Texas state court. Ewing tendered its defense to its insurer, Amerisure Insurance Company. Amerisure denied coverage, relying on the policy's contractual liability exclusion, which stated there would be no coverage for "'property damage' for which [Ewing] is obligated to pay damages by reason of the assumption of liability in a contract or agreement."

Ewing subsequently filed a declaratory judgment action in the United States District Court for the Southern District of Texas. Relying on the 2010 Texas Supreme Court decision in *Gilbert Texas Construction, L.P. v. Underwriters at Lloyd's London*, 327 S.W.3d 118 (Tex. 2010), the District Court held that Amerisure owed no duty to defend Ewing because the contractual liability exclusion operated to exclude coverage. The Fifth Circuit partially affirmed the District Court's decision, holding that the District Court had properly interpreted the meaning of the contractual liability exclusion. To understand the Fifth Circuit's reasoning, a brief review of the *Gilbert* case is necessary.

In *Gilbert*, the Dallas Area Rapid Transit Authority (DART) contracted with Gilbert Construction Company to construct a light rail system. The DART/Gilbert contract required Gilbert to protect a third-party adjacent property owner from damages caused by Gilbert's work, and to repair any damages to the third-party's property. After heavy rains damaged the adjacent property,

(Continued on page 7)

(Continued from page 6)

the adjacent property owner sued DART and Gilbert. All claims asserted against Gilbert except a breach of contract claim (under the theory that the adjacent property owner was a third-party beneficiary of the DART/ Gilbert contract) were ultimately dismissed on summary judgment. After Gilbert settled the litigation and sought reimbursement from its insurance carrier, its claim was denied on the grounds that the contractual liability exclusion excluded coverage. The Texas Supreme Court eventually held that Gilbert's obligation to repair the adjacent property was an undertaking of legal accountability which triggered the contractual liability exclusion. As Gilbert enjoyed governmental immunity, there was no independent basis for liability against Gilbert in the absence of the DART/Gilbert contract, and thus Gilbert's liability existed solely based on its contractual obligation to the third party. Accordingly, the contractual liability exclusion operated to exclude coverage for the claims made by the adjacent property owner.

Relying on *Gilbert*, the District Court in *Ewing* held that as the school district's complaint alleged Ewing breached its contract, the contractual liability exclusion was triggered. Attempting to distinguish *Gilbert*, Ewing argued that merely entering into a construction contract did not rise to the level of assuming liability for faulty workmanship under that contract. In *Gilbert* the contractor had promised to repair a third party's property – which was an assumption of liability, as other than that promise there was no basis for the contractor's liability – while in *Ewing*, the only promise made by the contractor was the implied promise contained in every construction contract. Taken to its logical conclusion, to hold the contractual liability exclusion triggered by the mere signing of a construction contract would essentially preclude coverage for all construction claims where breach of contract claims were asserted. Nevertheless, the District Court granted summary judgment in Amerisure's favor, holding that it owed no duty to defend or indemnify Ewing on the grounds of the policy's contractual liability exclusion.

Ewing appealed to the Fifth Circuit Court of Appeals. In a 2-1 decision, the Fifth Circuit partially affirmed, holding that Amerisure had no duty to defend Ewing. The crux of the Fifth Circuit's opinion centered on whether Ewing's obligation to perform its contract in a workmanlike manner constituted an "assumption of liability" which would trigger the contractual liability exclusion as the Texas Supreme Court found in *Gilbert*. Ewing argued that merely entering into a construction contract – which the District Court held to be an assumption of liability sufficient to trigger the contractual liability exclusion – was not the same as actually assuming liability for faulty workmanship under the contract. The Fifth Circuit noted that in *Gilbert*, however, the Texas Supreme Court rejected what it called a "technical" meaning of the contractual liability exclusion – a meaning which is accepted in many other jurisdictions – that "assumption of liability" means the assumption of liability of another, as in a hold-harmless agreement. The Fifth Circuit noted that its analysis "preserved the principle that a CGL policy is not protection for the insured's poor performance of a contract," while admitting that it reached its holding through a different reasoning than other jurisdictions, though the result remained the same.

The dissent argued that the majority had misread *Gilbert* in holding that Ewing's agreement to perform under the contract was sufficient to trigger the contractual liability exclusion, and that *Gilbert* merely stood for the proposition that when an insured agreed to be liable for damages in excess of what it would have otherwise been, such liability is excluded from coverage under the contractual liability exclusion. The dissent argued that the majority's decision to interpret a standard construction contract as an assumption of liability – which would result in the exclusion of coverage in nearly all cases – constituted a gross misreading of *Gilbert*.

On August 8, 2012, however, the Fifth Circuit withdrew its decision, and certified the question of whether a general contractor who enters into a construction contract is deemed to "assume liability" for damages arising out of its defective work so as to trigger the contractual liability exclusion. In seeking guidance from the Supreme Court of Texas, the Fifth Circuit noted the importance of the questions presented, noted that the Texas Supreme Court's opinion would have a significant impact on Texas insurance law, and admitted that "[w]here state law governs an issue, such policy factors are better gauged by the state high court than by a federal court on an *Erie* guess."

Clearly, the Fifth Circuit's decision in *Ewing* had the potential to throw much of the construction industry into a state of turmoil, as it greatly expanded the scope and effect of the standard contractual liability exclusion common to all CGL policies. Under this expansion, the contractual liability exclusion would no longer operate to exclude coverage for liability assumed by an insured; it would exclude coverage for essentially all claims made against contractors where the contractor performed its work pursuant to a contact with an owner.

It now falls upon the Texas Supreme Court, which is hearing oral argument on February 27, 2013, to resolve this issue. Given the analysis and holding in *Gilbert*, and following the majority of jurisdictions, the Court is likely to answer the question certified by the Fifth Circuit in the negative, and hold that a contractor's mere contractual obligation to complete a construction project, without more, is not an "assumption of liability" sufficient to trigger a contractual liability exclusion.

Mark D. Shifton
Seiger Gfeller Laurie LLP
mshifton@sgllawgroup.com
www.sgllawgroup.com

100 Overlook Center, 2nd Floor
Princeton NJ 08540
P: 609.375.2602
F: 609.375.2001

330 Madison Ave, Sixth Floor
New York New York 10017
P: 212.653.8861
F: 646.495.5006

Editor's Corner

Thomas L. Hillers, Editor

I would like to specifically thank Mark Shifton, Jason Farley and Sam Jones for the great articles that they submitted for this month's newsletter. We are still seeking articles and authors for our upcoming newsletters. We plan to publish again in April, July and October, so if you know someone who may want to write a short article for us, please do not hesitate to put the author in contact with Tim Ford. His e-mail address is tford@hwhlaw.com. Tim also deserves recognition for his willingness to bring Michael Clark and myself to the helm for the upcoming newsletters as Michael and I will be alternating as vice co-editors to seek out articles and authors. We can be reached at mclark@siegfriedlaw.com and tom@cdrlaw.com.

Thomas L. Hillers
Cartwright, Druker & Ryden
112 W. Church Street
Marshalltown, Iowa 50158

tom@cdrlaw.com
www.cdrlaw.com
P: 641.752.5467
F: 641.752.4370

Schedule of Upcoming Division 7 Events:

Division 7 Dinner at Mid-Winter Meeting in Naples, FL

Thursday, January 31, 2013 at 8:00 pm at Pincher's Crab Shack (bus to pick up all who have RSVP'd from the ABA Reception at 7:30 pm). Please RSVP to Dan King at dking@fbtlaw.com or 317-237-3957.

Division 7 Co-Hosting a Lunch Presentation with Division 9 (Specialty Trade Contractors & Suppliers)

Thursday, February 21, 2013 from 12:15 to 1:30 pm
Speakers: Sam Laurin and Michael Clark will be joining forces with Division 9's Dave Fine
Topic: It's Miller (Act) Time!

Schedule of Upcoming Division 7 Monthly Calls:

Thursday, February 7, 2013

1:00 – 2:00 p.m. EDT (NOON – 1:00 p.m. CDT). Phone: 866-646-6488, Pass Code 711-487-1942.

Thursday, March 7, 2013

1:00 – 2:00 p.m. EDT (NOON – 1:00 p.m. CDT). Phone: 866-646-6488, Pass Code 711-487-1942. This meeting will include a hot topic presentation.

Thursday, April 4, 2013

1:00 – 2:00 p.m. EDT (NOON – 1:00 p.m. CST). Phone: 866-646-6488, Pass Code 711-487-1942.

Schedule of Upcoming ABA Construction Forum Programs:

ABA Forum 2013 Mid-Winter Meeting

January 31 – February 1, 2013 at Naples Grande, Naples, Florida.
Topic: Making Dollars and Sense of Construction Damages.

ABA Forum 2013 Annual Meeting

April 25 – 27, 2013 at St. Regis Monarch Beach, Dana Point, California.

DIVISION 7
INSURANCE, SURETY & LIENS

www.americanbar.org/groups/construction_industry/divisions.html

DIVISION 7 LEADERSHIP

CHAIR
Patrick J. Poff
Trenam Kemker et al.
Tampa, FL
(813) 223.7474
pjpoff@trenam.com

IMMEDIATE PAST CHAIR
David J. Theising
Harrison & Moberly
Indianapolis, IN
(317) 639.4511
dtheising@harrisonmoberly.com

STANDING SUBCOMMITTEES

Membership
Dan King, Chair
dking@fbtlaw.com

Programming
Ryan A. Hiss, Chair
rhiss@lymannielsen.com

Publications
Timothy C. Ford, Chair
tford@hwhlaw.com

Technology
V. Samuel Laurin, Chair
slaurin@boselaw.com

STEERING COMMITTEE
Natalie D'Amora
Timothy C. Ford
Larry Lerner
Ryan A. Hiss
Elizabeth B. Howard
Daniel P. King
V. Samuel Laurin
Diane J. Zelmer

Governing Committee Liaison
Eddie James

FORUM STAFF
Bridget Miller
Manager, Forum on the Construction Industry
American Bar Association
312.988.5579
bridget.miller@americanbar.org