Michigan Court of Appeals Rejects Insurer's Effort to Expand Contractual Liability Exclusion to Claims Arising Out of Insured's Performance of its Own Contract

By Matthew W. Heron / Aug 07, 2014

In Travelers Prop. Cas. Co. of America v. Peaker Services, Inc., Docket No. 315070, ___ Mich. App. ___ ; 2014 Mich. App. LEXIS 1360 (July 22, 2014), the Michigan Court of Appeals recently held that the contractual liability exclusion under a standard CGL policy cannot be used as a basis to deny coverage where the insured seeks coverage for its own potential liability, not the assumption of the liability of another, regardless of the theory of liability pursued against the insured.

In 2011 the University of Michigan had filed a breach of contract suit against Peaker Services, Inc., arising out of work performed by Peaker at the University's power plant in 2007. Peaker tendered a claim for defense and indemnity to its insurer, Travelers Property Casualty Company, which initially defended the underlying suit. Several months after the underlying suit had been filed, however, Travelers filed a declaratory judgment action seeking a determination that the contractual liability exclusion barred the claim. Travelers contended that since the University's complaint only alleged breach of contract, and since the statute of limitations had expired on any potential negligence claim, the only viable theory of liability necessarily arose out of the contract between Peaker and the University, and, therefore, fell within the contractual liability exclusion. Travelers relied on language in the exclusion which states that “[t]his insurance does not apply to . . . ‘bodily injury’ or ‘property damage’ for which the insured is obligated to pay damages by reason of the assumption of liability in a contract . . . .”

In rejecting Travelers' position, the Michigan Court of Appeals first noted that the CGL policy did not define the phrase "assumption of liability," and that no published case law in Michigan defined the phrase. However, consistent with how legal treatises had addressed the issue, numerous state and federal courts had held that the contractual liability exclusion applied to contracts involving the assumption of liability of a third party. The Michigan Court of Appeals adopted this rationale and held:

"We find these authorities persuasive and hold that "assumption of liability" in the context of a CGL policy's contractual liability exclusion refers to those contracts or agreements wherein the insured assumes the liability of another. To conclude otherwise and construe "assumption" to encompass an insured's own liability for breach of contract renders the phrase "assumption of liability" surplusage."

The Travelers decision is significant because it clarifies that in Michigan the contractual liability exclusion may only be used where the insured has assumed the liability of a third party, the interpretation customarily given to the exclusion since its inception. This interpretation of the exclusion constitutes a defeat for insurers who sought to expand the exclusion to include claims arising out of work performed directly by the insured pursuant to contract. Further, the Travelers decision recognized that even in jurisdictions where the contractual liability exclusion may be used to bar claims arising out of the insured's performance of its own contract, the insured must have agreed to take on additional legal obligations and liabilities beyond those imposed at general law for the exclusion to apply. Travelers has until September 2, 2014, to file an application for leave to appeal with the Michigan Supreme Court.

Peaker Services, Inc., was represented by Matthew W. Heron of Clark Hill PLC. Although the Court of Appeals Opinion interprets an insurance policy under Michigan law, because the issue of insurance coverage under a contractual liability exclusion is one being contested in many states, this Update is being sent to all our clients. For questions regarding contractual liability exclusions or other facets of your insurance coverage, contact Matthew Heron (313-965-8361) or any member of Clark Hill's Construction Practice Group.