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Drilling of Shallow Well Constitutes “Property Damage,” But Excluded Under CGL Policy

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On August 7, 2020, the United States District Court for the Eastern District of Texas addressed coverage under a commercial general liability policy for the insured's drilling of a shallow well. In *Kinsale Ins. Co. v. ETOPSI Oil & Gas LLC*, the underlying action involved the faulty drilling of a new injection well for the property owner, McBride, that was too shallow to reach the geological formation beneath it. The well was declared valueless. McBride filed suit alleging that ETOPSI controlled the drilling operation for the well because it designed the well, brought in the contractor for the drilling, indicated the total depth of the well, and how deep to set the casings in the well. During ETOPSI's design of the well it had a general liability policy through Kinsale Insurance Company, which denied coverage for the loss. Kinsale argued that the suit did not assert claims for “property damage,” or alternatively, the “damage to property” exclusion, exclusion j.(5), barred coverage. The term “property damage” was defined as physical injury to tangible property or loss of use of tangible property that has not been physically injured.

Kinsale filed a declaratory judgment action seeking a declaration that the insurance policy does not require coverage for the lawsuit. Both parties filed motions for summary judgment. As respects “property damage,” Kinsale argued that McBride alleged solely economic damages resulting from the shallow well and that the underlying complaint contained no factual allegations of actual damage to or loss of tangible property. Kinsale relied upon the Fifth Circuit's decision in *PPI Tech. Servs., L.P. v. Liberty Mut. Ins. Co.*, 515 F. App'x 310 (5th Cir. 2013), which held that damages resulting from an insured's drilling of a well in the wrong location failed to satisfy a nearly identical definition of “property damage.” McBride, however, argued that the well in *PPI Tech* caused only economic damages because it was a functioning, live well (albeit in the wrong location), and that the well drilled by ETOPSI was incapable of any production at all.

The District Court agreed with McBride. Unlike the well in *PPI Tech*, the court reasoned that ETOPSI's well did deprive McBride of the use of property. McBride attempted to rework the well to a deeper depth, but that proved unsuccessful. The court also noted that the underlying action alleged “physical injury to the earth caused by [ETOPSI] has prevented the use of the wellbore.” Accordingly, the District Court found that the presence of a non-functioning well on McBride's land is an injury to property and that “the valueless well constituted a physical injury to tangible property.”

Kinsale also argued that if installation of the non-functioning well was “property damage,” then various policy exclusions preclude coverage. The court focused solely on exclusion j(5) providing that the policy does not cover “‘property damage’ to... [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.” McBride argued that the exclusion did not apply because it requires “action” and his claim alleges “inaction.” In other words, the damages at issue were not based on what ETOPSI did do, but rather on what ETOPSI *did not do* (i.e., failure to drill to a correct depth), which arguably fell outside the exclusion. Further, McBride argued that the “property damage” did not occur during the insured’s “ongoing operations” so exclusion j.(5) did not apply.

Here, the District Court was not persuaded by McBride’s argument. Instead, the court relied the Fifth Circuit Court of Appeals decision in *Cook v. Admiral Ins. Co.*, 438 F. App’x 313 (5th Cir. 2011), which addressed a nearly identical argument. In *Cook*, the Fifth Circuit concluded that the “‘property damage,’ i.e., the completion of the well at an incorrect depth” arose from the negligent actions of the company that designed the well and oversaw construction when they failed to secure the appropriate amount of casing for the depth of the well. In *Kinsale*, the District Court likewise determined that there was no genuine dispute as to the alleged damage to the physical property occurring during the performance of ETOPSI’s operations. ETOPSI agreed to provide McBride with a functioning well and that it failed to do so. As respects the timing of damages, the court “focus[ed] on the factual allegations that show the origin of the damages,” which according to the underlying petition, were when ETOPSI completed the non-functioning well. Accordingly, the District Court found that exclusion j(5) (damage to real property) applied entitling Kinsale to declaratory judgment.