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News

FIFTH CIRCUIT COURT OF APPEALS CERTIFIES QUESTION TO TEXAS SUPREME COURT REGARDING COMMONLY USED TERMS IN COMMERCIAL GENERAL LIABILITY POLICIES

Newsbrief

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Last week, the Fifth Circuit Court of Appeals in New Orleans asked the Texas Supreme Court for help in determining if commonly used terms in commercial general liability policies are ambiguous under Texas law in U.S. Metals' suit seeking liability coverage for a \$6.3 million settlement with Exxon over allegedly defective refinery equipment.

The Fifth Circuit appeal arose from a dispute between U.S. Metals and Liberty Mutual regarding coverage of certain damages pursuant to two exclusions in a commercial general liability insurance policy. The coverage case ended up in Federal Court in Houston and was resolved in Liberty's favor by summary judgment. The insured appealed and the Fifth Circuit panel found this case involves important questions of Texas law regarding the interpretation of terms within common exclusions of commercial general liability policies, as to which there is no controlling Texas Supreme Court precedent. They determined the resolution of this case turns on two questions of Texas law, neither of which has been directly addressed by the Supreme Court of Texas: (1) whether the terms "physical injury" and "replacement" found in the common "your product" and "impaired property" exclusions are ambiguous; and (2) if not, what do these terms mean pursuant to Texas law? The panel declined to make an "Erie guess" and certified four questions to the Supreme Court of Texas.

The following questions of law were certified to the Supreme Court of Texas:

1. In the "your product" and "impaired property" exclusions, are the terms "physical injury" and/or "replacement" ambiguous?
2. If yes as to either, are the aforementioned interpretations offered by the insured reasonable and thus, must be applied pursuant to Texas law?
3. If the above question 1 is answered in the negative as to "physical injury," does "physical injury" occur to the third party's product that is irreversibly attached to the insured's product at the moment of incorporation of the insured's defective product or does "physical injury" only occur to the third party's product when there is an alteration in the color, shape, or appearance of the third party's product due to the insured's defective product

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that is irreversibly attached?

4. If the above question 1 is answered in the negative as to “replacement,” does “replacement” of the insured’s defective product irreversibly attached to a third party’s product include the removal or destruction of the third party’s product?

The panel said they could find no controlling Texas case law discussing the meaning of “replacement” within the commonly used impaired property exclusion, but noted a Texas federal court interpreted replacement to include the cost of tearing down other injured components, even if the other components were physically injured upon the installation of defective equipment.

The panel further noted a Texas appeals court said the incorporation of a defective product is not “property damage” to the defective product itself, but the panel also noted that that opinion doesn’t discuss whether damage to other integrated components would be considered property damage.

In explaining its rationale for certification, the panel found the Texas Supreme Court’s interpretation of these terms will have “far-reaching implications due to the commonality of these exclusions within CGL policies.” It further noted: “the answer to our certified questions will affect a large number of litigants. No Texas court or any other state or circuit court has determined whether the terms “physical injury” or “replacement” found within the “your property” and “impaired property” exclusions are ambiguous.”

Late last week, the Texas Supreme Court accepted the case and issued a briefing schedule to allow the parties to address the precise questions raised by the Fifth Circuit. We will keep our readers updated regarding any further developments in this important case.

[Editor’s Note: Liberty Mutual is represented in this case by Chris Martin, Levon Hovnatanian and Bruce Ramage of MDJW.]