Martin, Disiere, Jefferson & Wisdom

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TEXAS INSURANCE LAW NEWSBRIEF

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FEDERAL JUDGE ENFORCES CONTRACTUAL LIABILITY EXCLUSION, FINDS NO DUTY TO DEFEND

A federal district judge in Sherman recently construed an unusually broad contractual liability exclusion and concluded an insurer had no duty to defend a breach of contract suit against its insured. In *Conifer Health Solutions, LLC, et al, V. QBE Specialty Ins. Co.*, 4:17-CV-00664, 2018 WL 4620613 (E.D. Tex. Sept. 26, 2018), Conifer contracted with a hospital to manage its entire revenue cycle. The hospital sued Conifer, alleging Conifer had badly bungled numerous aspects of the contracted work, causing damages of over $35 million. The hospital asserted causes of action including breach of contract, breach of express warranty, unjust enrichment, and gross negligence/willful and wanton conduct.

The Policy contained a broad Contract exclusion which excluded coverage for:

"…any liability in connection with any contract, agreement, warranty or guarantee to which an Insured is a party, provided 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."

Conifer argued the exclusion did not apply because the live pleading did not allege Conifer was a party to the contract, but instead alleged Conifer had assumed responsibility for the contract by way of an assignment or transfer, and an assignee or transferee is distinct from a party to a contract. The court disagreed, noting that a fundamental principle of Texas law holds that an assignee stands in the shoes of its assignor.

Conifer also argued the suit alleged wrongful acts that were independent of the contract, thus requiring QBE to defend the entire suit. However, focusing its inquiry on the alleged facts and not the asserted legal theories of recovery, the court concluded all of the allegations were in fact connected to Conifer's performance of the contract, regardless of the fact that some causes of action more properly sounding in tort were alleged. The court observed that without the contract in place, Conifer could not be held liable for failing to meet contractual performance standards which it had no obligation to meet.

Editor's Note: The contract exclusion in this policy was unusually broad and quite different from the language commonly found in ISO policy forms, which typically refer to the assumption of liability in a contract, rather than merely the performance of a contract. Thus, the court did not discuss *Ewing Const. Co., Inc. v. Amerisure Ins. Co.*, 420 S.W.3d 30 (Tex. 2014) and the limitations it placed on the more common Contractual Liability exclusion.

SAN ANTONIO COURT HOLDS DISPUTES ON OVERHEAD & PROFIT AND TAX ARE APPRAISABLE, ORDERS SUITS ABATED

In a pair of nearly identical sister cases, the San Antonio court of appeals granted mandamus, ordering the trial court to send two first-party commercial property cases to appraisal and also ordering the suits abated pending the outcome of the appraisal process. *In re Acceptance Indem. Ins. Co.*, No. 04-18-00232-CV, --- S.W.3d ---, 2018 WL 4608261 (Sep. 26, 2018) and *In re Acceptance Indem. Ins. Co.*, No. 04-18-00232-CV, --- S.W.3d ---, 2018 WL 4610902 (Sep. 26, 2018) were two wind/hail lawsuits brought by owners of several apartment complexes against Acceptance. In both cases, the insureds alleged that the loss estimates prepared by Acceptance failed to include overhead, profit, and sales tax. The insureds signed proofs of loss for the undisputed actual repair costs, but reserved the right to continue seeking the overhead, profit, and sales tax. In response to pre-suit demand letters from the insureds, Acceptance invoked appraisal. The insureds contended appraisal was not appropriate and sued Acceptance. Acceptance moved to compel appraisal and abate both lawsuits, which the trial court denied.

On mandamus, the court of appeals considered several arguments lodged by the insureds in an effort to escape appraisal. First, the insureds argued that Acceptance had waived the right to appraise by undue delay. Applying the standard enunciated by the Supreme Court of Texas in *In re Universal Underwriters*, 345 S.W.3d 404 (Tex. 2011), the court sought to determine when the parties reached an impasse, whether an unreasonable time had elapsed after impasse, and whether the insureds had been prejudiced by the delay. Observing that an impasse requires more than mere disagreement, but a mutual understanding that neither party will negotiate further, the court found no evidence that impasse had been reached at all, let alone that an unreasonable delay after impasse had occurred. The court held that a pre-suit demand letter cannot be evidence of impasse because its inherent purpose is to encourage settlement, which implies further negotiation.

The insureds also argued that the dispute regarding overhead, profit, and tax is not subject to appraisal because it is not a value dispute on the amount of loss, but a legal dispute over whether they are owed at all. But Acceptance agreed that some amount was due, and the question was how much, thus bringing it squarely within the "amount of loss," which is precisely what the appraisal clause covers.

Then the insureds argued that Acceptance had breached the policy by not paying overhead, profit, and tax, and because of that breach, they no longer had any duty to comply with any art of the policy. The court disagreed because the only reason it had not yet been paid was the dispute over the amount, which Acceptance had invoked appraisal to resolve.

Finally, the insureds argued the appraisal clause lacks mutuality and is illusory because the carrier expressly retains the right to deny the claim, and therefore any award the carrier does not like will simply result in a denial. Again, the court disagreed, pointing out that both sides can invoke the appraisal clause, and both sides retain the right to dispute coverage after an appraisal award is issued – the carrier by denying the claim, and the insured by filing suit.

Editor's Note: While the court's ruling upholding the insurer's right to appraisal is consistent with a well-established body of law enforcing the appraisal clause in most circumstances, the court went further and also ordered the trial court to abate the suits pending the outcome of the appraisal process. This ruling is quite surprising in light of ample Texas precedent holding that abatement is not necessary during appraisal and is at the trial court's discretion. In *In re Universal Underwriters*, the Supreme Court of Texas expressly stated, "…the trial court's failure to grant the motion to abate is not subject to mandamus, and the proceedings need not be abated while the appraisal goes forward."