Fanning Harper Martinson Brandt & Kutchin

From left to right: Jennifer Kelley, George Lankford, Kathryn Vaughan

COVERAGE LITIGATION:
Jennifer Kelley
Direct Dial: 972-860-0304
jkelley@fhmbk.com
Kathryn Vaughan
Direct Dial: 972-860-0309
kvaughan@fhmbk.com

COVERAGE AND BAD FAITH LITIGATION:
George Lankford
Direct Dial: 972-860-0362
glankford@fhmbk.com

www.fhmbk.com

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FIFTH CIRCUIT FINDS EXCESS LIABILITY INSURER DOES NOT OWE INSURED-LAW FIRM A DUTY TO INDEMNIFY FOR DAMAGES AWARDED IN ARBITRATION FOR WRONGFUL WITHHOLDING OF FEES AND EXPENSES UNDER CLIENT FEE AGREEMENTS

In *John M. O'Quinn, P.C. v. Lexington Ins. Co.*, No. 16-20224, 2018 WL 5075485 (5th Cir. Oct. 18, 2018), the United States Court of Appeals for the Fifth Circuit affirmed a federal district court's finding that an insured law firm was not entitled to recover $10 million under its excess liability insurance after settling a legal malpractice claim against the firm. The insured law firm, John M. O'Quinn, P.C. represented many plaintiffs in litigation against breast implant manufacturers and obtained substantial awards for those clients through various settlements. Some of the plaintiffs disputed with O'Quinn whether some litigation expenses were properly deducted by O'Quinn from the settlement amounts paid to each plaintiff. An arbitration demand was filed by a certified class of plaintiffs against O'Quinn, which settled the professional liability claims for $46.5 million. O'Quinn sought to recover $15 million of the settlement amount from its primary and excess professional liability insurance carriers. O'Quinn's primary insurer paid its full primary policy limit of $5 million, but the excess carrier, Lexington, denied there was coverage under the excess policy for its $10 million policy limits.

The coverage provided under the Lexington excess policy followed the form of the primary policy, meaning the excess policy obligated Lexington to indemnify O'Quinn only for a "loss" arising from "any actual or alleged Wrongful Act" when that act was committed by any person or entity "in the rendering or failing to render Professional Legal Services". The dispute between Lexington and O'Quinn centered around the policy's definitions of "Loss" and

"Wrongful Act". Loss was defined under the policy as "damages, judgments, settlements, and Defense Costs" but not to include "fines, penalties, sanctions, taxes, punitive or exemplary damages . . . reimbursement of legal fees, costs, or expenses, any amount for which the Insured is not financially liable . . . or matters which may be deemed uninsurable under the law". The policy defines "Wrongful Act" to include "an act, error, or omission, including but not limited to breach of contract or duty (including but not limited to Fiduciary duty)."

The arbitration panel found that O'Quinn's fee agreements "do not allow for the deduction of BI General Expenses and that certain of the BI General Expenses charged to Plaintiffs were inappropriate." Reviewing the policy's definition of "loss" and "wrongful act" in light of the arbitration panel's findings, the Fifth Circuit noted that although the arbitration panel found O'Quinn breached its contract with its clients, and breach of contract was a wrongful act, the district court nevertheless concluded that O'Quinn's breach of contract was not covered under the policy.

As noted, the Lexington excess policy's definition of loss did not include "reimbursement of legal fees" which the arbitration panel awarded to the plaintiffs in an amount of $2.5 million and pre-judgment interest of nearly $4 million. As such, the Fifth Circuit held that O'Quinn was not entitled to reimbursement from Lexington for costs its client were not financially liable. Likewise, the Fifth Circuit agreed with the district court's finding that there was no coverage under the excess policy for the arbitration panel's award of damages for breach of fiduciary duty because "loss" as defined in the policy does not include "fines, penalties, [or] sanctions". As such, the Fifth Circuit affirmed the federal district court's finding that Lexington did not owe its insured a duty to indemnify O'Quinn for $10 million O'Quinn agreed to pay as settlement for its wrongful withholding of expenses from awards O'Quinn obtained for its clients.

NORTHERN DISTRICT OF TEXAS GRANTS SUMMARY JUDGMENT ON INSURED'S BREACH OF CONTRACT AND EXTRA-CONTRACTUAL CLAIMS AGAINST PROPERTY INSURER BECAUSE INSURED COULD DID NOT PRODUCE ANY EVIDENCE OF ACTUAL DAMAGES

In *Univ. Baptist Church of Fort Worth v. Lexington Ins. Co.*, No. 4:17-CV-962-A, 2018 WL 4938567 (N.D. Tex. Oct. 11, 2018, mem. op.), the United States District Court for the Northern District of Texas granted Lexington Insurance Company's motion for summary judgment with respect to the insured's, University Baptist Church of Fort Worth's, breach of contract and extra-contractual claims arising out of hail and windstorm damage to the tile roof of the church. Lexington issued the church a property insurance policy which included a $250,000 "Code upgrade" and "law and ordinance" sublimit that was applicable to the loss in question.

The church retained an independent adjuster to determine the required repairs, including in relevant part, a proposal for Ludowici tiles of the same type that were on the church building when the roof was damaged. Instead, however, Verea tile was used in the re-roofing of the church building which the church claimed was a breach of Lexington's duty under the policy to

pay "the cost to repair, replace and rebuild the property with material of like kind and quality". Notably, the parties did not dispute "that Lexington paid [the church] the policy limit of $250,000 for the code upgrade work, and that, except for the Verea vs. Ludowici issue, Lexington complied with all of its policy obligations." The total cost to repair and upgrade the roof to code exceeded the policy sublimit by approximately $600,000.

The church filed a lawsuit against Lexington alleging that Lexington breached its obligations under the policy to repair the roof with materials of a like kind and quality and that the Verea tile that was used was inferior to the Ludowici tiles that were previously on the roof of the church building. The church also claimed Lexington breached the duty of good faith and fair dealing, and brought claims under chapters 541 and 542 of the Texas Insurance Code. Specifically, the church claimed that Lexington failed to attempt in good faith to effectuate a prompt, fair, and equitable settlement, failed to promptly provide a reasonable explanation of the basis for Lexington's denial of its claim, and for refusing to pay the church's claim without conducting a reasonable investigation of the church's claim. Lexington moved for summary judgment with respect to the contractual and extra-contractual claims. The district court granted Lexington's motion finding that there was no breach of the policy and the church's extra-contractual claims all failed as a matter of law.

As summary judgment evidence, affidavits of the roofing contractor and the independent adjuster were submitted. The roofing contractor stated that the Verea tiles were inferior to the Ludowici product that was included in the original proposal, but that the independent adjuster would not approve the use of Ludowici tiles. Instead, the roofing contractor had to propose Verea, an inferior tile product, to bring the project to a price the independent adjuster would approve. On his part, the independent adjuster claimed that a repair with Ludowici tiles of like kind and quality would involve removing and relaying tiles on the damaged portion of the roof using matching tile from salvage yards. Thus, the adjuster claimed that the church in fact received a repair that was better than a like kind and quality repair because the church received a replacement roof with entirely new clay tiles.

Resolving summary judgment, the court held that the independent adjuster's affidavit established that the church had suffered no damages by the use of new Verea tiles instead of salvaged Ludowici tiles. The "absence of evidence of damages is, standing alone, fatal to Church's breach of contract claim". Therefore, the court granted summary judgment with respect to the breach of contract claim. As to the church's extra-contractual claims, the court first addressed the church's claim that Lexington failed to deal fairly or act in good faith with respect to the claim. The court noted that the church styled, but did not actually allege facts supporting a claim for breach of the duty of good faith and fair dealing. Although an insurer owes a duty to act in good faith and deal fairly, "there is no duty beyond the contract itself" and therefore, "absent a breach of the policy contract, there is no violation of the insurer's duty to act in good faith and deal fairly with the insured".

Turning to the church's claims of insurance code violations, the district court found no evidence to support any of the insurance code claims because the church's "insurance policy

required Lexington to pay [the church] after costs had been incurred by [the church], and Lexington did just that. There were no need for a settlement because the Lexington timely paid Church the full amount it was entitled to under the policy—$250,000." In addition, Lexington did not fail to provide a reasonable explanation for denial because "Lexington was not required to inform Church of its policy limit as an explanation for why it was not paying more than $250,000 for the code upgrade work. . . . the policy itself disclosed that limit." Finally, the court noted that the church did not produce "any evidence that it suffered actual damages" and there "can be no recovery for extra-contractual damages for mishandling claims unless the insured establishes that it suffered damages by reason of the mishandling." For these reasons, the court granted Lexington's motion for summary judgment holding that Lexington satisfied all of its policy obligations.

WESTERN DISTRICT OF TEXAS GRANTS MOTION TO COMPEL PRODUCTION OF INVESTIGATION CLAIM FILE IN LAWSUIT INVOLVING A SEPARATE CLAIM

In *Crossland v. Nationwide Mutual Insurance Co*. No. EP-18-CV-00085-DCG, 2018 WL 4905354 (W.D. Tex. [El Paso Division], Oct. 09, 2018, mem. op.), the United States District Court for the Western District of Texas granted an insured's motion to compel Nationwide Mutual Insurance Company to produce, via discovery, claim and investigation files for roof damage to nearby properties unrelated to the claim and lawsuit at issue. Nationwide denied plaintiff Gary Crossland's claim for property damage on a building Crossland owned. Crossland filed suit against Nationwide alleging Nationwide breached the policy and breached its duty of good faith and fair dealing. During the course of discovery, Crossland sought from Nationwide, documents from Nationwide's internal claim investigation file regarding a separate building owned by Crossland. According to Crossland, Nationwide's internal documents were relevant to his claims for breach of contract and breach of the duty of good faith and fair dealing because Nationwide paid the property damage claim on the separate building Crossland owned, while denying the claim on the property damage at issue in the lawsuit. Nationwide objected to Crossland's demand for these documents on the grounds that the claim investigation file for the separate building was not relevant and would not lead to the discovery of admissible evidence.

Nationwide cited two cases in support of its argument that the claim file was irrelevant. The district court rejected Nationwide's argument because the circumstances in the cited cases were "quite different" from those in the lawsuit. Rather,

> the discovery sought is to a building where the factual circumstances are remarkably similar to the building at issue . . . . The separate building was damaged in the same storm, is located within two miles of the building at issue in the instant case, is also owned by Plaintiff, and also suffered roof damage . . . by comparing the files, it would provide Plaintiff with an understanding of why the roof damage on the two buildings resulted in different claim outcomes. Plaintiff is not on a fishing expedition and is not asking for overbroad discovery. Instead, his request is narrowly tailored and reasonable.

Based on the similarity between Crossland's two claims, the district court concluded that the information was discoverable and ordered Nationwide to produce its separate claim file.

SOUTHERN DISTRICT OF TEXAS GRANTS INSURANCE CARRIER'S MOTION TO ABATE INSURED'S CLAIMS (INCLUDING EXTRA-CONTRACTUAL CLAIMS) BASED ON APPRAISAL PROVISION IN HOMEOWNER'S INSURANCE POLICY

In *Debesingh v. Geovera Specialty Ins. Co.*, No. 4:18-CV-02316, 2018 WL 4810629, at *1 (S.D. Tex. Oct. 4, 2018), the United States District Court for the Southern District of Texas considered GeoVera Specialty Insurance Company's Plea in Abatement requesting that the district court abate the policyholder's breach of contract and Texas Insurance Code claims against it based on the appraisal provision in the homeowner's insurance policy.

The policyholder purchased a homeowner's insurance policy from GeoVera to cover specified risks with respect to her home in La Porte, Texas. The "CONDITIONS" section of the homeowner's policy includes an appraisal provision which states that:

> If you and we fail to agree on the amount of loss, either may demand an appraisal of the loss. . . .
>
> If there is an appraisal:
>
> a. You and we agree that any suit for or involving a disagreement in the amount of loss claimed under this policy shall be abated on the demand for appraisal by either you or us until after an appraisal award is issued in accord with this Condition . . . .

The policyholder sued GeoVera in Texas state court alleging that GeoVera had underpaid an insurance claim the policyholder made for damage to her residence from Hurricane Harvey. The policyholder also alleged that GeoVera's adjuster performed a substandard investigation, failed to report all observed damage, undervalued the damage he did report, and that GeoVera conducted an unreasonable investigation.

GeoVera removed the state court lawsuit to federal court. Based on the "plain language of the appraisal provision", the district court concluded "that the case should be abated pending completion of the appraisal process described in the Policy." The appraisal provision allows either party to demand an appraisal if the parties fail to agree to an amount of loss. Upon such demand, "any suit for or involving a disagreement in the amount of loss claimed under this policy shall be abated." The district court noted these conditions were satisfied when "GeoVera demanded appraisal following Plaintiff['s] filing of suit." In addition, Plaintiff's lawsuit expressly "'involv[es] a disagreement in the amount of loss,' as alleged in her breach of contract claim based on undervaluation of the damage to her residence."

The policyholder also argued that even if the breach of contract claims must be abated pursuant to the appraisal provision, her non-contractual claims brought under the Texas Insurance Code and the Texas DTPA should not be abated, arguing the extra-contractual claims are "independent from her breach of contract claim and thus will not be affected by the outcome of appraisal." The court refused the policyholder's argument, instead "enforc[ing] the unambiguous Policy 'as written'" and, accordingly, "abate[d] the lawsuit 'until after an appraisal award is issued in accord with' the Policy."

EASTERN DISTRICT OF TEXAS FINDS "CONTRACT EXCLUSION" PRECLUDES INSURER'S DUTY TO DEFEND.

In *Conifer Health Solutions, LLC, et al, V. QBE Specialty Ins. Co.*, No. 4:17-CV-00664, 2018 WL 4620613 (E.D. Tex. Sept. 26, 2018), the United States District Court for the Eastern District of Texas considered a coverage dispute regarding QBE Specialty Insurance Company's duty to defend its insured, Conifer. Conifer provides health management services to hospitals. Reid Hospital outsourced its revenue cycle management to Dell Marketing, LP pursuant to a Master Agreement for Revenue Cycle Outsourcing. The Master Agreement was assumed by Conifer, conferring on Conifer all duties and obligations under the agreement, including responsibility for Reid Hospital's revenue cycle.

In 2017, Reid Hospital sued Conifer in federal district court alleging Conifer was responsible for "prequalifying patients, case management services, coding, medical records, timely billing for Reid's services, timely responding to requests for additional information from third party payors (i.e. insurers, Medicaid and Medicare), timely appealing and pursuing denials, and ultimately collecting all sums due Reid for its services". Instead, however, Conifer allegedly "chose to understaff its personnel at Reid, causing $35,606,730 in damages to Reid" as a result of Conifer's attempt to cut costs due to inability to turn a profit on the Reid Project. To that end, Reid Hospital asserted claims for breach of contract, breach of warranty, willful misconduct, and fraud.

QBE issued a surplus lines commercial policy to Conifer, written on a manuscript form, which included a "Contract" exclusion which provided that no coverage was available under the policy for "any liability in connection with any contract, agreement, warranty or guarantee to which an Insured is a party, provided that this Exclusion B shall not apply to Loss to the extent that such Insured would have been liable for such Loss in the absence of such contract, agreement, warranty or guarantee".

QBE argued it had no duty to defend Conifer with respect to the lawsuit because it arose out of a contract, namely, the Master Agreement between Reid Hospital and Dell Marketing that was assumed by Conifer. Conifer argued contrary, noting that the exclusion specifically excludes coverage for "liability in connection with any contract . . . <u>to which an Insured is a party</u>", pointing out that the lawsuit did not "allege that Conifer was a party and, instead, describe Conifer to have assumed the agreement's full duties and obligations through an assignment or

transfer. Conifer contends that an 'assignee' or 'transferee' is legally distinct from a party and the Court must narrowly construe the Contract Exclusion in its favor." QBE countered that there is no meaningful difference between someone who assumes all the duties and obligations under a contract and a "party" to the contract.

The district court agreed with QBE, finding that the "Contract Exclusion" did preclude coverage with respect to the allegations in the lawsuit. Conifer's argument was, essentially, "that one who assumes all duties and obligations under of a contract is not a party to the contract." Nevertheless, the court noted a "fundamental Texas contract law principle that 'an assignee generally stands in the shoes of his assignor.'" Conifer did not argue that Dell, the assignor, was not a party to the contract before assignment. Indeed, the lawsuit alleged that Conifer assumed all duties and obligations under the Master Agreement. Thus, the court concluded that "Conifer was undoubtedly a party under its ordinary meaning and under the Policy's Contract Exclusion."

Conifer also argued that the lawsuit included allegations of wrongful acts that were independent of the Master Agreement, specifically the allegations of gross negligence, unjust enrichment through undervaluation of fees, and simple negligence because of inadequate training and incompetence. Conifer argued that because there were some covered allegations, QBE was obligated to defend Conifer against all allegations in the lawsuit. The court, however, followed well established Texas law focusing its inquiry not on the manner in which claims are styled, or on whether allegations sound in tort versus contract, and instead looked at the origin of plaintiff's damages. The court concluded, therefore, that all allegations are necessarily "based in connection with the Master Agreement" and were, therefore, included within the scope of the Contract exclusion.

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