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# APRIL 2019 TEXAS INSURANCE LAW UPDATE

## Showdown between two Texas federal courts on the scope of the Breach of Contract Exclusion anticipated.

Because it appears that two different Texas federal courts have reached opposite conclusions regarding the scope of a CGL Policy's Breach of Contract exclusion, we can anticipate an appeal to the Fifth Circuit asking that court to settle the matter.

The subject Breach of Contract Exclusion applies to preclude coverage for damages because of bodily injury or property damage that arises "directly or indirectly" from breach of an express or implied contract. Last year, in *Slay Engineering*,[1] the federal court for the Western District of Texas held that the "directly or indirectly" and "arising out of" language in the breach of contract exclusion required the insurer to demonstrate that the insured's breach of contract was a "but for" (though not necessarily proximate) cause of the alleged property damage. The court further said that the fact that all claims contained in the underlying suit have some relation to the insured's contract with the plaintiff or that the insured has been sued for breach of contract are not alone enough to trigger the Breach of Contract Exclusion.

The underlying petition in *Slay Engineering* alleged negligence and breach of contract against the general contractor, Slay//Huser. The insurer (Mt. Hawley) argued that "but for the contract, there would

[1] *Mt. Hawley Ins. Co. v. Slay Engineering, Tex. Multi-Chem, Texas Multi-Chem, and Huser Construction Company, Inc.*, 335 F.Supp.3d 874 (W.D. Tex. Aug. 15, 2018).

be no cause of action to bring against [the insured]." The Western District found that the problem with the insurer's comparison is that it conflated the insured's causation of "property damage" with the insured's ultimate contractual liability for economic losses. The court found that merely because the insured may ultimately be liable for certain of the plaintiff's economic losses under a breach of contract theory does not necessarily mean that all of the alleged property damage was causally attributable to the insured's alleged breach of its contract with the plaintiff. Applying this standard, the court agreed with the insurer that the insured's breach of contract itself may have been one "but for" cause of the underlying property damage, however, that alone was not enough to negate the insurer's duty to defend. The court held that for the insurer's duty to be erased, it would have to also be true that the facts alleged in the underlying suit demonstrate that there are no other independent, covered (non-excluded) "but for" causes of the alleged property damage.

The Western District court recited the proposition that "[w]hen two separate events−one that is excluded and one that is covered by the general liability policy−may independently have caused the accident, Texas law mandates that the general liability policy also provide coverage despite the exclusion" and based on that proposition held that, because the plaintiff's petition specifically asserted that "work performed by [the insured], *its subcontractors and suppliers*, was [ ] defective" the face of the petition "clearly alleges that entities other than [Huser] were responsible for the allegedly defective work and the resulting damage, either in whole or in part." Thus, because the allegations "[left] open the possibility that the property damage *may* have occurred 'even in the absence of' a breach of contract or implied duty by Huser," the court found Mt. Hawley had a duty to defend.

In *Slay Engineering*, the insurer argued that the subcontractor exception to the Your Work Exclusion was "irrelevant" because it had been overridden by the endorsement containing the Breach of Contract Exclusion and that Huser's subcontractors' alleged failures were also subsumed by the Breach of Contract Exclusion because their work was incidentally related to Huser's work and breach of contract. The court stated it was obligated to read endorsements and policy provisions together and attempt to give meaning to all component parts of the agreement, and in doing so, held that:

> … a natural reading of the Breach of Contract Exclusion is that "it pertains to [the insured's] liability for repairing its own deficient work or to specific contractual obligations that [the insured] has assumed." *See Aguilar*, 2008 WL 11342656, at *3. On the other hand, it is not natural to interpret the Breach of Contract Exclusion such that it encompasses all work incidentally related to the Project regardless of the party that performed the work or the capacity in which it did so. Indeed, doing so in this case would both (i) *unnecessarily* render the subcontractor exception to the Your Work Exclusion without meaning, and (ii) mean that the Court has *impermissibly* resolved any potential ambiguity related to the scope of the exclusions in favor of the *insurer*, rather than the *insured*.

On that reasoning, the court "declines to adopt the sweeping interpretation asserted by Mt. Hawley, and instead finds that the Policies should be interpreted such that the subcontractor exception to the Your Work Exclusion still has meaning."

Just last month, in a declaratory judgment action involving some of the parties and counsel in the *Slay Engineering* case, *Mt. Hawley Insurance Company v. Huser Construction, Inc.* ("*Huser*"),[2] the

[2] No. H-18-0787, 2019 WL 1255756 (S.D. Tex., Mar. 19, 2019).

Southern District of Texas addressed the very same issues of whether the insurer (Mt. Hawley) owed a duty to defend in a construction defect lawsuit where the CGL and excess policies included a breach of contract exclusion which barred coverage for liability arising from breach of express or implied contract, as well as the "your work" exclusion, which barred coverage for property damage arising from the insured's work. The policy contained the same exception to the "your work" exclusion which preserved coverage in the event liability arose from the insured's subcontractors' work as in the *Slay Engineering* case. Huser, as general contractor, contracted with Eagle Heights Pleasanton, LLC ("EHP") to build an apartment complex. Huser also hired subcontractors including Schaffer to design and install an HVAC system. Huser completed the work, after which EHP allegedly found multiple deficiencies in the workmanship and materials used by Huser. EHP filed an action against Huser and Schaffer alleging breach of contract and negligence against Huser, as well as allegations of defective work against Schaffer. The court granted *judgment to Mt. Hawley*, finding it had *no duty to defend* Huser in the underlying action.

The *Huser* court found that EHP clearly alleged breach of contract against Huser and alleged Huser was a "but for" cause of the property damage since Huser allegedly failed to hire and supervise qualified subcontractors whose work caused the property damage (negligent supervision). The Southern District rejected Huser's argument that the policies' "your work" exclusion preserved coverage by the exception for work involving subcontractors. The court noted that even if the "your work" exclusion does not apply due to work of subcontractors, the exception only modified the "your work" exclusion; it did not apply to other exclusions, such as breach of contract exclusion. The court ruled that EHP's claims against Huser were excluded due to the breach of contract exclusion in the policies and that Mt. Hawley had no duty to defend Huser. Since Huser's alleged liability arose directly or indirectly out of the alleged breach of contract, the same facts that negated Mt. Hawley's duty to defend also negated its duty to indemnify.

Huser has now filed a Motion to Alter or Amend the Judgment, which is currently pending. With polar opposite results reached in the Western District and the Southern District on the exclusion, one can anticipate an appeal if Huser is not successful on its Motion.

## Texas Court of Appeals Affirms Take Nothing Judgment in Favor of Insurer Because the One Satisfaction Rule Limited the Insured's Award to Significantly Less than the Insurer's Offer of Settlement.

In *Salinas v. State Farm Lloyds*, No. 13-18-00129-CV, 2019 WL 1561998 (Tex. App. – Corpus Christi 2019), the Plaintiffs/Appellants Israel and Hilda Salinas ("Salinases") sued Defendant/Appellee State Farm Lloyds ("State Farm") for breach of their insurance contract. Judgment was entered in favor of the Salinases. After an ex parte hearing at which the Salinases were not present, the trial court issued a modified final judgment that reduced the Salinases' award to zero. In their sole issue on appeal, the Salinases argued that the trial court erred by issuing a modified final judgment after holding an ex parte hearing.

In April of 2012, the Salinases' house was hit by a hailstorm. In June of 2014, the Salinases filed suit against State Farm, alleging multiple causes of action, including breach of contract and unconscionable conduct. The Salinases asserted that State Farm took advantage of their lack of

knowledge in construction and insurance claims processes, misrepresented losses covered under the policy, and failed to promptly and reasonably investigate and pay the amount covered under the policy. On September 16, 2014, State Farm offered the Salinases a settlement of $25,900 pursuant to TEX. CIV. PRAC. & REM. CODE ANN. § 42.002 and TEX. R. CIV. P. 167.1. State Farm's settlement offer expired without a response from the Salinases.

The case proceeded to jury trial wherein the jury returned a verdict in favor of the Salinases. The jury found that State Farm breached the insurance contract it had with the Salinases and awarded the Salinases $10,500 for the breach of contract. The jury also found that State Farm had engaged in unconscionable conduct under the Texas DTPA and awarded the Salinases $10,500 for the unconscionable conduct. The final judgment ordered that the Salinases be awarded $10,500 for State Farm's breach of contract, $9,066.82 for prejudgment interest, $10,500 for necessary and reasonable attorney's fees, and $8,097.05 for "costs of court," for a total of $38,163.87. State Farm then filed a motion to modify the final judgment, arguing that application of Rule 167.4 required the court to enter a take-nothing judgment for the Salinases. According to State Farm, its settlement offer "triggered an offset that exceeds [the Salinases'] monetary recovery at trial" because the final amount that the Salinases were awarded was less than eighty percent of what State Farm originally offered to the Salinases as a settlement. The Salinases never filed a response to State Farm's motion to modify.

After the trial court heard the motion to modify without the Salinases' counsel or the Salinases present, the trial court signed a modified final judgment which reduced the Salinases' award to zero. The trial court's reasoning for the modification was as follows:

> The "total damages" found by the jury on Plaintiffs' breach of contract claim total $10,500. The monetary damages awarded for Plaintiffs' claim that State Farm engaged in unconscionable conduct are for the same amount ($10,500). As these identical amounts are damages for the same injury, pursuant to the one-satisfaction rule, Plaintiffs may recover damages under either of the legal theories under which damages are sought, but not under both. Thus, the amount of actual damages recoverable pursuant to the jury's verdict is $10,500. Because attorney's fees are allowable under Plaintiffs' breach of contract theory, the Court finds that Plaintiffs should recover under this theory rather than the "unconscionable conduct" theory. The applicable Policy deductible for Plaintiff's claims was $1,566.00, which reduces Plaintiffs' recoverable damages under breach of contract to $8,934.00. Plaintiffs' attorney's fees incurred prior to the October 4, 2014 expiration of Defendant's settlement offer were $3,150.00
> . . .
> Pursuant to Insurance Code Chapter 542, interest at a rate of 18% per annum would be payable on the amount due Plaintiffs under their breach of contract claim. Plaintiffs contend that such interest should be calculated from September 19, 2012. Interest from that date until October 4, 2014 totals $3,285.45 (745 days at $4.41/day).
>
> The amount of the judgment in Plaintiff's favor as of October 4, 2017 is therefore $15,354.45 ($8,934.00 in in [sic] recoverable damages, $3,135 [sic] in attorney's fees, and $3,285.45 in interest). This is an amount significantly less than 80 percent of State Farm's Offer of Settlement. Plaintiff's monetary damages are therefore significantly less favorable than State Farm's Offer of Settlement pursuant to Texas Rule of Civil Procedure 167.4, and State Farm is entitled to an award of its litigation costs as a setoff to

> the jury's verdict. Pursuant to Rule 167.4(f), Plaintiffs are not able to recover attorney's fees after the date the Offer of Settlement was rejected. State Farm has shown litigation costs ... totaling $31,254.35, which completely offsets the monetary damages awarded to the Plaintiffs. Accordingly, Plaintiffs take nothing against State Farm.

The Salinases then filed a motion to vacate the modified order. However, they did not challenge the trial court's application of the one-satisfaction rule or calculation of the monetary damages; rather, the Salinases only argued that the modified final judgment should be vacated because it was granted as a result of an ex parte hearing. The trial court never ruled on the Salinases' motion to vacate and it was overruled as a matter of law. The appeal followed.

The Corpus Christi court of appeals found that the trial court held an improper ex parte hearing and that such conduct constituted error; however, it determined that such error was not harmful. The court held that the trial court properly applied the one-satisfaction rule (that if the plaintiff has suffered only one injury, even if based on overlapping and varied theories of liability, the plaintiff may recover only once) and that under Rule 167, when the amount of the judgment is significantly less favorable to the offeree than the rejected offer (less than 80 percent of the offer), the trial court must award litigation costs to the offeror. (TEX. R. CIV. P. 167.4.) Applying these rules, the court concluded that:

> Applying the one-satisfaction rule would allow the Salinases to recover for breach of contract or unconscionable conduct but not both; recovering for both breach of contract and unconscionable conduct in this case would be allowing a double recovery, which is exactly what the one-satisfaction rule is designed to prevent. The Salinases can recover for breach of contract because that also allows the Salinases to recover the greatest amount in that they can also recover attorney's fees. The Salinases' actual damages, taking the $10,500 for breach of contract and adding pre-judgment interest and attorney's fees incurred before the expiration of the settlement offer, total less than eighty percent of what State Farm offered in its original settlement, meaning State Farm would be entitled to offset the Salinases' award of damages with State Farm's litigation costs—$31,254.35. Therefore, the Salinases have not demonstrated how the ex parte hearing actually harmed them because they have not shown that the trial court's analysis was incorrect in any manner. (citations omitted)

Because the Salinases failed to show that their presence at the hearing would have made any difference in the trial court's application of the one-satisfaction rule, they failed to demonstrate that the ex parte hearing led to an improper judgment that harmed them.

**Federal Magistrate Recommends Denial of Motion to Remand Where Insured's Allegations and Pre-Suit Demand Letter Show the Amount in Controversy Met the Federal Minimum for Diversity Jurisdiction.**

In *Horton v. Allstate Vehicle and Property Ins. Co*., No. 5-19-CV-00140-FB-RBF, 2019 WL 1552494 (W.D. Tex. Apr. 9, 2019), a federal magistrate recommended that the Plaintiff insured's motion to remand to matter back to state court be denied. At issue was whether Allstate had carried its burden to

show that the amount in controversy exceeded $75,000 for federal jurisdiction. Finding there was no meaningful dispute as to the complete diversity of the parties, the magistrate determined Allstate met the amount-in-controversy requirement.

The Plaintiff had submitted a property-damage claim to her insurance company, Allstate, for damage to her home's composition shingle roof, roofing components, fascia and storage shed. Allstate denied the claim. Plaintiff then sent Allstate a demand letter claiming a total of $28,384.28 in damages: (1) $18,554.34 to repair her dwelling ($19,764.34 less her $1,210 deductible); (2) $4,629.94 in interest pursuant to the Texas Prompt Payment Act; and (3) $1,200 in attorney's fees incurred as of that date. The demand only related to Horton's causes of action under the Texas Insurance Code; it did not include any damages related to Horton's potential Texas Deceptive Trade Practices Act ("DTPA") claims, which could permit the recovery of treble damages. The letter advised Allstate that the settlement offer of $28,384.28 "represents a tremendous savings to Allstate given [its] potential exposure under the Texas Insurance Code," as juries have allegedly awarded close to $100,000 to well-over $1 million when faced with claims involving similar causes of action.

No settlement was reached, and thereafter, Plaintiff sued Allstate. Plaintiff's Original Petition raised the following claims: (1) breach of contract; (2) breach of the common law duty of good faith and fair dealing; (3) unfair settlement practices in violation of Section 541.151 of the Texas Insurance Code; (4) violation of the Texas Prompt Payment Act, Tex. Ins. Code § 542.058; (5) various violations of the DTPA, Tex. Bus. & Com. Code § 17.41-63; and (6) fraud. Plaintiff sought in relief: (1) actual damages, including loss of the benefits that allegedly should have been paid under the policy and damages for mental anguish; (2) attorneys' fees; (3) treble damages under the DTPA; (4) 18 percent interest pursuant to the Texas Prompt Payment Act, Tex. Ins. Code § 542.060; and (5) costs. The magistrate found that the allegations in Plaintiff's Original Petition sufficiently alleged the $75,000 jurisdictional threshold had been met. The magistrate also considered the Plaintiff's pre-suit demand letter, which was attached to Allstate's Notice of Removal. Because Plaintiff refused to stipulate to less than $75,000 in damages, the magistrate held that remand should be denied.

## Federal Court in Dallas Determines Expert Testimony Sufficiently Provided a Basis Upon which Jury Could Apportion Covered vs. Non-Covered Damages.

In a recent case from the Northern District of Texas involving a coverage dispute concerning hail damage under a commercial property policy, *2223 Lombardy Warehouse, LLC v. Mount Vernon Fire Insurance Company*, No. 3:17-CV-2795-D, 2019 WL 1583558 (N.D. Tex. Apr. 12, 2019), the district court determined that the insureds had produced sufficient evidence to defeat the insurer's motion for summary judgment by producing expert testimony that at least a portion of the roof was most likely damaged by hail and that the damage to the roof was functional. The insured argued that the insureds did not meet their burden of segregating harm resulting from concurrent causes. The court stated that although an insured who suffers damage from both covered and excluded perils is not precluded from recovering, "[w]hen covered and excluded perils combine to cause an injury, the insured must present some evidence affording the jury a reasonable basis on which to allocate the damage." "Because an insured can only recover for covered events, the burden of segregating the damage attributable solely to the covered event is a coverage issue for which the insured carries the burden of proof." The court further stated "[i]t is essential that the insured produce evidence which will afford a reasonable basis for

estimating the amount of damage or the proportionate part of damage caused by a risk covered by the insurance policy." The insurer argued that the testimony of the Plaintiffs' expert (Dr. Hall) indicated that Plaintiffs' roof was damaged by both covered and non-covered causes of loss. Dr. Hall had testified that some of the degranulation of the roof was caused by ordinary wear and tear rather than by a hail storm. The court agreed that this was evidence of concurrent causes, which triggered Plaintiffs' burden to provide evidence by which a jury might reasonably apportion the resulting harm. The court found that the Plaintiffs met this burden, stating that the Plaintiffs were not obligated to present "overwhelming evidence that would allow a jury to flawlessly segregate covered...from non-covered" damages, or to provide "precise percentages" and that although Dr. Hall himself made no attempt to segregate wear-and-tear damage from hail damage, he "provided a reasonable basis on which a jury could do so."

The court's opinion also addressed other issues including (1) determining the court had subject matter jurisdiction (concluding that the defendant independent insurance adjuster was improperly joined because there was no possibility that the insured could recover from him), (2) that the insurer was not prejudiced by the insured's 11-month delay in providing notice of the claim, and (3) that plaintiff's extra-contractual claims did not fail due to plaintiffs' failure to produce evidence of extra-contractual damages because there was a genuine issue of material fact existed as to whether the hail damage to plaintiffs' roof was covered by the insurance policy (an issue central to the breach of contract claim).

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