

CASE NO. 05-50796

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

MID-CONTINENT CASUALTY COMPANY,
Plaintiff-Counter Defendant-Appellant

v.

JHP DEVELOPMENT, INC.
Defendant-Appellee

TRC CONDOMINIUMS, LTD.
Defendant-Counter Claimant-Appellee

Appeal from the United States District Court for the
Western District of Texas, San Antonio
No. SA-04-192-XR

**BRIEF OF AMICUS CURIAE TEXAS BUILDING BRANCH –
ASSOCIATED GENERAL CONTRACTORS OF AMERICA
IN SUPPORT OF APPELLEE TRC CONDOMINIUMS, LTD.**

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CERTIFICATE OF INTERESTED PERSONS

The undersigned counsel of record certifies the following listed persons or entities have an interest in the outcome of this case. These representations are made in order that Judges of this Court may evaluate possible disqualification or recusal.

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IDENTITY AND INTEREST OF AMICUS CURIAE

The Texas Building Branch of the Associated General Contractors of America (“TBB-AGC”) is a branch of the Associated General Contractors of America (“AGCA”). The AGCA is the oldest and largest of nationwide associations representing construction contractors. AGCA was formed in 1918 and it represents more than 32,000 firms in nearly 100 chapters throughout the United States. The TBB-AGC is comprised of twelve AGCA building chapters located throughout the State of Texas. The membership of these twelve chapters consists of approximately 370 general contractors and 3,890 specialty contractors, subcontractors and suppliers, all doing business in Texas.

Because of its unique perspective as an influential representative of a broad segment of the construction industry, this organization has submitted amicus curiae briefs in numerous jurisdictions across Texas. Moreover, it has a great interest in the many risks that are inherent in the construction process, and insurance has long played an important role for its members in managing those risks. Whether members of the TBB-AGC can depend on their commercial general liability (“CGL”) insurance policies to provide some reasonable degree of protection against financial harm is a matter of continuing and urgent interest to the members of this organization. Consequently, though it is not a party to this appeal, this brief

was filed by the TBB-AGC as amicus curiae through the undersigned independent counsel, who was paid a fee by the TBB-AGC for its preparation.

ISSUES PRESENTED

In its role as amicus curiae, TBB-ACG addresses the following two issues relevant to this appeal:

1. WHETHER THE DISTRICT COURT WAS CORRECT IN HOLDING THAT EXCLUSION J(5), THE OPERATIONS EXCLUSION, DOES NOT APPLY SO AS TO DENY INDEMNITY TO TRC.
2. WHETHER THE DISTRICT COURT WAS CORRECT IN HOLDING THAT EXCLUSION J(6), THE FAULTY WORKMANSHIP EXCLUSION, DOES NOT APPLY SO AS TO DENY INDEMNITY TO TRC.¹

SUMMARY OF THE ARGUMENT

The District Court correctly concluded that exclusions J(5) and J(6) did not apply to negate coverage for the default judgment obtained by TRC. Notably, contrary to Mid-Continent’s arguments, the District Court properly construed the precise words of the exclusions by giving meaning to the carefully-crafted policy language. In particular, the District Court properly limited the exclusions to “that particular part” of the property on which JHP was actively performing operations at the time that the damage occurred. Similarly, the District Court properly recognized that “if defective work is performed by or on behalf of the insured, and

¹ While TBB-ACG supports TRC with respect to the other issues before this Court, the scope and application of exclusions J(5) and J(6) are of ultimate importance to TBB-ACG.

such defective work causes damage to other work of the insured that was not defective, then there would be coverage for repair, replacement, or restoration of the work which was not defective.” *Mid-Continent Cas. Co. v. JHP Develop., Inc.*, 2005 WL 1123759 (W.D. Tex. April 21, 2005) (internal citations omitted). In contrast, Mid-Continent ignores the express language utilized in exclusions J(5) and J(6) and would instead apply those exclusions to *any* damages that occur to a project as long as it was within the insured’s contractual undertaking. Such a broad interpretation effectively vitiates coverage for insured general contractors and, at the same time, nullifies the limiting language in the exclusions. Finally, the District Court’s application of exclusions J(5) and J(6) fits the facts of the case, as the damages awarded were not for the defective work itself, but rather for the resulting water damage to other non-defective components and finishes.

ARGUMENT & AUTHORITIES

TBB-AGC acknowledges that Mid-Continent relied on defenses other than exclusions J(5) and J(6) at the District Court. In large part, however, Mid-Continent’s other defenses have been wholly rejected by the Supreme Court of Texas. For example, the precise arguments made by Mid-Continent with respect to the “property damage” and “occurrence” requirements squarely were rejected by the Supreme Court of Texas in *Lamar Homes v. Mid-Continent Casualty Company*, 242 S.W.3d 1 (Tex. 2007) (holding that allegations of defective

workmanship that result in physical injury to tangible property constitute “property damage” caused by an “occurrence.”). *See also Archon Inv., Inc. v. Great Am. Lloyds Ins. Co.*, 174 S.W.3d 334 (Tex. App.—Houston [1st Dist.] 2005, pet. denied) (same); *Gehan Homes, Ltd. v. Employers Mut. Cas. Co.*, 146 S.W.3d 833 (Tex. App.—Dallas 2004, pet. denied) (same); *Lennar Corp. v. Great Am. Ins. Co.*, 200 S.W.3d 651 (Tex. App.—Houston [14th Dist.] 2006, pet. denied) (applying same analysis to duty to indemnify). To its credit, Mid-Continent seemingly concedes this point as exclusions J(5) and J(6) are the only two policy defenses referenced in its briefing before this Court. Mid-Continent’s other argument appears to be that *State Farm Insurance Co. v. Gandy*, 925 S.W.2d 696 (Tex. 1996), somehow invalidates the default judgment that was taken in the Underlying Lawsuit. Again, although not abandoned by Mid-Continent, this argument recently has been undermined by the Supreme Court of Texas. *See Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 2008 WL 400394 (Tex. Feb. 15, 2008) (restricting *Gandy* to the facts before the Court).

Because of *Lamar Homes* and *ATOFINA*, and because the main focus of Mid-Continent’s arguments focus on the scope and application of exclusions J(5) and J(6), this brief is limited to the scope and application of exclusions J(5) and J(6). Moreover, although the facts of the Underlying Lawsuit will be utilized, the

discussion of the exclusions, as well as the ramifications of this Court's holding, will go beyond the instant set of facts.

A. The Exclusions

Exclusions J(5) and J(6) provide that a CGL policy does not apply to “property damage” to:

- (5) That particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations if the ‘property damage’ arises out of those operations; or
- (6) That particular part of any property that must be restored repaired or replaced because ‘your work’ was incorrectly performed on it.

Paragraph 6 of this exclusion does not apply to ‘property damage’ included in the ‘products-completed operations hazard.’

(TRC App. 125.) (emphasis added).² By their very wording, the exclusions contain certain limitations. The key limitation in both exclusions, and the one that Mid-Continent largely ignores and/or misconstrues, is the opening phrase that restricts the scope of the exclusions to “that particular part” of the property in question. Exclusion J(5) also requires that the insured be actively performing operations at the time of the damage, whereas exclusion J(6) requires that the damaged property must have had work incorrectly performed on it.

² References to the Record below are to “R. ____.” In addition, references to exhibits to the Record are to “TRC App. ____.”

These limitations, when read in conjunction with one another, demonstrate the intent of the drafters. Exclusions J(5) and J(6) were intended to apply to course-of-construction damages (i.e., as opposed to the separately defined “products-completed operations hazard”), but only to “that particular part” of the property that actively was being worked on at the time the damage occurred and only when the faulty work was performed on the damaged property. Stated differently, damages to otherwise non-defective work that occurs during the course of construction falls outside the scope of exclusions J(5) and J(6).

B. Exclusion J(5) – The Operations Exclusion

Exclusion J(5) eliminates coverage for “[t]hat particular part of real property on which you or any contractors or subcontractors working directly or indirectly on your behalf are performing operations, if the ‘property damage’ arises out of those operations.” (TRC App. 125.) The exclusion only applies to damages to real property that occur *while* operations are being performed. *See Lamar Homes*, 242 S.W.3d at 11 (“This exclusion applies while operations are being performed.”); *Lennar Corp.*, 200 S.W.3d at 686 (“Giving the exclusion its plain meaning, the use of the present tense indicates the exclusion applies only to ‘property damage’ arising *while* Lennar is *currently* working on a project.”); *Luxury Living, Inc. v. Mid-Continent Cas. Co.*, 2003 WL 22116202 (S.D. Tex. 2003) (noting that exclusion J(5) could not apply because the underlying plaintiff claimed damage to

the home after its closing); *CU Lloyd's of Texas v. Main Street Homes*, 79 S.W.3d 687, 695 (Tex. App.—Austin 2002, no pet.) (“Since the underlying petitions indicate that Main Street had completed construction and sold the homes to the home buyers before the alleged damage resulted, the exclusion does not preclude Lloyd’s duty to defend Main Street.”).

Further, and most importantly for the purposes herein, the exclusion negates coverage only for “that particular part” of the real property on which work is being performed by or on behalf of the insured. Accordingly, the exclusion does not apply to property on which the insured was not working. *See Scottsdale Ins. Co. v. Knox Park Constr., Inc.*, 2003 WL 22519536 (N.D. Tex. Nov. 6, 2003). Stated otherwise, despite the exclusion, coverage exists for the repair, replacement, or restoration of otherwise non-defective work that is damaged as a result of defective construction. *See Mid-United Contractors, Inc. v. Providence Lloyds Ins. Co.*, 754 S.W.2d 824, 828 (Tex. App.—Fort Worth 1988, writ denied); *Dorchester Dev. Corp. v. Safeco Ins. Co.*, 737 S.W.2d 380, 382 (Tex. App.—Dallas 1987, no writ).³ Unfortunately, however, some courts have given a broad interpretation to the “that particular part” language and have ruled that it equates to the insured’s contractual undertaking. *See, e.g., Sw. Tank & Treater Mfg. Co. v. Mid-Continent Cas. Co.*, 243 F. Supp. 2d 597, 604 (E.D. Tex. 2003). Certainly, it makes no logical sense to

³ While these cases construed language in an earlier form of the CGL policy, the logic employed by the courts applies equally to exclusion J(5), as well as exclusion J(6).

hold that an entire building or condominium complex constitutes “that particular part.” Surely, if that was the intended effect, the Insurance Services Office (“ISO”), the insurance industry organization that promulgates standard liability insurance forms, would have eliminated the “that particular part” language and simply stated that no coverage exists for “property damage” to “your work.” For example, exclusion L—which applies only to completed operations—excludes coverage for “‘Property damage’ to ‘your work’ arising out of it or any part of it and included in the ‘products-completed operations hazard.’” (TRC App. 125.) Notably absent from exclusion L is any limitation to “that particular part.”

Courts in other jurisdictions have interpreted the “that particular part” language as narrowing the scope of the exclusion. For example, the Supreme Court of Missouri addressed the issue in *Columbia Mutual Insurance Co. v. Schauf*, 967 S.W.2d 74 (Mo. 1998). In *Schauf*, the insured had been hired to paint, stain or lacquer all the interior and exterior surfaces of a home. In doing so, a fire started, causing extensive damage to the entire house. In turning to exclusion J(5), the court found that the use of “that particular part” was an obvious attempt at narrowing the scope of the exclusion as much as possible. Thus, the court stated that the subject of the insured’s work should be defined with “great specificity.” *Id.* at 80. In *Schauf*, the court found that both the insurer and the insured had

reasonable interpretations of the exclusion. Thus, as is the law in Texas, the insured's interpretation was followed. *See id.* at 81.

An interpretation that equates the “that particular part” limitation to the insured's contractual undertaking undermines the plain meaning of the limiting language and, in effect, would provide no meaningful coverage to a general contractor for property damage that occurs during the course of construction. The “that particular part” language, when properly construed, however, provides coverage to a general contractor for otherwise non-defective work that is damaged as result of the insured's operations. That is precisely the situation in the instant case. In particular, otherwise non-defective building materials and interior finishes were damaged as result of JHP's defective work. (R. 147.)

The “that particular part” language is not the only limiting language in exclusion J(5). In order for the exclusion to apply, the exclusion requires that the insured must be “performing operations” at the time that the damage occurs. Once more, Mid-Continent interprets this language to mean that the exclusion applies so long as damage occurs prior to completion and the damage is within the insured's contractual undertaking. A more reasonable interpretation, however, is that the “are performing operations” language works in conjunction with the “that particular part” language to make clear that the exclusion applies only to the portion of the work that is being performed at the time that the damage occurs. Again, any other

interpretation effectively would nullify insurance coverage for a general contractor when the “property damage” occurred during the course of construction.⁴

The District Court correctly concluded that Exclusion J(5) did not apply to the Underlying Lawsuit because: (i) the damages sought, and the ultimate judgment entered, were for otherwise non-defective building materials and interior finishes (R. 147); (ii) no evidence exists that JHP was actively performing operations on the otherwise non-defective building materials and interior finishes at the time the damages occurred (TRC App. 28); and (iii) the actual defective work, to which the exclusion would apply, related to the exterior finishes and other components of the exterior through which water penetrated (R. 147).

C. Exclusion J(6) – The Faulty Workmanship Exclusion

Exclusion J(6), the “faulty workmanship” exclusion, excludes coverage for “[t]hat particular part of any property that must be restored, repaired or replaced

⁴Texas law on insurance contract interpretation principles is well-settled. *See Balandran v. Safeco Inc. Co.*, 972 S.W.2d 738, 740 (Tex. 1998). The primary goal of contract interpretation is to “ascertain the intent of the parties as expressed in the instrument.” *Nat’l Union Fire Ins. Co. v. CBI Indus.*, 907 S.W.2d 517, 520 (Tex. 1995). Moreover, in undertaking contract interpretation analysis, a court must read all parts of the instrument together in order to give meaning to every sentence and to avoid rendering any portion inoperative. *See id.* “Under Texas law, the maxims of contract interpretation regarding insurance policies operate squarely in favor of the insured.” *Lubbock County Hosp. Dist. v. Nat’l Union Fire Ins. Co.*, 143 F.3d 239, 242 (5th Cir. 1998). Accordingly, if a contract of insurance is susceptible to more than one reasonable interpretation, the court must adopt the construction most favorable to the insured. *See State Farm Fire & Cas. Co. v. Reed*, 873 S.W.2d 698, 699 (Tex. 1993). Moreover, according to the Supreme Court of Texas, the insurance contract interpretation rules dictate that a court “must adopt the construction urged by the insured so long as that construction is not unreasonable, even if the construction urged by the insurer appears to be more reasonable or a more accurate reflection of the parties’ intent.” *Balandran*, 972 S.W.2d at 741.

because ‘your work’ was incorrectly performed on it.” (TRC App. 125.) Unlike exclusion J(5), the exclusion is not limited to “real property” and thus, in that sense, the exclusion is broader than exclusion J(5). That difference, however, is not material to the issues presented in this appeal.

The term “your work” is defined in the CGL policy as “[w]ork or operations performed by you or on your behalf; and [m]aterials, parts or equipment furnished in connection with such work or operations.” The exclusion goes on to state, however, that it “does not apply to ‘property damage’ included in the ‘products-completed operations hazard.’” The policy defines the “products-completed operations hazard” to include all property damage arising out of the insured’s work—except “work that has not been completed or abandoned.” As a result, exclusion J(6) only applies to work that has not been completed or abandoned. *See Luxury Living*, 2003 WL 22116202, at *18 (“[T]he property damage to the Wards’ home is, by definition, part of the ‘products-completed operations hazard,’ as Luxury no longer owns or rents the Wards’ residence and the work done on the house has long been completed.”); *Main Street Homes*, 79 S.W.3d at 696–97 (holding that exclusion J(6) was inapplicable because the house had been completed and sold to the claimant prior to the claimed damage).

Even if the damages occur during the course of construction, the exclusion does not apply if the defective work causes damage to otherwise non-defective

work. The reasoning is that exclusion J(6), like exclusion J(5), contains the “that particular part” limitation. For example, in *Durbrow v. Mike Check Builders, Inc.*, 442 F.Supp.2d 676 (E.D. Wis. 2006), the court held that that the exclusion did not apply to “work on *other* parts of the property that was damaged *as a result* of Check Builder’s work.” *Id.* at 681. The court’s conclusion was based on the “that particular part” limitation in the exclusion. *See id.*

Moreover, exclusion J(6) also limits the exclusion to property damage to “[t]hat particular part of any property that must be restored, repaired or replaced because ‘your work’ was *incorrectly performed on it.*” *See Ohio Cas. Ins. Co. v. Wholesale Mulch Prods., Inc.*, 2006 WL 87604 (N.D. Ill. Jan. 10, 2006). In *Wholesale Mulch*, Cargo Carriers alleged that Wholesale Mulch Products damaged its barges when it negligently operated a hydraulic backhoe used to unload road salt from two barges. *Id.* at *1. Ohio Casualty, Wholesale Mulch’s insurer, denied coverage for the claim under, among other things, exclusion J(6). *Id.* at *2. In turning to that argument, the court found that both parties raised reasonable—but conflicting—interpretations of the word “on” in that exclusion. More specifically, Ohio Casualty argued that it meant “located on,” while Wholesale Mulch believed that it meant “directed towards” or “as to.” *Id.* at *3. The court analyzed the findings in several cases, ultimately concluding that the insured’s interpretation of

the word “on” was reasonable and that doubts with respect to coverage had to be construed in favor of the insured. *Id.* at *4–*5.

The District Court correctly concluded that Exclusion J(6) did not apply to the Underlying Lawsuit because: (i) the damages sought, and the ultimate judgment entered, were for otherwise non-defective building materials and interior finishes (R. 147); and (ii) the *incorrectly performed* work was not *on* the damaged building materials and interior finishes that comprised the District Court’s Judgment, but rather had to do with the improper sealing of exterior finishes and other exterior components through which water intruded. (R. 147; TRC. App. 2).

D. The History and Evolution of Exclusions J(5) and J(6) Support their Narrow Application

Mid-Continent pays lip service in its briefing to the drafting history of the “business risk” exclusions in its policy, including exclusions J(5) and J(6). Notably, Mid-Continent fails to acknowledge the fact that history and evolution of exclusions J(5) and J(6) demonstrate a purposeful broadening of coverage for construction insureds such as JHP.⁵

The briefing submitted by TRC does a good job of setting forth the evolution of the CGL policy that ultimately culminated in the promulgation of the Broad

⁵ The evolution of the exclusions is important to the Court’s analysis. *See Lamar Homes*, 242 S.W.3d at 11–12 (discussing the evolution of the CGL policy and finding that the changes were meant to broaden, rather than narrow, coverage); *King v. Dallas Fire Ins. Co.*, 85 S.W.3d 185, 192–93 (Tex. 2002) (same).

Form Property Damage Endorsement (“BFPDE”) and the eventual adoption of the modern day language of exclusions J(5) and J(6). *See* BRIEF OF APPELLEE, at 15-21. The broadening effect of the BFPDE endorsement as to the particular part of property damage arising out of operations being performed by the insured was recognized by ISO. In its General Liability Circular GL 79-12, dated January 29, 1979, ISO stated the following as to the difference between the scope of coverage expanded by exclusion y(2)(d) and a policy not modified by a BFPDE as follows:

This paragraph is intended to precisely define the extent to which damage to property on which the insured is *actually* working is to be excluded. Under the present policy language, with respect to general contracting risks, the exclusion relating to property in the care, custody or control of the insured is intended to remove from coverage all property damage caused by an insured in many situations.

Under this care, custody or control exclusion, if the general contractor who is in charge of a project damages a portion of it, the damage is excluded even though that portion may be work being performed by a subcontractor. On the other hand, if a subcontractor damages some portion of the job beyond his own scope of operations, the damage would be covered. The intent under these endorsements is to give the same coverage to both the general and subcontractor for damage arising out of their own operations and to exclude only damage to the particular property on which the insured is working.

The exclusion [Exclusion y(2)(d) of the BFPDE] is intended to apply only to the *part* of the property on which the operations are being performed. *In this context, ‘property’ is intended to mean any unit of property which may become the subject of liability.* For

example, consider an insured subcontractor who is erecting steel beams furnished to him by the general contractor. Having erected four steel beams, the subcontractor is in the process of erecting a fifth steel beam and this beam falls, resulting in damage to all five beams. ‘That particular part’ of the property would be the fifth beam. As another example, if the insured were an electrical subcontractor and, in the process of installing a switch which was furnished to him, he damaged the switch which resulted in burning out the electrical system, the switch would be ‘that particular part’ of the property.

INSURANCE SERVICES OFFICE, INC., “BROAD FORM PROPERTY DAMAGE COVERAGE EXPLAINED,” General Liability Circular GL 79-12 (Jan. 29, 1979) (emphasis added). A copy of the circular is attached at Tab A of this brief.⁶

A subsequent ISO publication confirmed that the coverage enhancements contained in the BFPDE were continued into the 1986 revisions to the standard form upon which the Mid-Continent policy is written. The ISO publication on that topic describes the effect of the BFPDE on coverage under the 1973 policy form as follows:

Broad Form Endorsement narrows concept of care, custody or control so that coverage is provided for parts of property other than those on which the insured is actually working at the time of the damage. Endorsement also covers damage caused by faulty workmanship to

⁶ The Broad Form Circular has been relied upon by courts in determining the scope of coverage provided under a CGL policy endorsed with a BFPDE. See *Maryland Cas. Co. v. Reeder*, 270 Cal. Rptr. 719, 724–26 (Cal. Ct. App. 1990); *Fireguard Sprinkler Sys., Inc. v. Scottsdale Ins. Co.*, 864 F.2d 648, 652 (9th Cir. 1988) (applying Oregon law).

other parts of work in progress; and damage to, or caused by a subcontractor's work after the insured's operations are completed.

INSURANCE SERVICES OFFICE, INC., ISO COMMERCIAL LINES POLICY AND RATING SIMPLIFICATION PROJECT: INTRODUCTION AND OVERVIEW (April 1985). A copy of this ISO publication is attached to this brief at Tab B. Specifically with regard to the move from the 1973 forms to the 1986 forms, that publication states, “‘broad form’ coverage has been incorporated in the new provisions.” *Id.*

This evolution of J(5) and J(6), as established by the two exhibits to this brief, shows that the exclusions were meant to be narrowly applied and actually broadened coverage over what was previously available to insured general contractors. Accordingly, it supports the position taken by TRC and TBB-AGC.

CONCLUSION

TBB-AGC respectfully requests that this Court affirm the District Court's granting of TRC's motion for summary judgment and the denial of Mid-Continent's motion. In addition, TBB-AGC respectfully requests that this Court affirm the judgment in favor of TRC in all respects, including the award of interest and attorneys' fees, together with such other relief that the Court deems just and equitable under the circumstances.

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CERTIFICATE OF COMPLIANCE

Pursuant to FED. R. APP. P. 32 and 5th Cir. R. 32, the undersigned certifies this brief complies with the type-volume limitations of FED. R. APP. P. 32(a)(7).

1. Exclusive of the exempted portions in FED. R. APP. P. 32(a)(7) and 5th Cir. R. 32, the brief contains 3,223 words.

2. The brief has been prepared in proportionally spaced typeface using Microsoft Office Word 2003 in Times New Roman (TrueType) 14 point font for text and Times New Roman (TrueType) 12 point font for footnotes.

3. The undersigned understands that a material representation in completing this certificate or circumvention of the type-volume limits in FED. R. APP. P. 32(a)(7) may result in this Court striking the brief and imposing sanctions against the person signing the brief.

Lee H. Shidlofsky

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the above and forgoing Amicus Brief of Texas Building Branch – Associated General Contractors of America, and a computer readable copy of the brief on computer disk was sent certified mail, return receipt requested, on this the 29th day of April, 2008, to the following counsel of record:

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EXHIBITS

INDEX TO EXHIBITS

- Tab A: INSURANCE SERVICES OFFICE, INC., “BROAD FORM PROPERTY DAMAGE COVERAGE EXPLAINED,” General Liability Circular GL 79-12 (Jan. 29, 1979)
- Tab B: INSURANCE SERVICES OFFICE, INC., ISO COMMERCIAL LINES POLICY AND RATING SIMPLIFICATION PROJECT: INTRODUCTION AND OVERVIEW (APRIL 1985)