



## Leadership Notes

### From the Chair

by David Wilson II

As I write this, we have reached the end of my first "DRI Year" as your Chair.



Further, we have just completed our both annual Construction Law Seminar, which took place in Phoenix, Arizona, and our final business meeting at the DRI Annual Meeting in New Orleans. This included a substantive presentation on the cross examination of experts from Toyja Kelly. Many of you know Toyja as a long time committee member, as well as a DRI Board Member. He will serve as our Board Liason for the next year. Thanks to each member who attended our seminar, our Annual Meeting presentation or both.

The seminar and the Annual Meeting presentation are just a couple of examples of the educational opportunities available for committee members. In addition, our expanding LinkedIn subgroup is another great opportunity to collaborate and share information about defending construction cases with other committee members. Danielle Walsh, our Website Chair and stalwart steering committee member, has done an excellent job getting the LinkedIn subgroup off the ground. If you have not already joined, I encourage you to do so.

In the coming year, just as we have revitalized this newsletter in the past year, our goal is to revitalize the Specialized Litigation Groups (SLGs). If you are interested in getting involved in one of our specialized litigation groups, please do not hesitate to contact me or one of the SLG chairs. The coming year will inaugurate newly appointed chairs to each committee, and I am confident that new ideas and fresh approaches will follow.

Finally, it is never too early to start planning to attend next year's DRI Construction Law Seminar. It will take place September 26-27, 2013 at the Cosmopolitan Hotel in beautiful Las Vegas, Nevada. I hope to see many of you there, or in New Orleans this October.

David Wilson II  
Hays, McConnell Rice & Pickering, P.C.  
December 2012

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## Featured Articles

### Condominium Conversions – Word to the Wise: Even if You Did Not Build It, They Will Sue, So Be Ready!

by Brenda K. Radmacher

With the changes in the economy and real estate over the past several years, California has seen an uptick in the number of condominium conversions. Condominium conversions occur when a structure, usually an apartment complex, is changed from rental units into condominiums, are then sold to individual unit owners. Technically, a conversion occurs when the Subdivision Map Act (Gov. Code Sections 66410, et seq.) is invoked and a tentative subdivision map is recorded. There are other obligations for a converter, including notice to the current tenants of the conversion, inspections of the property, and disclosures to the purchasers. Even if a converter seemingly complies with these obligations, there is a risk of liability exposure. This article will discuss five common exposure issues condominium converters face and provide practical tips for limiting converter liability.

**Construction Defect Claims.** Converter liability can arise out of construction defects in the units and/or the common areas. A review of complaints filed against



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condominium converters revealed frequently alleged defects included: leaks in roofs, windows, doors, and pipes; mold; and plumbing, mechanical, and electrical issues. Defects in these areas commonly expose converters to liability. Thus, careful inspection of these categories should be performed.

**Negligent Repair or Renovation.** Negligent repair is a common claim of unhappy buyers. Courts have found a converter can be held liable for negligent conversion of a condominium. Negligent conversion exists when repairs are performed by the converter and those repairs are found to be inadequate, in which case the converter may be liable. Further, a converter may be liable under a theory of negligence *per se* if it violates a city or local ordinance regulating condominium conversions.

**Failure to Disclose.** Another area of exposure is failure to disclose the "true condition" of the property. In California, failure to disclose in conversions is governed by Civil Code Section 1134, which requires that converters perform a reasonable investigation and disclose any substantial defects in the major systems of the property. Major systems include, but are not limited to, the roof, walls, floor, heating system, air-conditioning system, plumbing, electrical system, and recreational facilities.

Section 1134(d) includes important language: "any person who willfully fails to carry out the requirements of this section" will be liable for damages suffered by the buyer. The inclusion of the word willful suggests that mere negligence would be **insufficient** to hold a converter liable. Instead, to be liable, a converter must willfully disregard the responsibility to perform a reasonable investigation and make required disclosures.

**Negligent Misrepresentation or Fraud.** Misrepresentation also presents a liability exposure risk. Misrepresentation typically appears when the condominium is represented to be "like new" with no substantial defects. If defects are later found, the purchaser may challenge this representation under a fraud theory. Further, an "as is" clause will not necessarily protect a converter from liability. Under Civil Code Section 1668, contracts that exempt an individual from the responsibility for his own fraud will generally be found invalid. Thus, even if the contract contains an "as is" provision, the converter still must disclose known defects. An "as is" clause may provide some protection if it states that the buyers is relying on her own inspection of the property, not the seller's representations. Converters must take care to ensure their representations and contract terms are clear.

**Breach of Fiduciary Duty.** Converters may face liability related to the formation of the homeowners' association and/or the converter's agents serving on the board of directors for the association. In this role, the converter must make decisions that are in the best interest of the association, rather than decisions that further the converter's own interest. Claims related to fiduciary duties arise in regard to whether the converter provided an adequate budget or failed to adequately prepare the association's reserves for reasonably anticipated maintenance or future repairs. Thus, converters must be aware of their additional responsibilities related to formation and operation of the homeowners' association.

### How Can a Converter Avoid Liability?

While condominium conversions present various risks, converters have many ways to avoid, or at least minimize, potential liability. Here are some key tips:

1. Disclose the Condition of the Property and All Potential Defects.

Detailed, written disclosures may assist in limiting liability for the converter. This disclosure includes not only known defects, but also repairs on the property. Disclosure may be made on a lot-by-lot basis, depending upon the size of the project. However, for extensive projects, it should be disclosed clearly if each unit was not inspected.

In addition, converters should disclose all repairs they are not performing. That is, if a converter only replaces the faucets, the converter should disclose that it has not inspected portions of the plumbing system behind the walls or made other repairs. Whereas if a converter only states that they put in new faucets, a buyer may claim the converter made plumbing repairs and thus should be liable for all plumbing, or that the converter knew or should have reasonably known that further plumbing repairs were required. While arguably this additional step is not required, a converter can nip a claim in the bud by taking these steps.

2. Keep Records of Everything.

A converter generally will not be liable for defects that stem from the original construction. Thus, it is important for a converter to keep **all** records of the conversion-related work to document the limited scope of work-- daily logs, subcontractor paperwork, insurance information. If any records are available from the previous owner (inspection reports, photos, etc.), the converter should maintain them as well. If a converter has these records, it will be able to avoid more handily potential liability where the alleged construction defects can be traced back to the original construction.

Further, a converter should keep an inventory of the work performed on each unit and common areas, and the financial arrangements to pay for these costs to defend against any claims of underfunding. Finally, if something is being represented as "like new" it is important to have documentation of improvements made so that condition can be substantiated. Overall, good record keeping can greatly help a converter defend against claims.

### 3. Perform a Detailed Inspection.

A converter should perform a reasonable inspection to avoid liability under Civil Code Section 1134. The issue is what constitutes a reasonable investigation? In creating Section 1134, the legislature did not intend for a converter to have to spend tremendous amounts of money on inspections, but only required a "reasonable" inspection. This likely means more than a walkthrough, as the buyer could perform that, but it likely does not go so far as multiple expensive inspections or destructive testing.

As noted above, since we know the commonly asserted defects, performing a thorough inspection focusing on these areas and disclosing details regarding the inspections may help limit liability. While the courts give little guidance as to what constitutes a "reasonable inspection," some affirmative steps can be taken. First, a converter can hire a company to prepare a condition report based on the ASTM standard E-2018. This detailed standard does not require destructive testing unless some clear underlying/concealed deficiency seems possible and does not require individual inspections of identical items that appear in multiple areas of the property. The inspector should also find out about past repairs and improvements or be advised that this information cannot be obtained.

Converters can also turn to the California Department of Real Estate's ("DRE") policies and procedures for guidance on reasonable inspections. The DRE recommendations include having the inspection performed by a structural or qualified engineer.

Further, an argument can be made that reasonable inspections should be treated similarly to inspections required by product manufacturers or property owners. Courts have previously analogized converters to manufacturers for purposes of strict liability; thus, such a comparison for purposes of defining a reasonable inspection would not be a drastic leap. Under this rationale, what constitutes a reasonable inspection would depend on the risk involved, the knowledge of the owner, and compliance with industry standards for inspection. While the courts have not adopted this test for reasonable inspections, an inspection of this type likely would meet the Section 1134 inspection requirements.

Finally, a converter should encourage a buyer to perform its own inspection prior to purchase. The converter can then argue the buyer had equal opportunity to learn about potential defects.

### 4. Comply With All City Ordinances Pertaining To Condominium Conversion.

Many liability issues that arise are based upon a converter's allegedly violating city ordinances regulating condominium conversions. Thus, first, it is important for converters to become familiar with the ordinances in their city regulating condominium conversions and comply with those ordinances. Oftentimes, unit owners will bring negligence *per se* claims against converters who violate city ordinances in a conversion. If a converter does not violate the city ordinance the converter will not be liable under such a theory.

### 5. Liability Insurance & Risk Transfer Options.

Lastly, a converter needs to have liability insurance to cover any potential claims. While it is of course costly to obtain insurance, it is important to be prepared to defend against claims. First, it is essential to consider the coverage you may need during construction, such as a builders' risk policy to cover any potential damages during construction that may impact the improvements in progress. Additionally, converters commonly procure commercial general liability insurance which protects them against claims of bodily injury and property damage. Another option is an owner controlled insurance program ("OCIP") which provides insurance coverage for the developer/owner, general contractor, and subcontractors. Converters may want to investigate gap coverage to address any lack of insurance the original contractors may have had or the inability to locate any such information as is often the case.

If possible, obtaining an indemnity agreement from the original builder/owner is a great option. Generally, however, it is not practical. Considering risk transfer options to any subcontractors performing work, and requiring them to name the converter as an additional insured under the subcontractor's insurance is necessary. Before allowing work to commence, be sure to get copies of the insurance certificates, additional insured endorsements and, if possible, a copy of the policy to review for exclusions that may eviscerate coverage.

In conclusion, converters commonly face liability in predictable areas. Forearmed with

knowledge and preparation, they can limit the scope and extent of claims as well as prepare a defense in advance. At the end of the day, it is important for converters to work closely with their insurance brokers and lawyers to take the necessary steps to protect themselves and to limit exposure when the claims and lawsuits start coming.

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## Despite Recent Chinese Drywall Settlements, Texas Catches Whiff of the Rotten Egg Litigation and You May, Too

by Josh Bowlin

A Texas lawsuit filed in August highlights the importance of recent Chinese drywall decisions and the impact this litigation may have on an installer's right to indemnity against a foreign manufacturer.



On June 15, 2009, the Judicial Panel for Multidistrict Litigation transferred all federal actions involving Chinese drywall to the Eastern District of Louisiana for coordinated and consolidated proceedings, *In re Chinese-Manufactured Drywall Products Liability Litigation* (referred to as "MDL 2047"). Following inception of MDL 2047, thousands of cases were consolidated and the court presided over numerous monthly status conferences, hearings and bellwether trials. Over the course of the last year, two companies heavily involved with the Chinese drywall litigation in MDL 2047, Banner Supply Co. and the "Knauf Entities," entered settlement agreements. Despite these settlements, on August 12, 2012, Perry Homes, LLC filed suit in Houston, Harris County, Texas, against an installation company, the seller, and the manufacturer of the Chinese drywall (the "Knauf Entities") used during construction. See Cause No. 2012-50584, *Perry Homes, LLC, et al, v. Aurora Commercial Construction, Inc., et al*, in the 125<sup>th</sup> Judicial District Court of Harris County, Texas.

As noted by the Consumer Products Safety Commission ("CPSC"), the majority of drywall damage reports came from consumers residing in Florida, which accounted for approximately 56 percent of the total number of household complaints. See [www.cpsc.gov](http://www.cpsc.gov). By contrast, of the 3,952 reported complaints to the CPSC involving damage caused by Chinese drywall, Texas accounted for only 50 of the reported household complaints. *Id.* In light of the recent *Perry Homes* lawsuit, however, more lawsuits may be on the horizon given the timing of Hurricane Ike in 2008.

Following Hurricanes Katrina and Rita in 2005, a housing boom occurred across the Gulf Coast resulting in a shortage of drywall to handle new construction and repair of damaged homes. According to various consumer reports and legal articles, homes built and/or reconstructed between 2005 and 2008 most frequently contained the Chinese drywall. Once Chinese drywall was installed, "homeowners first noticed a rotten-egg smell, and then a pattern of failed air conditioning coils, rotten wiring and corroded metal appliances slowly came to light." Porter, Rebecca, *Attorneys Seek MDL to Scale Chinese Drywall Problem*, 45 Trial 64 (2009). Similar new construction and repair occurred following Hurricane Ike's landfall in September 2008 in Texas.

As early as December 2008, the CPSC received an incident report linking electronic malfunctions and corroded wires to Chinese drywall. [www.cpsc.gov](http://www.cpsc.gov). According to the CPSC, residents in 43 states reported certain health symptoms and corrosion of certain metal components in their homes related to problems caused from Chinese drywall. *Id.* In a span from immediately to two years following installation of the toxic drywall, affected homes would manifest some indication of corrosion from household exposure to the sulfur-compound gasses being emitted from the defective drywall. Penofsky, Daniel J., *Chinese and Domestic Toxic Drywall Liability Litigation*, 124 Am. Jur. Trials 1 at § 13 Resultant Home Property Damage (August 2012).

Corrosion was often evidenced by i) corrosion of copper pipes and wires, air conditioning and HVAC coils; ii) corrosion and failure of household electrical appliances; iii) bright flashes or sparks from around wiring switches or circuits; iv) black copper; and v) fires. *Id.*; See also Cetrulo, Lawrence G., *4 Toxic Torts Litigation Guide*, § 40: 6 (2011), citing Press Release, Chinese Drywall Complaint Center, *The Chinese Drywall Complaint Center Fears Only 1 in 40 Knauf Chinese Drywall Homes Have Been Identified in Florida*, May 7, 2010.

Some of the Chinese drywall product was manufactured by two companies wholly-owned by Knauf International, GmbH, based in Germany. See *Attorneys Seek MDL to Scale Chinese Drywall Problem, supra*. The "Knauf Entities" are German-based, international manufacturers of building products, including drywall, whose Chinese subsidiary, Knauf Plasterboard (Tianjin) Co., Ltd. ("KPT"), manufactured and sold its Chinese drywall in the United States. The largest manufacturer of the defective

drywall, Taishan Gypsum Co. Ltd. ("Taishan"), largely ignored numerous state court lawsuits and MDL 2047 class actions, allowing numerous default judgments to occur.

Consumers and builders had a difficult time making their way back up the supply chain to hold responsible parties accountable for property damage and health effects of the defective drywall until the class actions were brought in Florida, along with others in Alabama, California and Louisiana. *Id.* Of course, obtaining service on foreign corporations and enforcing a judgment is difficult, especially when one of the subsidiary companies is based in China. *Id.*

MDL 2047 resolved many of these problems by coordinating litigation efforts in one venue. In fact, it was only a year ago in August 2011 that U.S. District Judge Eldon E. Fallon preliminarily approved the Banner Settlement Agreement, a \$55 million settlement for a nationwide class of known and unknown claims. See <http://www.laed.uscourts.gov/Drywall/Knauf.settlement.prelim.app.or.pdf>; See also *Defective Chinese Drywall Driving Charities to the Wall*, 35 Construction Contacts Law Report 214 (2011). The settlement was reached with Banner Supply Co. of Miami, Florida, and its related entities who purchased, marketed and supplied over a million sheets of Chinese drywall, most of which was manufactured by Knauf Plasterboard Tianjin Co.

The Knauf Entities are named defendants in numerous cases consolidated with the MDL litigation and first entered their appearance in the MDL litigation on July 2, 2009. On January 10, 2012, the MDL court preliminarily approved another landmark settlement agreement involving the Knauf Entities. This settlement applied to all plaintiffs who filed lawsuits on or before December 9, 2011, alleging damages arising from, or otherwise related to, the Knauf Chinese drywall. See <http://www.laed.uscourts.gov/Drywall/Knauf.settlement.prelim.app.or.pdf>. According to the settlement documents, two funds, the "Remediation Fund" and "Other Loss Fund," will inure to the benefit of the class members. *Id.* The Remediation Fund is uncapped with an initial investment of \$200 million. *Id.*

Default judgments against foreign manufactures of the Chinese drywall originally appeared to have little value, particularly against Taishan, which previously refused to submit to United States jurisdiction. However, very recently, on September 4, 2012, Judge Fallon entered a decision denying Taishan's motion to vacate two default judgments in federal class actions by homeowners and homebuilders. Judge Fallon also declined to dismiss two other class actions after finding the court had personal jurisdiction over the company.

"Taishan seeks to insulate itself from personal jurisdiction by arguing that it did not know the identity of the final purchasers or users of its drywall," Fallon wrote, but "the evidence suggests otherwise." See <http://www.laed.uscourts.gov/Drywall/Orders/9-4-12.taishan.pj.pdf>. State courts may follow suit in light of Judge Fallon's opinion, the decision of Miami Circuit Judge Joseph Farina denying a motion by Taishan to vacate a 2010 default judgment. [http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters\\_Content/2012/09\\_-\\_September/taishan.pdf](http://newsandinsight.thomsonreuters.com/uploadedFiles/Reuters_Content/2012/09_-_September/taishan.pdf)

These recent decisions may give hope to innocent sellers and installers of the Chinese drywall in Texas for indemnification purposes, particularly against a foreign manufacturing company. Rather recently, the Texas Supreme Court determined that a subcontractor is a "seller" under the Texas Civil Practices and Remedies Code and that the manufacturer owes the subcontractor a statutory indemnity duty. *Fresh Coat, Inc. v. K-2, Inc.*, 318 S.W.3d 893 (Tex. 2010).

Although the Texas Products Liability Act regulates a manufacturer's indemnity obligations involving products liability claims, the Act is only as valuable to a subcontractor to the extent the court has jurisdiction. Tex. Civ. Prac. & Rem. Code § 82.001 (Lexis 2010). Under the Texas Products Liability Act, a products liability action is defined as "any action against a manufacturer or seller for recovery of damages arising out of...property damage allegedly caused by a defective product whether the action is based in strict tort liability, strict products liability, negligence, misrepresentation, breach of express or implied warranty, or any other theory or combination of theories." *Id.* at § 82.001(2).

Particularly noteworthy for purposes of the Chinese drywall litigation in Texas, the Supreme Court rejected arguments that products placed into the stream of commerce lose their status as "products" once they are integrated into real property. *Fresh Coat, Inc.*, 318 S.W.3d at 897. For those Chinese drywall installation contractors in Texas, this recent case will provide some comfort in dealing with new lawsuits involving their services. Moreover, based on Judge Fallon's and Judge Farina's decisions, foreign manufacturers are now incentivized to participate and indemnify sellers and installers of their drywall. Otherwise, should they resist jurisdiction and demands for indemnity they may find egg on their face in Texas state courts, among other jurisdictions.

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## Trying Not to Mess with Texas: Fifth Circuit Certifies Questions on Contractual Liability Exclusion

by Mark D. Shifton



On June 15, 2012, the Fifth Circuit Court of Appeals issued a groundbreaking decision in an insurance coverage case, a decision that 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 exclusion operated to exclude coverage. *Ewing Construction Company v. Amerisure Insurance Company*, 684 F.3d 512 (5th Cir. 2012). Less than two months later, however, the Fifth Circuit withdrew its opinion and certified two questions to the Texas Supreme Court. \_\_\_ F.3d \_\_\_, 2012 WL 3205557 (5th Cir., Aug. 8, 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 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, 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:

*Gilbert*, principally, stands for the proposition that a CGL policy's contractual liability exclusion excludes coverage for property damage when "the insured assumes liability for . . . property damage by means of contract. . . ." The School District's complaint in the underlying lawsuit reflects that the insured, Ewing, assumed liability for defective construction by agreeing in a contract to complete a construction project, specifically to build tennis courts. Whether the breached promise was implied or express, the promise was of a contractual nature, all the same. We therefore hold that the CGL policy's contractual liability exclusion excludes coverage in the instant case.

The Fifth Circuit further noted:

Applying this plain meaning approach preserves the longstanding principle that a CGL policy is not protection for the insured's poor performance of a contract . . . [a]lthough other jurisdictions adopt this principle by holding that poor contractual performance is not, under a CGL policy, an occurrence causing property damage, Texas chooses to arrive at this holding through its interpretation of coverage exclusions . . . Our holding today respects this choice.

An insightful and vigorous dissent followed, which 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. According to the dissent, *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, then such liability is excluded from coverage under the contractual liability exclusion. The dissent noted 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*. The dissent also noted that in many similar circumstances, coverage would be excluded by other business risk exclusions common in CGL policies, such as the "your work" exclusion.

On August 8, 2012, however, the Fifth Circuit withdrew its decision, and certified the following questions to the Supreme Court of Texas:

1. Does a general contractor that enters into a contract in which it agrees to perform its construction work in a good and workmanlike manner, without more specific provisions enlarging this obligation, "assume liability" for damages arising out of the contractor's defective work so as to trigger the Contractual Liability Exclusion.
2. If the answer to question one is "Yes" and the contractual liability exclusion is triggered, do the allegations in the underlying lawsuit alleging that the contractor violated its common law duty to perform the contract in a careful, workmanlike, and non-negligent manner fall within the exception to the contractual liability exclusion for "liability that would exist in the absence of contract."

In seeking guidance from the Supreme Court of Texas, the Fifth Circuit noted the importance of the questions presented and noted that the Texas Supreme Court's opinion would have a significant impact upon Texas insurance law:

[B]oth sides argue that their interpretation of *Gilbert* better advances the goals of Texas insurance law and is more compatible with the structure of the CGL. As their arguments reveal, this case could have a significant impact on an important area of Texas insurance law and both parties have urged us to certify these questions to the Texas Supreme Court. Where 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 contract with an owner.

It now falls upon the Texas Supreme Court 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.

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## Amendments to Washington's Construction Anti-Indemnification Statute RCW 4.24.115

by Jack Levy

On March 29, 2012, Washington Governor Christine Gregoire signed into law amendments to Washington's anti-indemnity law that will have significant repercussions to risk transfer in the construction and insurance industries.



As background, the construction anti-indemnity law, RCW 4.24.115, voids indemnity provisions requiring construction contractors and designers to defend personal injury and property damage claims caused by another party's negligence. The law does allow an indemnitee (i.e., general contractor) to obtain indemnity for concurrent negligence, but 1) only to the extent of the indemnitor's (i.e., subcontractor's) negligence and 2) only if the contract specifically and expressly provides for such.

The law also allows the general contractor to get a waiver from the subcontractor of the subcontractor's workers' compensation immunity; again, only if the contract specifically and expressly provides the waiver. These aspects of the law have not been changed.

Substitute House Bill (SHB) 1559, however, broadened RCW 4.24.115 to include the "duty to defend" (costs incurred to defend a lawsuit until it is settled or a judgment is rendered) in addition to the "duty to indemnify" (costs of the ultimate judgment obtained in a lawsuit). This revision expressly limits the subcontractor's defense obligation to what the subcontractor expressly agreed to in the contract.

Second, SHB 1559 clarified RCW 4.24.115's reference to "construction contracts." Prior to SHB 1559, what contracts qualified as construction contracts under the law was unclear. Design professionals often argued RCW 4.24.115 applied to them. With this revision, contracts for "architectural, landscape architectural, engineering and land surveying services" are now specifically included in the law.

Third, SHB 1559 expanded the application of RCW 4.24.115 to include damages arising out of the services provided in the contract in addition to damages arising out of bodily injury or property damage.

The SHB 1559 amendments eliminate some uninsurable risks created by all-encompassing, broad construction contract indemnity provisions. However, it is also a game-changer with respect to how contractors and their insurers allocate defense costs.

The amendments to RCW 2.24.115 became effective June 7, 2012, and applies prospectively only to contracts entered into after June 7, 2012.

The updated statute is quoted below:

### SUBSTITUTE HOUSE BILL 1559

"SECTION 1. RCW 4.24.115 and 2011 c 336 s 95 are each amended to read as follows:

(1) A covenant, promise, agreement, or understanding in, or in connection with or collateral to, a contract or agreement relative to the construction, alteration, repair, addition to, subtraction from, improvement to, or maintenance of, any building, highway, road, railroad, excavation, or other structure, project, development, or improvement attached to real estate, including moving and demolition in connection therewith, a contract or agreement for architectural, landscape architectural, engineering, or land surveying services, or a motor carrier transportation contract, purporting to indemnify, including the duty and cost to defend, against liability for damages arising out of such services or out of bodily injury to persons or damage to property:

(a) Caused by or resulting from the sole negligence of the indemnitee, his or her agents or employees is against public policy and is void and unenforceable;



(b) Caused by or resulting from the concurrent negligence of (i) the indemnitee or the indemnitee's agents or employees, and (ii) the indemnitor or the indemnitor's agents or employees, is valid and enforceable only to the extent of the indemnitor's negligence and only if the agreement specifically and expressly provides therefor, and may waive the indemnitor's immunity under industrial insurance, Title 51 RCW, only if the agreement specifically and expressly provides therefor and the waiver was mutually negotiated by the parties. This subsection applies to agreements entered into after June 11, 1986.

(2) As used in this section, a "motor carrier transportation contract" means a contract, agreement, or understanding covering: (a) The transportation of property for compensation or hire by the motor carrier; (b) entrance on property by the motor carrier for the purpose of loading, unloading, or transporting property for compensation or hire; or (c) a service incidental to activity described in (a) or (b) of this subsection, including, but not limited to, storage of property, moving equipment or trailers, loading or unloading, or monitoring loading or unloading. "Motor carrier transportation contract" shall not include agreements providing for the interchange, use, or possession of intermodal chassis, containers, or other intermodal equipment in ORS 30.140."

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## Ladders on the Edge...

by John Ong

Picture this... you are on the balcony of high-rise under construction, getting ready to install an exterior light fixture. Placing your portable step ladder next to the balcony railing, you step up several rungs, rising untethered above the height of the railing. The view is great, but are you OSHA compliant?



Recently, confronted with "experts" in a personal injury case who advised that simply stepping onto a portable ladder removes a worker from their obligation to comply with fall protection requirements, I sought clarification. Is any fall protection required when you use a portable ladder, even if you are exposed to a fall far greater than the height of a ladder?

### Ladders at Work

Despite their relative simplicity, portable ladders are one of the more dangerous tools workers use on their jobsites each day. Recent data from the U.S. Bureau of Labor hold that 14% of work-related fatalities were caused by falls, and fully 20% of those falls involved ladders. Clearly, preventing worksite falls from ladders is a legitimate risk management and safety goal.

### Fall Protection, Portable Ladders and OSHA

OSHA at 29 CFR 1926, Subpart M mandates that construction workers use fall protection when exposed to falls greater than 6 feet regardless of whether the exposure is created as a result of "unprotected sides and edges," "holes" or "walking/working surfaces not otherwise addressed. Subpart M further mandates and approves a variety of fall protection options intended to prevent falls, such as guardrail systems, safety net systems and personal fall arrest systems. However, Subpart M specifically states that "[r]equirements relating to fall protection for employees working on stairways and ladders are provided in Subpart X of this part."(29 CFR 1926.500 (a) (2) (vii)).

A review of Subpart X reveals fall protection requirements for certain fixed ladders, but silence regarding fall protection for workers on portable ladders. Is it then truly the case that workers are required to have fall protection anytime they are exposed to a fall of 6 feet or greater, but not while up on a portable ladder?

This question has been raised with OSHA several times over the years. The Directorate of Construction for the Department of Labor responded to such an inquiry by stating that "[n]either the ladder standard (29 CFR 1926, Subpart X) nor the fall protection standard (29 CFR 1926, Subpart M) requires fall protection for workers while working on portable ladders." (January 13, 2000, Letter of Interpretation)

When subsequently faced with a question of whether fall protection was required for construction workers using a portable ladder on top of a large piece of equipment or on the roof of a structure within a larger building, the Directorate of Construction noted that the top surface of the equipment or roof would be considered a walking/working surface. As such, the requirements of Subpart M would apply such

that "[e]ach employee on a walking/working surface (horizontal and vertical surface) with an unprotected side or edge which is 6 feet or more above a lower level shall be protected from falling by the use of guardrail systems, safety net systems, or personal fall arrest systems." The Directorate then noted that:

However, with respect to fall protection requirements for a worker on the ladder, §1926.500(a)(2)(vii) states:

Requirements relating to fall protection for employees working on stairways and ladders are provided in Subpart X....

Subpart X (29 CFR 1926.1050 et seq.) does not require fall protection for a worker on a portable ladder. Therefore, no **additional** fall protection is required while the worker is on the ladder. The fact that the ladder is on either of the surfaces you describe, rather than on the ground, does not alter this conclusion. (emphasis applied)

(May 21, 2003, Letter of Interpretation)

This interpretation was confirmed in 2007 by a later Directorate of Construction for the Department of Labor who wrote that "[t]here is no provision in Subpart X that requires fall protection for an employee while working from a portable stepladder." However, he went on to advise that "...if the employee will be on a surface prior to ascending or upon exiting the ladder for which another Subpart of 1926 requires fall protection, **then fall protection would be required** at such times." (emphasis applied) (November 28, 2007, Letter of Interpretation)

Taken together, these letters strongly suggest that the requirements of Subparts M and X should not be read in isolation. Taken further, they suggest that when evaluating whether a construction worker using a portable ladder is in compliance with OSHA, consideration must be given to the circumstances surrounding the ladder and whether the surroundings would mandate fall protection. Put another way, being on a portable ladder does not exempt one from fall protection if it would otherwise be required.

Turning to the example raised at the outset, if asked to assess the circumstances, OSHA probably would find that placing a portable step ladder in close proximity to the balcony railing such that a worker would be exposed to a fall over the railing would be a violation not only of common sense, but also of the fall protection requirements of Subpart M.

#### Conclusion

While it is true that there is no requirement for fall protection simply by virtue of being on a step ladder, it is also true that being on a step ladder does not alleviate the obligation to comply with fall protection requirements that would otherwise apply. Consideration should be given to the ladder's placement not only to avoid locations where they can be easily displaced by workplace activities, but also to the potential for a worker to fall over adjacent railings or unprotected sides and edges while using the ladder.

# # #

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