

Texas CGL Case May Boost Insureds In Property Damage Suits

By Jeff Sistrunk

Law360, Los Angeles (October 10, 2014, 4:16 PM ET) -- The Texas Supreme Court is set to weigh in on the interpretation of two terms commonly used in exclusions in commercial general liability policies, and attorneys say a ruling that the terms are ambiguous under state law would provide a huge boost to policyholders in property damage coverage litigation.

The Texas high court recently accepted certified questions from the Fifth Circuit asking for clarification on whether the terms "physical injury" and "replacement," which are found in common business risk exclusions in CGL policies, are ambiguous.

The definitions of the terms are at issue in U.S. Metals Inc.'s suit seeking coverage from insurer Liberty Mutual Group Inc. for a \$6.3 million settlement with Exxon Inc. over the replacement of allegedly defective refinery equipment. A Texas federal court granted summary judgment to Liberty after finding that a policy exclusion applied to Exxon's claims, prompting U.S. Metals to appeal to the Fifth Circuit.

According to attorneys, if the Texas Supreme Court rules the terms at issue in the instant case are ambiguous, U.S. Metals will likely win, and other insureds litigating similar disputes could get a leg up on insurers.

"A finding that these terms are ambiguous ... could help insureds in other cases, depending on the facts in each particular case, and the reasoning given by the court for finding the terms to be ambiguous," said Noah Nadler, an attorney in Haynes Boone LLP's insurance coverage and business litigation practice groups.

Under Texas law, if language in an exclusionary clause of an insurance contract is ruled ambiguous, the court must adopt the insured's interpretation of the language as long as it is reasonable. Therefore, if the high court finds the terms are ambiguous, U.S. Metals and insureds in other cases would likely be able to prevail by showing their interpretations of the terms are reasonable.

In its certification order, the Fifth Circuit said the court's answers to its questions will have "far-reaching implications" affecting a large number of litigants, noting there is no controlling Texas Supreme Court precedent regarding the interpretation of "physical injury" and "replacement," which appear in the common "your product" and "impaired property" business risk exclusions of CGL policies.

Neel Lane, a San Antonio-based partner at Akin Gump Strauss Hauer & Feld LLP, said if the Texas Supreme Court issues a ruling on the interpretation of "physical injury" and "replacement" that is

favorable to U.S. Metals, it could "enlarge the scope of protection against property damage to include protection against defective product claims."

"The danger here is that it would be an expansion of coverage, which alone could be costly for insurers," Lane said.

A ruling that the terms are ambiguous would be especially troublesome for insurers if the Texas Supreme Court also finds in a separate case that the state doesn't recognize the "sophisticated insured" exception to the general rule that construes policy ambiguities against the insurer, according to Lane. The Fifth Circuit has asked the state high court to weigh in on that question in the dispute between BP PLC and Transocean Ltd. over \$750 million in coverage for the Deepwater Horizon oil spill.

"The worst scenario would be if the Texas Supreme Court determines that there is no 'sophisticated insured' exception in Deepwater Horizon and that these terms are ambiguous in U.S. Metals," Lane said. "If that happens, an insurer would invariably be on the hook for a broader scope of loss than the parties bargained for or the underwriters priced for."

On the other hand, if the Texas Supreme Court rules that the terms are unambiguous and adopts interpretations favorable to Liberty, it could establish binding precedent benefiting all insurers that issue CGL policies, attorneys say.

David White, an attorney in Thompson & Knight LLP's Dallas office, said he thinks the state high court will follow the reasoning of a Georgia federal court in its 2008 ruling in a case called Gentry Machine Works Inc. v. Harleysville Mutual Insurance Co., which applied the impaired property exclusion and held that physical damage to parts connected to a defective product — that is, parts that must be destroyed or damaged in the replacement process — are treated like the defective product itself and not covered.

The district court in the U.S. Metals case relied on Gentry in granting summary judgment to Liberty, ruling there is no coverage for damage sustained by components surrounding allegedly defective steel flanges provided to Exxon by U.S. Metals during the replacement and removal of the flanges themselves.

"The crucial question should be whether any parts, not the product itself, were physically damaged when the product failed, not during the replacement process," White said.

Other attorneys say that, even if the terms are found to be unambiguous, Liberty would face an uphill battle in proving that the coverage exclusions apply to U.S. Metals' claims, and the court may still rule in the insured's favor.

Allen R. Wolff, a shareholder in Anderson Kill PC's insurance recovery, real estate and construction groups, said a slew of recent Texas Supreme Court rulings favorable to policyholders have "reflected a pretty consistent approach on issues occurring" in the U.S. Metals case.

"Recently, the Texas Supreme Court has really been holding insurance companies accountable for the language in their policies, and not letting them come in and say, 'we know that the policy said 'x,' but it should be interpreted in a way that means 'y,'" Wolff said.

Liberty "would have to prevail on virtually every disputed issue in the case relating to the application of the exclusion," and if it "fails to satisfy any elements of the exclusion, it will likely lose," Wolff said.

Regardless of how the Texas Supreme Court rules on the questions, the "fact that this question arose will affect the conduct of insurers and their underwriters," according to Lane.

"This argument by the policyholder gained enough traction to get to the Texas Supreme Court — if it doesn't succeed in its current form, you might see permutations in other cases," Lane said. "Insurers will be keen to avoid situations where a coverage dispute may arise and, to the extent possible, anticipate a potential dispute. In the future, at a minimum, insurers must be sure to define 'physical injury' and what is included in 'replacement' costs so that coverage is not broader than bargained for."

U.S. Metals is represented by Graig J. Alvarez, Lance R. Bremer and Ryan M. Perdue of Fernelius Alvarez PLLC.

Liberty Mutual is represented by Bruce E. Ramage, Levin G. Hovnatanian and Christopher W. Martin of Martin Disiere Jefferson & Wisdom LLP.

The case is U.S. Metals Inc. v. Liberty Mutual Group Inc., case number 14-0753, before the Texas Supreme Court.

--Editing by Richard McVay.