



Fifth Circuit's Expansive Reading of Contractual Liability Exclusion Serves as a Reminder That How Asset Purchases Are Structured Can Affect Coverage

By Alison K. Roffi

In a recent decision, the U.S. Court of Appeals for the Fifth Circuit made it harder to recover insurance proceeds on liabilities arising from purchased assets. The court reversed a U.S. District Court for the Western District of Texas ruling that an insurer was required to defend the insured in an underlying lawsuit when the insured assumed the “tort liability” of a third party through a purchase agreement. *Colony Nat. Ins. Co. v. Manitex, L.L.C.*, No. 11-50068, 2012 WL 555524 (5th Cir. Feb. 20, 2012). Applying Texas law, the Fifth Circuit concluded that the insurer was not required to defend the insured based on the unambiguous language of the insurance contract because the insured did not assume its predecessor-in-interest’s “tort liability” to trigger coverage.

Facts & Procedural History

In 1996, Powerscreen, USC, Inc. purchased a product line of cranes from a prior manufacturer, JLG Industries, Inc., and assumed JLG’s liabilities in connection with the business. In 1998, the policyholder, Manitex, L.L.C. purchased some cranes from Powerscreen. As part of the purchase, Manitex agreed to indemnify Powerscreen for any liabilities related to the cranes.

Plaintiff Colony National Insurance Company (“Colony”) issued a liability insurance policy to Manitex covering the period December 30, 2005 to December 30, 2006. During the policy period, two individuals were injured by a JLG-manufactured crane that allegedly malfunctioned. The individuals brought claims against JLG for negligence, breach of warranty and strict liability. Manitex was not named in the suit but defended JLG because it believed that its purchase agreement with Powerscreen obligated it to do so. Manitex, in turn, sought coverage from Colony.

Colony disputed coverage and sought a judicial declaration that it had no duty to defend or indemnify Manitex. On cross motions for summary judgment, the district court found that Colony owed Manitex a duty to defend but certified the ruling for interlocutory appeal to the Fifth Circuit.

Contact the Author:

Alison K. Roffi
Managing Associate, New York
(212) 506-5366
aroffi@orrick.com

Key Policy Provisions at Issue

Three policy provisions were implicated in the dispute: a coverage provision, a contractual liability exclusion, and an exception to the exclusion.

The coverage provision provided that Colony “will pay those sums that the insured becomes legally obligated to pay as damages because of ‘bodily injury’ or ‘property damage’ to which this insurance applies.” However, the contractual liability exclusion specified that coverage would not apply to “[b]odily injury’ or ‘property damage’ for which the insured is obligated to pay damages by reason of the assumption of liability in a contract or agreement.” Colony contended that this exclusion barred coverage for the liabilities Manitek had assumed by contract.

The contractual liability exclusion had two exceptions. It did not apply to liability for damages: “(1) That the insured would have in the absence of the contract or agreement; or (2) Assumed in a contract or agreement that is an ‘insured contract’...” Manitek contended that, while the exclusion purported to remove from coverage any liability that was contractually assumed by the insured, coverage was restored by the exception for “insured contracts.” Thus, the case turned on whether the liabilities contractually assumed by Manitek constituted an “insured contract.”

The policy definition of “insured contract” included: “That part of any other contract or agreement pertaining to your business ... under which you assume the tort liability of another party to pay for ‘bodily injury’ or ‘property damage’ to a third person or organization. Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.” Colony and Manitek disagreed over whether Manitek assumed JLG’s “tort liability” through the Powerscreen-Manitek Purchase Agreement, which provided that Manitek assumed “[a]ll liabilities of the Seller [Powerscreen] for claims, ... and actions in law ... brought after the Effective Time of Closing by any Person seeking recovery from personal injury.” *Colony*, 2012 WL 555524, at *3. If it did, the purchase agreement would constitute an “insured contract” and fall within the exception to the contractual liability exclusion.

The Argument & Decision

According to Colony, JLG was the only entity with “tort liability” because that was the only liability “that would be imposed by law in the absence of any contract or agreement.” *Colony*, 2012 WL 555524, at *2. Manitek’s liability was assumed by contract, not tort liability, as it could only be imposed through the Powerscreen-Manitek Purchase Agreement. Contractual liability, Colony argued, is distinguishable from tort liability, and is dispositive with respect to whether or not a contract qualifies as an “insured contract.”

The district court rejected Colony’s argument and found in favor of Manitek, finding the policy ambiguous and therefore accepting Manitek’s reasonable interpretation in accordance with Texas law. The district court found that Colony’s alternative interpretation was strained and contrary to common sense because “[a]n insurance policy that specifically covered contractually-assumed tort liability, yet removed from coverage any agreement involving more than a single contractual link, seems unlikely to have been intended by the parties.” *Colony*, 2012 WL 555524, at *3.

The Fifth Circuit disagreed, finding the policy unambiguous. According to the Fifth Circuit, Manitek assumed Powerscreen’s liability through the Powerscreen-Manitek Purchase Agreement. Powerscreen did not have “tort liability” for the claims of the two individuals, but only *contractual liability* through its purchase agreement with JLG. Because Manitek assumed a contractual liability—not a tort liability—through the Powerscreen-Manitek Purchase Agreement, the agreement did not qualify as an “insured contract” under the exception to the contractual liability exclusion.

Policyholder Implications

While the Fifth Circuit decision is unpublished and may be of limited precedential value, it is nonetheless a significant reminder of the need of policyholders to take care that they consider the impact of relevant transactional agreements when analyzing coverage rights. Giving the contractual liability exclusion a broad reading, the Fifth Circuit rejected the district court’s view that Manitek’s “perceived obligation” to defend JLG pursuant to its purchase agreement with Powerscreen was reasonable. The Fifth Circuit accorded no flexibility to the exception to the policy exclusion or the related definitions to reach what the district court had viewed as a more “common sense” interpretation of the coverage. Going forward, policyholders should take care to ensure that the language of transaction documents comports with that of their insurance policies to ensure that potential coverage rights are preserved, particularly taking into account any distinctions between “tort liability” and “contract liability” where there is a history of prior transactions.