

## Texas Supreme Court Issues Opinions Regarding Insurance, Fighting A Texas Forum, Landowner Liability, Professional Liability, Fiduciary Litigation, Exemplary Damages, Security Agreements, and Products Liability

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**I. Insurance Law: Court Decides Cases Consistent With Two Trends: (1) Court Interprets Policy By Plain Language Used In Policy, And (2) Court Rejects Equitable Theories That Alter Duties And Rights Under Policy.**

**A. In Workers' Compensation Dispute, The Sixty-Day Deadline For Challenging Compensability Does Not Apply When It Is An Extent Of Injury Dispute.**

In *Zenith Insurance Co. v. Ayala*, a window fell on an employee who injured her lower back. No. 09 0292, 2010 Tex. LEXIS 418 (Tex. June 11, 2010). She was originally diagnosed with a back strain, and on March 1st, Zenith received notice of her injury and commenced paying benefits. On April 13th, the employee's original diagnosis was revised to include several other lumbar syndromes. On April 27th, Zenith pre-authorized treatment of an epidural steroid injection, which was performed. On July 28th, Zenith notified the employee that it disputed her entitlement to benefits for the lumbar syndromes because the syndromes were degenerative and not the result of her injury at work. The Texas Department of Insurance, Division of Workers' Compensation, held a contested case hearing. The officer concluded that, although the employee failed to prove the work accident was a producing cause of the lumbar syndromes, they were compensable because Zenith failed to dispute compensability within sixty days from receiving notice of the employee's initial injury. The Division Appeals Panel affirmed, and Zenith sought judicial review. On competing motions for summary judgment, the trial court held that Zenith waived its right to contest compensability by not timely disputing the lumbar condition diagnosis in accordance with Texas Labor Code Section 409.021. The court of appeals affirmed.

The Texas Supreme Court held that the sixty-day deadline in Section 409.021(c) applied only to compensability disputes and not disputes over the extent of an injury. Instead, when a carrier disputes the extent of an injury, "it has up to forty-five days from the date it receives a complete medical bill to dispute whether that treatment was necessary." *Id.* The Court noted that Zenith agreed that the employee's initial injury, a back sprain, was compensable. Zenith then disputed only the subsequently added diagnosis – the syndromes. Because the dispute was about the extent of injury, the sixty-day deadline did not apply, and Zenith should have had up to forty-five days after it received a complete medical bill to dispute whether the treatment for the lumbar syndromes was necessary.

The Court also concluded that the carrier's pre-authorization of the injection did not make the carrier liable for the syndromes:

Instead, pre-authorization merely precludes a carrier from later disputing the medical necessity of the treatment. A carrier, upon receipt of the bill for pre-authorized treatment, may still argue that the condition treated is not related to the compensable injury. Thus, Zenith's pre-authorization does not preclude Zenith from disputing extent of injury in this case.

*Id.* The Court reversed in favor of the insurer.

**B. Under Homeowner's Policy, Insurer Had Duty To Insure Mold Damage To Personal Property But Not To The Dwelling.**

In *State Farm Lloyds v. Page*, the Texas Supreme Court decided whether Texas Standard Homeowner's Policy Form B afforded coverage for mold contamination to real and personal property resulting from plumbing leaks. No. 08 0799, 2010 Tex. LEXIS 415 (Tex. June 11, 2010). The insured discovered mold and water damage to her home and some of her personal property. She filed a claim with her insurer pursuant to her homeowner's policy. The insurer retained a specialist to test for environmental quality, and that test revealed a variety of different molds growing in the home. The insurer provided the insured with roughly \$26,000 to pay for remediation and repair of the structure, personal property remediation, and three months of living expenses while the work was being performed. Later, the insured sought additional funds to repair damage to carpet, but the insurer refused to pay.

The insured filed suit against the insurer alleging breach of contract, breach of the duty of good faith and fair dealing, fraudulent misrepresentation, and DTPA and Insurance Code violations regarding to the insurer's decision to not fully remediate and repair the home and its contents.

The insurer filed a motion for summary judgment, which the trial court initially denied. After the Texas Supreme Court issued *Fiess v. State Farm Lloyds*, 202 S.W.3d 744 (Tex. 2006), the trial court reconsidered and granted the insurer's motion. The court of appeals reversed, holding that the insured's policy covered mold damage to the dwelling and its contents.

The Texas Supreme Court first stated the general rules for insurance contract construction:

Our primary goal is to determine the contracting parties' intent through the policy's written language. We must read all parts of the contract together, giving effect to each word, clause, and sentence, and avoid making any provision within the policy inoperative. Our analysis of the policy is confined within the four corners of the policy itself. Whether a particular provision or the interaction among multiple provisions creates an ambiguity is a question of law. The fact that the parties may disagree about the policy's meaning does not create an ambiguity. Only if the policy is subject to two or more reasonable interpretations may it be considered ambiguous.

*Id.*

The policy provided separate coverages for dwellings and for their contents. For dwelling coverage, it stated that the insurer would insure against all risks of physical loss to the property unless the loss was excluded in the Section I Exclusions. Mold was listed in the exclusions.

Regarding the personal -property coverage, it stated that the insurer protected against physical loss to the property caused by a specified peril unless the loss was excluded in Section I Exclusions. But it also stated that it would cover losses resulting from a plumbing, heating or air-conditioning leak or the overflow of water or steam. It further stated that exclusions, which included mold, did not apply to a loss caused by this peril.

As the Texas Supreme Court described:

Under Coverage A, the dwelling is insured against all risks except those excluded in Section I Exclusions. Under Coverage B, on the other hand, personal property is only insured against twelve enumerated perils, plumbing leaks being one. As with Coverage A, Coverage B is limited by the exclusions listed in Section I Exclusions. Those exclusions state that the following exclusions apply to the loss of property described under Coverage A or Coverage B, we do not cover loss caused by...rust, rot, mold or other fungi.

*Id.* The Court then described *Fiess and Balandran v. Safeco Insurance Company*, 972 S. W.2d 738 (Tex.1998).

Ultimately, the Court concluded that the insurer was not obligated to pay for losses incurred with regard to mold damage to the dwelling, but was obligated to pay for losses due to mold damage to personal property. The Court held that the exclusion repeal provision only applied to personal property coverage and not to the dwelling coverage. The Court stated that to construe the repeal provision to reinstate mold coverage for the insured's dwelling would wholly ignore the structure of the policy. But the Court also held that to ignore the repeal provision's impact as to the personal property coverage would be to outright ignore it altogether.

Regarding the insured's extra-contractual claims, the Court held that they could not exist to the extent they relied on the insurer's failure to pay for mold damage to the dwelling. However, to the extent they relied on the insurer's failure to pay for mold damage to personal property, they could survive. Therefore, the Court reversed the court of appeals's decision regarding coverage of mold damage to the dwelling, but affirmed the court of appeals's decision as to the mold damage to personal property and remanded for further proceedings.

### **C. Contractual Liability Exclusion In CGL Policy Applied To Bar Excess Insurer's Duty To Indemnity For Settlement.**

In *Gilbert Texas Construction, LP v. Underwriters at Lloyd's of London*, during a Dallas Area Rapid Transit Authority ("DART") construction project, unusually heavy rains resulted in water damage to a building adjacent to the construction site. No. 09 0246, 2010 Tex. LEXIS 407 (Tex. June 4, 2010). The owner of the building sued DART and its contractors, alleging that construction activities caused the water damage. The building owner sued the general contractor in tort and for breach of contract as a third

party beneficiary. In the breach of contract claim, the owner alleged that the contractor assumed liability for the damage under its contract with DART. Except for the breach of contract claim, the trial court granted summary judgment for the contractor due to governmental immunity. The contractor later settled the breach of contract claim and sought indemnity from its insurers. The excess insurer denied coverage.

The contractor sued its excess insurer for breach of contract and Texas Insurance Code violations, urging that the excess insurer waived its right and was estopped to deny coverage. After both parties moved for summary judgment, the trial court granted the insured's motion as to coverage and granted the excess insurer's motion as to the insured's statutory, waiver, and estoppel claims. Both parties appealed.

The court of appeals reversed and rendered judgment for the excess insurer, holding that the breach of contract claim fell within the contractual liability exclusion. The court of appeals also held that the excess insurer had not waived its policy defenses and was not estopped from raising the defense of non coverage because the excess insurer had not assumed the insured's defense.

The Texas Supreme Court affirmed. The primary issue was whether the contractual liability exclusion in a CGL policy excluded coverage for property damage when the only basis for liability was that the insured contractually agreed to be responsible for the damage, and if so, whether an exception to the exclusion operated to restore coverage.

The CGL policy provided that the insurer would "pay those sums that the insured becomes legally obligated to pay as damages because of bodily injury or property damage to which this insurance applies...the bodily injury or property damage must be caused by an occurrence." *Id.* Exclusion 2(b) provided that coverage does not extend 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 or agreement. This exclusion did not apply to liability for damages either: (1) assumed in a contract or agreement that is an "insured contract," or (2) that the insured would have in the absence of the contract or agreement. The Court defined the term "insured contract" to include seven types of agreements including:

that part of any other contract or agreement pertaining to your business under which you assume the tort liability of another to pay damages because of bodily injury or property damage to a third-person organization, if the contract or agreement is made prior to the bodily injury or property damage.

*Id.* Tort liability means a liability that would be imposed by law in the absence of any contract or agreement.

The excess insurer argued that the exclusion precluded coverage because when the insured settled, the trial court had already granted summary judgment on all of the statutory and tort claims, and the only remaining basis for liability was breach of the

DART contract. The insured contended that the contractual liability exclusion applied more narrowly and should only apply in the limited situation in which the insured had assumed the liability of another such as in hold harmless and indemnity agreements.

The insured contended that in order to give meaning to the word "assumption" in the exclusion, the liability assumed must be that of another. In other words, "[the insured] would have us read the exclusion to say 'property damage' for which the insured is obligated to pay damages by reason of the assumption of another's liability in a contract or agreement." *Id.* The excess insurer countered that the Court should not judicially rewrite the exclusion by inserting the word "another's" into it. The Court agreed with the excess insurer.

In so holding, the Court acknowledged that it disagreed with other jurisdictions, including the federal Fifth Circuit. The Court also held that its holding did not conflict with its previous decision in *Lamar Homes*, where it held that a breach of contract can constitute an occurrence that causes property damage thus bringing some breach of contract claims within the general grant of coverage for purposes of determining a duty to defend. The Court noted that the contractual liability exclusion was not an issue in *Lamar Homes*, where the Court concluded whether property damage to a house that resulted from construction defects could come within the general terms of liability coverage because the damage resulted from an occurrence as defined by the CGL policy. Whether a claim triggers an insurer's duty to defend and whether a claim is eventually covered or excluded for purposes of indemnity are different questions. The Court noted that *Lamar Homes* does not address the duty to indemnify, but rather the separate duty to defend.

An insurer's duty to defend is determined under the eight corners doctrine, but the duty to indemnify is determined by the facts in the underlying suit. In this case, the facts demonstrated that the insured settled a breach of contract claim after the trial court granted judgment in the insured's favor on all other theories of liability, and the insured did not contend that the trial court erred in granting summary judgment. Thus, the Court held that the insured's liability fell within the policy's contractual exclusion for purposes of determining the excess insurer's duty to indemnify.

The insured also argued that the second exception to the policy exclusion applied. As modified by the second exception, the exclusion precludes an insurer's liability for indemnity if the insured is obligated to pay only because it contractually assumed liability. If the insured's liability arises from an otherwise covered basis in addition to its contractually assumed liability, the second exception brings the claim back into coverage. The Court noted that because the tort claims were properly dismissed, the only viable claim underlying the insured's settlement was for breach of contract, and that the insured asserted no other basis for its settlement other than the breach of contract claim. Thus, the insured's settlement payment for which it sought indemnity simply was not a liability for damages it had apart from its contract with DART, and the second exception did not apply.

Finally, the Court determined that the excess insurer did not assume control over the defense of the lawsuit and therefore was not estopped to deny coverage. The Court stated the rule that:

if an insurer defends its insured when no coverage for the risk exists, the insurer's policy is not expanded to cover the risk simply because the insurer assumes control of the lawsuit defense. But, if the insurer's actions prejudice the insured, the lack of coverage does not preclude the insured from asserting an estoppel theory to recover for any damages it sustains because of the insurer's actions.

*Id.* The insured argued that the excess insurer assumed control of the defense by urging the insured's counsel to move for summary judgment on the basis of governmental immunity even though the excess insurer intended to deny coverage on the basis of the contractual liability exclusion if the tort claims were dismissed due to the governmental immunity defense. Furthermore, the excess insurer had taken the position that the case should not have been mediated until the trial court ruled on the summary judgment motion. The insured's attorney testified that he was pressured by the excess insurer to move for summary judgment on governmental immunity issue and he believed that if he did not do so that the excess insurer would have invoked the cooperation clause to deny coverage.

The Court held that this evidence was not sufficient to meet the level of assuming control over the defense. The excess insurer had a contractual right to associate with the insured and with the primary insurer in defending the underlying claim, and the excess insurer also had the right to stand on the cooperation clause in its policy. The insured was represented by counsel independent from the excess insurer. The Court held that estoppel did not apply and affirmed the court of appeals's holding in favor of the excess insurer.

**D. Trial Court Lacked Discretion To Cut Health Insurer Out Of Settlement Of Estate's Claim Due To The Made-Whole Doctrine Where There Was An Express Subrogation Clause.**

In *Texas Health Insured Risk Pool v. Sigmundik*, a plaintiff was injured in an oil-field explosion and spent fifty-two days in the hospital before succumbing to his extensive injuries. No. 09-0772, 2010 Tex. LEXIS 405 (Tex. May 28, 2010). His insurer paid over \$300,000 in medical expenses resulting from the accident. After his death, the insured's wife filed a negligence action on behalf of herself, her two minor sons, and the insured's estate against the alleged culpable party. The insurer intervened, arguing it had a subrogated right to the estate's recovery based on an express subrogation provision in the health insurance policy. Later the suit settled for \$800,000, but the settlement agreement did not specify how the funds would be allocated. The trial court held a bench trial on allocation of the settlement and awarded the entire \$800,000.00 to the family, finding they had not been made whole by the settlement. The court of appeals affirmed.

The Texas Supreme Court noted that shortly before the court of appeals issued its decision affirming the trial court, the Supreme Court had issued *Fortis Benefits v. Cantu*, 234 S.W.3d 642 (Tex. 2007) that held that the made-whole doctrine did not apply where the parties' contract provided a clear and specific right of subrogation. The Court held that the made-whole doctrine was inapplicable in this case where there was an express subrogation provision. The Court noted that "the rub is, however, that a contractual lien against recovery means nothing if there is no recovery by the insured – that is, if the estate receives no part of the settlement." *Id.* Thus, if the settling parties are the three family members and the estate, any amount allocated to the estate would not go to his wife and children but would go to the insurer, as subrogee. The trial court avoided the insurer's subrogation rights by directing all of the settlement funds to the family and none to the estate. The Court held that it was improper to cut the insurer out of the settlement to which it, through the estate, has a valid claim, just as it would be in error to cut out any other estate creditor or recipient in this situation. The Court held that the trial court could not cut the estate completely out of the settlement just because the estate's main beneficiary is an insurance company or, more to the point, because the trial court believed the surviving family needed the money more than the insurer. "This is especially true where beneficiaries and representatives are trying to remove others with an interest in the estate, notwithstanding fiduciary and other obligations owed by those asserting control of the estate." *Id.* The Court concluded, "While the trial court was free to exercise some discretion in directing the settlement funds, it abused its discretion by awarding the insurer nothing." *Id.* The Court remanded to the trial court for determination of what portion of the settlement funds should be allocated to the estate.

#### **E. An Erroneous Order Of Dismissal With Prejudice Was Sufficient To Establish A Res Judicata Defense By Insurer In Second Suit.**

In *Travelers Insurance Company v. Joachim*, the Texas Supreme Court decided whether a trial court's erroneous dismissal of a suit with prejudice, following the plaintiff's filing of a non-suit, operated to bar a later suit because of res judicata. No. 08 0941, 2010 Tex. LEXIS 380 (Tex. May 14, 2010). An insured sued his insurer for damages caused by an automobile accident with an uninsured driver. Later the insured filed a notice of non-suit and asked that the case be dismissed without prejudice. Several months later, the trial court sent notice that if a draft of the final order was not filed within ten days, the court would dismiss the case with prejudice for want of prosecution. When the court did not receive an order, it dismissed the case with prejudice. The insured later filed the same case against his insurer in a different court. The insurer filed a motion for summary judgment based on res judicata due to the first court's judgment with prejudice.

The second trial court granted the insurer's motion and ordered that the insured take nothing. On appeal, the court of appeals reversed, holding that the first court's order was void and not merely voidable, and could not support a defense of res judicata.

The Texas Supreme Court disagreed. It noted that it had previously held that a dismissal with prejudice for want of prosecution, though mistaken, was merely voidable and must be attacked directly to prevent the order from becoming final for the purposes of establishing *res judicata*. The Court further held that when such an order happens to follow a non-suit, it does not make it void. The Court held that the trial court's order of dismissal with prejudice, though erroneous, was not void, but was voidable. Therefore, the Court held that the insured should have either challenged that order directly in the first case, or challenged it later by a bill of review if the insured never received notice of the order. The Court then held that the trial court's voidable order of dismissal was sufficient to establish the insurer's *res judicata* defense.

## **II. Security Agreements: Ex-Husband Did Not Breach Security Agreement By Converting The Collateral, Stock In Company, Into Limited Partnership Shares.**

In *Grohman v. Kahlig*, a wife sued her ex-husband for various torts and breach of a security agreement that was entered into pursuant to their divorce settlement when the husband changed the security, which was stock in two corporations, into limited partnership units. No. 09 0093, 2010 Tex. LEXIS 474 (Tex. July 2, 2010). The husband filed a counterclaim seeking declaratory relief that his acts did not constitute a breach of the security agreement. The trial court submitted a breach of contract claim to the jury but did not submit any of the tort claims, finding that there was no evidence to support them. The jury found that the husband did not breach the agreement, and the trial court entered a take-nothing judgment. The court of appeals affirmed the trial court's judgment as to tort claims, but held that the husband breached the security agreement as a matter of law. Both parties appealed to the Texas Supreme Court.

The Texas Supreme Court first addressed whether the husband's conversion of his stock into limited partnership shares constituted a breach of the security agreement. The Court stated:

Contract language should be interpreted by a court as a matter of law if it can be given a certain or definite meaning. If the contract is ambiguous, the parties' intent is a question of fact for the jury. Whether a party has breached a contract is a question of law for the court, not a question of fact for the jury, when the facts of the parties' conduct are undisputed or conclusively established.

*Id.* The agreement provided that collateral could not be transferred, disposed of, or destroyed, but it defined "collateral" as shares of stock "and all replacements, additions and substitutions therefor now owned or hereafter acquired by the husband, plus all cash and non-cash proceeds and all proceeds of proceeds arising from those shares." *Id.* Thus, as defined, the collateral encompassed the shares of stock and any representation of interest in the companies that could replace or substitute the shares so long as the husband continued to own them.

The Court noted that when the conversion occurred the shares of stock were inevitably cancelled, but first they were replaced with units of a limited partnership that represented the same interest in the businesses. The husband remained the sole owner of his business interest throughout the business conversions, and at no point in the conversions was his interest in the business entities destroyed. The collateral may have changed form but it was not destroyed.

The wife also contended that the husband breached the agreement because the plan of reorganization involved movement of interest in the companies between the husband and holding companies. The Court rejected this argument: "Despite the fact that the business interest technically moved between Kahlig and his holding companies, Kahlig retained ownership of his entire interest in the companies throughout the conversion. Thus, the collateral was not transferred, and Grohman's security interest was not impaired." *Id.* The Court concluded by stating that the security agreement gave Kahlig "all rights and all responsibilities in respect to the collateral...not inconsistent with the security agreement" and stated that the most reasonable interpretation of the security agreement was that it did not prohibit Kahlig from converting the business entities. Therefore, the Court found that the husband did not breach the security agreement as a matter of law and the trial court's judgment was correct.

Regarding the dismissal of the wife's tort claims, the Court affirmed the trial court's judgment. It held there was no evidence to support the wife's fraud claim. The Court also held that the wife's negligence claim was barred because the husband breached no tort duty separate from the security agreement and the wife's action for breach of the agreement was in contract alone. The Court then remanded to the court of appeals for a decision as to the propriety of the trial court's award of declaratory relief and attorney's fees for the husband.

### **III. Fighting The Forum: Court Enforces Arbitration Agreement And Motions To Dismiss For Forum Non Conveniens And For Forum-Selection Clause.**

#### **A. Arbitration Agreement In Employment Setting Is Enforceable.**

In *In re Odyssey Healthcare, Inc.*, an employee was injured when she tripped over an uneven step at a patient's home and sued her employer and supervisor for negligence. No. 09-0786, 2010 Tex. LEXIS 357 (Tex. May 7, 2010). The employer filed a motion to compel arbitration based on provisions in the employee's agreement stating: "All claims or disputes that cannot otherwise be resolved between the company and you are subject to final and binding arbitration," and "the arbitrator selected by the parties shall be selected from a panel of arbitrators located in Dallas County, Texas." *Id.* The agreement also stated:

The company reserved the right to amend, modify and terminate the plan at any time; provided, however, that no such amendment or termination will alter the arbitration for provisions incorporated into this booklet with respect to, or reduce the amount of any benefit payable to or with respect

to you under the Plan in connection with, an injury occurring prior to the date of such amendment or termination. In addition, any such amendment or termination of the arbitration provisions incorporated into this booklet shall not be effective until at least fourteen days after written notice has been provided to you.

*Id.* After a hearing, the trial court denied the employer's motion to compel arbitration finding that the provision forcing the employee to arbitrate in Dallas was unconscionable.

The Texas Supreme Court stated that a party seeking to avoid arbitration bears the burden of proving its defenses against enforcing an otherwise valid arbitration provision after the party seeking to arbitrate has proved the existence of a valid arbitration agreement between the parties. The employee asserted several grounds why the arbitration clause was invalid: substantive unconscionability, the non-waiver provision of the Texas Workers' Compensation Act, Tenth Amendment violation, and lack of consideration. The Court first turned to the substantive unconscionability defense. "Substantive unconscionability refers to whether the arbitration provision ensures preservation of the substantive rights and remedies of a litigant." *Id.* The employee argued that the arbitration clause was unconscionable because it forced her to arbitrate in Dallas, which would cause substantial expense by having to produce witnesses in Dallas. When a party contests arbitration due to substantial expense, that party bears the burden of proving the likelihood of incurring the expense and must provide some specific information concerning those future costs. The Court noted that the record did not show any specific information or evidence about what costs the employee would likely incur and that the employee's conclusory assertions about costs were "legally insufficient." *Id.* The court also noted that nothing in the agreement required arbitration to occur in Dallas; rather, it only required that the arbitrator must be selected from a panel of arbitrators from Dallas.

The Court next turned to the non-waiver provision of the Texas Workers' Compensation Act, which provides that an employer and employee may not agree to waive an employee's cause of action for personal injuries or debt sustained by the employee in the course and scope of employment. The Court held that that provision does not render an arbitration agreement void.

The Court then turned to whether the Federal Arbitration Act violated the Tenth Amendment of the United States Constitution by encroaching on a state's power to enact and regulate its own workers' compensation system. After discussing the requirements for such a challenge, the Court concluded that compliance with the Federal Arbitration Act would not "directly impair Texas's ability to structure integral operations in areas of traditional governmental functions." *Id.*

Finally, the Court addressed the employee's consideration argument. The Court held that mutual promises to submit all employment disputes to arbitration is sufficient consideration for such agreements and noted that mutual obligations existed in this case. Moreover, the Court held that the arbitration clause was not illusory because one

party could not avoid its promise to arbitrate by amending the provision or terminating it altogether without providing sufficient notice. The Court concluded that because of the limitations on the employer's right to amend or terminate the agreement, the arbitration agreement did not contain an illusory promise by the employer. The Court conditionally granted the writ of mandamus and ordered the trial court to compel arbitration.

**B. Trial Court Abused Its Discretion In Denying Statutory Forum Non Conveniens Motion To Dismiss Even Though The Defendants Were Based In Texas Because The Accident Occurred And Most Of The Evidence Existed Out Of State.**

In *In re Enesco Offshore International Company*, an Australian citizen employed by an Australian company was killed on a drilling rig that was in the territorial waters of Singapore. No. 09 0317, 2010 Tex. LEXIS 355 (Tex. May 7, 2010). The citizen's wife filed suit in Dallas County against the owners of the rig, who were corporate entities based in Dallas, Texas. The defendants filed a motion to dismiss based on forum non conveniens, which the trial court denied.

The Texas Supreme Court conditionally granted mandamus relief finding that the factors for forum non conveniens weighed in favor of granting the motion to dismiss. The forum non conveniens statute found in Texas Civil Practice and Remedies Code section 71.051(b) provides that if a court finds that in the interests of justice and the convenience of the parties, a claim would be more properly heard in a forum outside the state, the court shall decline to exercise jurisdiction under the doctrine of forum non conveniens. The statute then provides six different factors that the court should consider. The first two factors require an examination of whether an alternate forum exists in which the claim may be tried and whether that forum provides an adequate remedy. The Texas Supreme Court held that an alternate forum is one where the defendant is amenable to process, and a forum is inadequate if the remedies it offers are so unsatisfactory that they really comprise no remedy at all. The Court held that the defendant did not have to explain the trial procedures of a particular location to demonstrate that it was an adequate alternate forum, and that such an analysis is relevant to a court's forum non conveniens decision only if a potential transfer would effectively result in no available remedy at all. The plaintiff did not so contend. The plaintiff did not claim that either of the alternative forms of Australia or Singapore were inadequate; rather, she claimed that the defendant had not identified a single alternate forum and had amalgamated the forums of Singapore and Australia into one. The Court stated, "Nothing in Section 71.051 indicates the legislature contemplated the denial of forum non conveniens motions because multiple adequate alternate forums existed, or that a defendant should be required to focus on only one alternate forum to the exclusion of other forums." *Id.* Therefore, the Court found that the first two statutory factors weigh in favor of granting the motion to dismiss.

The third factor is whether maintaining the claim in Texas would work a substantial injustice to the moving party. The Court held that the defendants' lack of compulsory process in Texas for reaching the great majority of witnesses would be substantially unjust. The Court also found that the fact that there was a separate

pending lawsuit in western Australia with regard to the defendants' indemnity rights against another party weighed in favor of a motion to dismiss. The fourth factor is whether an alternate forum could exercise jurisdiction over all of the defendants. The plaintiff agreed that such a factor existed.

A fifth factor required balancing public and private interest factors. The private interest considerations include ease of access to proof, availability and cost of compulsory process, and other practical problems that make trial easy, expeditious, and inexpensive. The relevant documents and potential witnesses were located around the world and were mostly located in Australia and Singapore. Physical evidence was in storage in Singapore, and it would be expensive to bring that material to Texas. The Court held: "The cost, time, and scheduling difficulties to obtain evidence and present witness testimony would be far greater if the case were tried in Texas." *Id.* Another consideration is the extent to which the individual's death resulted from acts or omissions that occurred in Texas. With regard to this issue, the Court noted that the statute did not place the burden of proof on either party: "To the extent evidence is necessary to support a party's position, the trial court must base its decision on the greater weight of the evidence." *Id.* There was no evidence that the individual's death resulted from an act or omission that occurred in Texas.

The public interest factors to consider include "administrative difficulties related to court congestion, imposition of jury duty on citizens who have no relation to the litigation, local interest in having localized controversies decided at home, and trying the case in a forum that is at home with the law that governs the case." *Id.* The plaintiff did not provide any evidence that the defendants' actions or omissions contributed to the individual's death, and did not identify any other Texans who had an interest in the case. The fact that the trial court had jurisdiction over the defendants because their offices were in Dallas was a separate issue from whether the case should have been dismissed on forum non conveniens grounds. Another consideration in determining the fifth statutory factor is whether Texas law would govern the case. The Court essentially held that because the most significant relationship was in Singapore or Australia, it was likely that Texas law would not apply. But even assuming Texas law applied, the Court held that all the other public interest factors favored dismissal of the case. The Court concluded that the fifth factor weighed in favor of granting the defendants' motion. The sixth factor was whether the dismissal of the suit would result in unreasonable duplication or proliferation of litigation. The plaintiff did not argue that the dismissal of the case would have such a result.

Finally, in denying the motion the trial court stated "while I do think all the factors weigh in favor of a different forum probably in Australia, I don't think that they weigh so heavily that I've got to dismiss this case." *Id.* The plaintiff argued that a trial court does not abuse its discretion in denying a motion unless the balance of factors strongly favor the defendant. The Court disagreed, stating that the statute's language does not require that the Section 71.051(b) factors "strongly" favor staying or dismissing the suit: "Here, all the factors weigh in favor of [the plaintiff's] claim being heard in a forum outside Texas, and the statute required that the trial court grant the motion and decline

to exercise jurisdiction.” *Id.* The Court conditionally granted the petition and ordered the trial court to grant the motion to dismiss.

### **C. Trial Court Did Not Abuse Its Discretion In Dismissing Suit Under Common-Law Forum Non Conveniens.**

In *Quixtar, Inc. v. Signature Management Team, LLC*, a commercial dispute arose between Quixtar and Signature. No. 09 0345, 2010 Tex. LEXIS 475 (Tex. July 2, 2010). Quixtar was a Virginia corporation with its principal place of business in Michigan, and Signature was a limited liability company organized in Nevada with a principal place of business in Michigan. Quixtar was a successor to Amway Corporation, which was a multi-level marketing corporation that sold products through a network of individual business owners (IBOs). Signature was a "tools company" that sold marketing tools, self-help books, seminars, and motivational speaker appearances to IBOs to assist them in developing their businesses. Quixtar also provided those services and was a direct competitor with Signature. Before the dispute, Quixtar alleged that Signature taught IBOs improper and potentially illegal business-building techniques that put Quixtar's entire business at risk. The entities met at Quixtar's headquarters in Michigan to discuss Signature's alleged non-compliance with Quixtar's rules of potential remedial measures. When the parties did not resolve their disagreements, Signature-affiliated IBOs filed a class action lawsuit against Quixtar in California. Over the next several days, Quixtar sent emails to its IBOs explaining the disagreements and warning Signature-affiliated IBOs that their business would be terminated if they continued to use Signature products. Signature-affiliated IBOs filed seventeen lawsuits, including seven in Michigan, seeking injunctive relief. Eventually, Signature initiated a suit in Collin County, Texas, alleging that Quixtar abused its power by interpreting rules governing IBOs to restrain Signature's trade and business with certain IBOs located in Collin County. Quixtar filed a motion to dismiss based on the common-law forum non conveniens doctrine, arguing that the suit arose from a business dispute centered in Michigan that had no substantial connection to Texas.

After the trial court granted the motion, the court of appeals reversed because "the plaintiff's choice of forum must be respected unless evidence shows the private interest and public interest factors strongly favor dismissal in favor of another forum." *Id.* The court of appeals held that the evidentiary showing was weak and did not meet the burden of proof which required a strong showing.

The Texas Supreme Court disagreed, holding that the defendant's burden of proof was not as stringent as determined by the court of appeals. The Court held that when a plaintiff is a non-resident of Texas, the presumption that it properly filed in Texas applies with less force and deserves substantially less deference than if the plaintiff was a Texas resident. In a footnote, the Court was careful to note that it expressed no opinion on whether a "strongly-favored" standard was appropriate for a resident plaintiff's forum choice.

In addressing the merits, the Court first stated the private and public considerations in making a common-law, forum non conveniens dismissal decision.

Private considerations include (1) the relative ease of access to sources of proof; (2) the availability of compulsory process for attendance of unwilling, and the cost of obtaining the attendance of willing, witnesses; (3) the possibility of the view of the premises, if appropriate; (4) the enforceability of a judgment once obtained; and (5) all other practical problems that make trial of a case easy, expeditious and inexpensive. Other considerations include (1) administrative difficulties for courts when litigation is piled up in congested centers instead of being handled at its origin; (2) the burden of jury duty that ought not to be imposed on the people of a community that have no relation to the litigation; (3) local interest in having localized controversies decided at home; and (4) avoiding conflicts of law issues.

Regarding these factors, the Court refused to lay down a rigid rule to govern discretion because each case turns on its own facts. The Court noted that requiring an extensive investigation to produce evidence for the dismissal hearing would defeat the purpose of the request for this type of dismissal altogether. “There needs to be enough information to enable the district court to balance the parties' interests, but the court does not require a detailed quantification of costs.” *Id.*

The Court held that Quixtar presented sufficient evidence for the trial court to determine that the private interest factors weighed in favor of dismissal. Both entities' principal places of business were in Michigan, a key meeting leading up to this dispute occurred in Michigan, and the vast majority of evidence that would be produced and key witnesses that would testify at trial are located in Michigan. Regarding the public interest factors, Michigan had a greater interest in seeing that Signature was compensated for any injuries and it would be more fair to require Michigan courts and jurors to bear the time and expense of litigating the dispute between two businesses that are essentially Michigan enterprises. “To the extent the controversy has a center of gravity, that center appears to be in Michigan, where a key meeting between Signature and Quixtar personnel took place and where Quixtar took the actions that allegedly resulted in injury to [Signature].” *Id.* The Court concluded:

The court of appeals recognized the trial court's legitimate dismissal, but did not give the trial court's decision appropriate deference. There is sufficient evidence to uphold the dismissal, and the trial court did not abuse its discretion. The court of appeals mechanically re-weighed the *Gulf Oil* factors under the scope of an excessive burden of proof. But forum non conveniens dismissals are within the sound discretion of the trial court and involve weighing various factors that may be difficult to quantify. We decline to establish a formulaic application for a trial court's forum non conveniens determination.

*Id.* Therefore, the Supreme Court held that the trial court's dismissal was not an abuse of discretion in light of the evidence before it and Quixtar's burden of proof, and reversed the court of appeals's judgment and reinstated the trial court's dismissal.

#### **D. Texas Supreme Court Enforces Forum-Selection Clause**

In *In re Lisa Laser USA Inc.*, a plaintiff sued two defendants for terminating a distributor agreement in Austin, Texas. No. 09-0557, 2010 Tex. LEXIS 318 (Tex. April 16, 2010). The distributor agreement had multiple exhibits; one was a terms and condition sheet that contained a forum-selection clause naming California as the exclusive jurisdiction for any dispute arising out of the agreement. The defendants filed a motion to dismiss based on the forum-selection clause, which the trial court denied.

The Texas Supreme Court held that the trial court's failure to enforce the clause was an abuse of its discretion. First, the Court held that the claims fell within the scope of the clause using a common-sense approach. Additionally, the Court held that direct-benefits estoppel applied such that the plaintiff could not sue the non-signatory defendant based on claims arising from the distribution agreement and avoid the forum-selection clause contained in that same agreement. Also, the Court held that even though the parties' agreement specified that California law governed, Texas law would govern the procedural issue of whether mandamus relief was available to correct the trial court's error. Further, regarding the substantive issue of whether the forum-selection clause was applicable, the Court held that the parties did not identify any difference in Texas and California law on the enforceability of the clause, and therefore, applied Texas law.

#### **IV. Products Liability: The Court Rejected Expert Evidence In A Products Liability Suit Because It Was Conclusory And Did Not Rule Out Alternative Causes.**

In *Wal-Mart Stores, Inc. v. Merrell*, two individuals died from smoke inhalation in the bedroom of their rented home. No. 09-0224, 2010 Tex. LEXIS 447 (Tex. June 18, 2010). When police officers arrived, they found a badly burned recliner, a damaged pole-style, floor lamp, and other furniture covered in soot and smoke. There were also candles, melted wax, an ashtray, and a blunt on the table next to the recliner as well as smoking paraphernalia throughout the house. The parents of one of the individuals brought wrongful death and survival claims against the store that allegedly sold the lamp, alleging that the lamp caused the fire. The plaintiff's expert attributed the fire to non-passive failure of the lamp igniting the recliner below. He opined that the lamp's halogen bulb exploded, sending burning shards of glass onto the recliner, which smoldered for several hours. He ruled out smoking materials as the cause because none were found in the immediate area of origin. He also discounted candles as the cause of the fire because, had the candles been the source of ignition, the candle wax on the table would not have survived the exposure. The expert then concluded that the non-passive failure of the lamp was consistent with the facts of this case and wholly consistent with his knowledge of fire science. The store's expert testified that the more likely cause of the fire was careless disposal of smoking materials. The store moved for summary judgment asserting that there was no evidence of any element of the plaintiff's causes of action. The trial court granted the store's motion for summary judgment, but the court on appeals reversed holding that the plaintiff produced some evidence on each challenged element of the cause of action.

In the Texas Supreme Court, the store contended that even if properly admitted, the plaintiff's expert's evidence constituted no evidence of defect or causation because his opinion lacked factual substantiation and was conclusory. Specifically, the store contended that the expert's testimony constituted no evidence that the lamp was more likely to have caused the fire than any other obvious potential sources. The Court agreed with the store and affirmed the trial court's summary judgment because the expert's testimony did not appropriately rule out other potential causes. The Court stated that the expert did not say why a burning cigarette could not have caused the fire. The expert did not appropriately dismiss the fact that the post-mortem toxicology reports revealed that the individuals had been smoking the very night of the fire. Further, the expert improperly disregarded the smoking materials as the cause because there was no evidence of burnt cigarettes, but there was likewise no evidence of charred or exploded glass to support his own theory. The Court concluded that an expert's failure to explain or adequately disprove alternative theories of causation makes his or her own theory speculative and conclusory. Because the expert's testimony lacked objective evidence that supported his conclusions, the Court rendered that the plaintiff take nothing.

**V. Landowner Liability: Naturally Occurring Ice That Accumulates Without The Assistance Or Involvement Of Unnatural Contact Is Not An Unreasonably Dangerous Condition Sufficient To Support A Premises Liability Claim.**

In *Scott & White Memorial Hospital v. Fair*, the plaintiff drove his wife to a doctor's appointment at the hospital the morning after a winter storm. No. 08-0970, 2010 Tex. LEXIS 353 (Tex. May 7, 2010). After the appointment, the plaintiff left the building to retrieve his car when he slipped and fell on ice and sued the hospital for damages. The hospital moved for summary judgment, which the trial court granted. The court of appeals reversed, holding that the hospital failed to conclusively establish that the ice accumulation was in its natural state and was not an unreasonably dangerous condition.

The Texas Supreme Court disagreed. It noted that it had previously held that dirt in its natural state and mud that accumulates naturally on an outdoor concrete slab do not pose unreasonable risks of harm. The plaintiff argued that ice should be treated differently from mud because, unlike mud, icy conditions occur rarely in Texas. The Court disagreed, holding that both conditions pose the same risk of harm, and ice, like mud, results from precipitation beyond the premises owner's control. Further, the Court held that invitees are as aware as "landowners of the existence of ice that has accumulated naturally outdoors" and "will often be in a better position to take immediate precautions against injury." *Id.* The Court also held that requiring premise owners to guard against wintry conditions would inflict a heavy burden because of the limited resources landowners have on hand to combat occasional ice accumulations. Ultimately, the Court held that naturally occurring ice that accumulates without the assistance or involvement of unnatural contact is not an unreasonably dangerous condition sufficient to support a premises liability claim. The Court also held that no evidence supported a position that the ice was unnatural. The fact that the hospital used a deicer did not create a condition substantially more dangerous. The Court

reversed the court of appeals and rendered judgment that the plaintiff take nothing.

## **VI. Fiduciary Litigation: Where A Party Breaches Its Fiduciary Duty In A Transaction With Its Principal, The Forfeiture Of The Contractual Consideration Received By The Defendant Is A Potential Remedy.**

In *ERI Consulting Engineers, Inc. v. Swinnea*, Snodgrass and Swinnea owned equal interests in two business entities, ERI and Malmeba, which they operated together for approximately ten years. No. 07 1042, 2010 Tex. LEXIS 351 (Tex. May 7, 2010). ERI was a small consulting company that managed asbestos abatement projects, and it leased office space from Malmeba, a partnership that owned the building. Snodgrass and ERI purchased Swinnea's interest in ERI in 2001, and ERI paid Swinnea \$497,500 to redeem the ERI stock and Snodgrass transferred his half interest in Malmeba to Swinnea. Unknown to Snodgrass, Swinnea's wife and the wife of another ERI employee had created a new company called Air Quality Associates a month before they executed the buy-out agreement. Swinnea did not disclose the existence of Air Quality Associates to Snodgrass during the ERI buy-out negotiations. In fact, because Swinnea believed Snodgrass would run ERI into the ground, he told the other ERI employee to be patient because they could buy the company back for fifty cents on the dollar.

Snodgrass sued Swinnea and Swinnea's new company for breach of fiduciary duty, breach of contract, and other related causes of action. After a bench trial, the trial court found for Snodgrass and ERI on the claims for statutory fraud, common law fraud, breach of a non-compete clause, and breach of fiduciary duty. It rendered judgment for ERI and Snodgrass for combined damages of \$1,020,700 and \$1 million in exemplary damages. The non-exemplary damages awarded by the trial court consisted of both equitable forfeiture and actual damages: forfeiture of \$437,500, a portion of the \$497,500 paid by ERI to Swinnea for the stock; forfeiture of \$150,000, the value of Snodgrass's one-half interest in Malmeba transferred to Swinnea; forfeiture of \$133,200, constituting the sum of the lease payments from ERI to Malmeba after the buyout; and \$300,000 as ERI's lost profits from its business relationship with one of its contractors, Merico. The trial court found that a civil conspiracy existed between Swinnea and Brady Environmental, Swinnea's new company, and held Brady Environmental jointly and severally liable with Swinnea for the damages.

The court of appeals reversed and awarded judgment in favor of Swinnea, finding the evidence legally insufficient to support the damage awards. In particular, the court of appeals found that ERI failed to prove any actual damages, and it found that the equitable remedy of forfeiture was unavailable because there was no fee paid to Swinnea to be forfeited.

The Texas Supreme Court stated that the primary question it must address is whether forfeiture of contractual consideration is available as a remedy against Swinnea. The Court noted that it had previously upheld equitable remedies for breach of fiduciary duty, and noted that it had held that a fiduciary may be punished for breaching its duty: "The main purpose of forfeiture is not to compensate an injured

principal...rather, the central purpose...is to protect relationships of trust by discouraging agent's disloyalty." *Id.* The Court held that courts may fashion equitable remedies such as profit disgorgement and fee forfeiture to remedy a breach of fiduciary duty. The Court framed the problem in this case:

The difficulty comes in categorizing the damages awarded in this case. Here, the damages awarded by the trial court were not ill-gotten profits from an outside opportunity or external competition, or compensation for work done by the fiduciary. Rather, the trial court returned a significant part of the contractual consideration paid by ERI and Snodgrass to Swinnea as part of the buy-out agreement. The situation arises because here the contracting party, Swinnea, was a fiduciary, such that we must consider whether under the circumstances an equitable remedy may cross the line from actual damages for breach of contract or fraud (redressing specific harm) to further, equitable return of contractual consideration.

*Id.* The Court held that where willful actions constituting breach of fiduciary duty also amount to fraudulent inducement, "the contractual consideration received by the fiduciary is recoverable in equity regardless of whether actual damages are proven, subject to certain limiting principles set out below." *Id.* "[A] fiduciary who breaches his duty should not be insulated from forfeiture if the party whom he fraudulently induced into contract is ignorant about the fraud, or fails to suffer harm." *Id.*

There are several factors for consideration when fashioning a particular equitable forfeiture remedy. Citing the Restatement (Second) of Trusts, the Court stated:

In the exercise of the court's discretion, the following factors are considered: (1) whether the trustee acted in good faith or not; (2) whether the breach of trust was intentional or negligent or without fault; (3) whether the breach of trust related to the management of the whole trust or related only to a part of the trust property; (4) whether or not the breach of trust occasioned any loss and whether if there has been a loss it has been made good by the trustee; and (5) whether the trustee's services were of value to the trust.

*Id.* The Court held that several of these factors were relevant to the case at hand: the gravity and timing of the breach of duty, the level of intent or fault, whether the principal received a benefit from the fiduciary despite the breach, the centrality of the breach of the scope of the fiduciary duty, and any threatened or actual harm to the principal. Likewise, the adequacy of other remedies, including any punitive damages award, is also relevant. Ultimately, the Court held that there was no indication in the record that the trial court followed these principles in fashioning its award. Therefore, the Court remanded the case to the trial court for consideration of these factors after resolution of other remaining issues by the court of appeals.

The Court also addressed whether the trial court properly admitted evidence offered to show that the lease agreement was intended to be consideration for the buy-

out agreement, and thus subject to potential forfeiture. The Court stated that the general rule for an unambiguous contract is that evidence of prior or contemporaneous agreements is inadmissible as parole evidence. However, an exception exists for consistent collateral agreements. A collateral agreement between parties concerning the relationship of several distinct obligations between them falls within the exception. The Court held that if the parties agreed that the lease obligation was additional consideration for the buy out, such an agreement was a consistent collateral agreement and evidence concerning this fact was properly admitted.

The Court next decided whether there was sufficient evidence of actual damages – lost profits. The trial court awarded \$300,000 in lost profits, constituting the loss of income from ERI's and Snodgrass's business relationship with Merico, another company that had stopped doing work with ERI due to ERI's use of Swinnea's business. Snodgrass testified that based on information from his accountant, ERI's net profit margin of revenue from Merico was approximately twenty-five to thirty percent. ERI also introduced evidence indicating that from January 2000 through August 2001, ERI averaged \$19,833.10 in revenue per month from Merico. Later, after September 2001 through May 2004, the average revenue dropped to \$1,792.59 per month. The Court held that contrasting revenue from a time period immediately before the period at issue was an established method of proving revenue for a lost profit damages calculation. Thus, the Court held that ERI's method for proving its lost profits was legally adequate. However, the Court found that the evidence did not support the amount awarded. The Court held that ERI's evidence failed to meet the minimum requirements for legal sufficiency regarding reasonable certainty as to the amount awarded. But, the evidence was legally sufficient to prove a lesser, ascertainable amount of less profits with reasonable certainty. In this situation, such a discrepancy between two reasonably certain amounts would not defeat recovery by ERI. Rather, the Court held that the appropriate remedy was to remand the case to the court of appeals to consider the possibility for remittitur on the lost profit damages. Alternatively, the court of appeals could remand for a new trial.

The Court then reviewed whether Swinnea's company, Brady Environmental, should have been held jointly liable for the damages as a conspirator. One of the elements of conspiracy is a meeting of the minds on the object or course of action. The Court held that Brady Environmental could not be a conspirator because Swinnea had formed it after all of the relevant bad acts were committed. The Court concluded:

The trial court's award included no equitable remedy tied to conduct in which Brady Environmental participated. Rather, the only equitable award, forfeiture of contractual consideration, arose from a transaction that occurred approximately a year before Brady Environmental existed. Under the circumstances of this particular case, we believe that even if Brady Environmental conspired in later breaches of fiduciary duty or fraud, Brady Environmental is not subject to liability for any particular equitable forfeiture amount from the return of contractual consideration given in the specific transaction at issue.

*Id.* The Court affirmed the court of appeals's judgment that ERI take nothing on its conspiracy claim against Brady Environmental.

## **VII. Professional Liability: Auditors Are Only Liable To Those Within The Scope Of Liability And No Fraud Claim Exists Where Plaintiff Had “Red Flags” That Made Reliance Unjustifiable.**

In *Grant Thornton LLP v. Prospect High Income Fund*, bond and hedge fund investors sued an auditing firm based upon an audit of Epic, a company in which the investors had purchased bonds. No. 06 0975, 2010 Tex. LEXIS 478 (Tex. July 2, 2010). Epic had registered its bonds with the SEC and sold them on the open market. These bonds were governed by an indenture that named a trustee for the bonds. The indenture also mandated that Epic file audited financial statements, an annual report, and an independent auditor's report. Epic also had to obtain a "negative assurance" statement from its auditor, confirming Epic's compliance with the indenture and Epic's requirement to maintain in an escrow account funds sufficient to make a required interest payment of \$8.45 million dollars. Failure to maintain this minimum escrow balance constituted an event of default under the Indenture. Various funds purchased Epic's bonds.

Epic retained Grant Thornton to audit its 1999 financial statements and to review its statements for the first three quarters of 2000. Grant Thornton discovered that Epic had opened a cash management account, instead of the stipulated escrow account, and the balance was short of the required minimum. Despite these discrepancies, Grant Thornton issued a report in April of 2000 that confirmed Epic's continued compliance with the escrow account requirement. Around December 2000, Epic's primary lender told it that it would not be renewing its credit arrangement. This relationship was critical to Epic's existence and ability to satisfy its obligations to bond holders. In April 2001, Grant Thornton issued its 2000 report that again confirmed the company complied with its escrow requirement. In June 2001, Epic missed its scheduled interest payment to bond holders. Four days later, the funds purchased more bonds and protected their investments by forcing Epic into bankruptcy in July 2001. The funds then sued Grant Thornton alleging, among other things, that the auditor's reports misrepresented the escrow account status and asserted claims for fraud, negligent misrepresentation, negligence, breach of contract, conspiracy to commit fraud, and aiding and abetting fraud. The funds sought damages equal to the face value of all bonds they purchased, plus five years of interest payments.

The trial court granted Grant Thornton's motion for summary judgment on all claims. The court of appeals affirmed in part but reversed on the negligent misrepresentation, fraud, conspiracy, and aiding and abetting claims. The funds alleged several bases for their claims: that Grant Thornton's misrepresentations: (1) led them to purchase additional bonds; (2) dissuaded them from investigating whether the minimum balance was maintained in the escrow account, which prevented them from forcing Epic into bankruptcy sooner; and (3) induced them to refrain from selling bonds.

The Texas Supreme Court initially conducted an in-depth discussion of auditor liability to third parties. Ultimately, the Court accepted the Restatement (Second) of Torts, Section 552, as the guiding law in Texas on auditor liability. The Court explained that Section 552's cause of action is available only when information is transferred to a known party for a known purpose. Under Section 552, a "known party" is one who falls in a limited class of potential claimants, "for whose benefit and guidance one intends to supply the information or knows that the recipient intends to supply it." *Id.* This formulation limits liability to situations in which the professional who provides the information is "aware of the non-client and intends that the non-client rely on the information." *Id.* Unless a plaintiff falls within this scope of liability, a defendant cannot be found liable for negligent misrepresentation.

One of the funds maintained that it was within the scope of liability because there was only a limited class of investors in the market who actually purchased the high-yield debt bonds at issue in the case. The Court found that argument to be unpersuasive, and noted that Epic's bonds were sold in the open market. The fund had no prior connection to Epic or Grant Thornton, and predicated scope of liability on Grant Thornton's general knowledge that investors may purchase Epic's bonds would "eviscerate the Restatement rule in favor of a de facto foreseeability approach – an approach we have refused to embrace." *Id.* The Court concluded, "because Cayman was not within a 'limited group' where it bought bonds in December 2000, it was outside Grant Thornton's scope of liability." *Id.*

Turning to the fund's fraud claim, the Court noted that it previously found that the intent standard for fraud under Section 531 of the Restatement (Second) of Torts required that a defendant have a "reason to expect" that its representations will affect other parties' conduct. The "reason to expect" standard requires more than mere foreseeability: "the claimant's reliance must be especially likely and justifiable, and the transaction sued upon must be the type the defendant contemplated." *Id.* The Court noted that "even an obvious risk by a third person will rely on a representation is not enough to impose liability." *Id.* The court of appeals held that there was a "fact issue regarding whether Grant Thornton had reason to expect that it was especially likely that the funds would receive and rely on Epic's audited financial statements." *Id.* The court of appeals based its determination on the indenture's reference to Epic security holders. Even if this provision suggested that Grant Thornton may have been aware of existing bond holders as a limited class, a question the Supreme Court did not reach, it does not meet the requisite standard as to prospective purchasers like the funds made the basis of this suit, who claimed to have relied on the 1999 audit report.

The Court then turned to the underlying plaintiffs' reliance. In 2001, several of the funds – both existing and prospective bond holders – bought Epic bonds. The parties highly disputed whether existing bond holders are within Grant Thornton's scope of liability. The Court, however, did not resolve that disagreement because it concluded there was no evidence that any of the funds justifiably relied on the audit reports or the negative assurance statement. The Court noted that both claims for fraud and negligent misrepresentation require that the plaintiff show actual and justifiable reliance. In measuring justifiability, the Court must inquire whether "given a fraud plaintiff's

individual characteristics, abilities, and appreciation of facts and circumstances at or before the time of the alleged fraud, it is extremely unlikely that there is actual reliance on the plaintiff's part." *Id.* Moreover, "a person may not justifiably rely on a representation if there are red flags indicating such reliance is unwarranted." *Id.*

Turning to the facts of the case, the Court noted that bonds purchased before Epic hired Grant Thornton could not have been bought in reliance on the audit reports. Further, a representative of the funds learned that Epic's lender would not renew Epic's credit arrangement. The Court agreed with Grant Thornton that, after that point, any reliance was unjustifiable. "Knowing that Epic had lost its primary source of funding, the funds continued to buy bonds in April, May and June." *Id.* "If these funds relied on the 1999 or 2000 audit reports in making the 2001 purchases, that reliance would not have been justifiable in light of the fund's knowledge that Prudential had cut off Epic's 'lifeblood.'" *Id.*

The Court also found that there was no evidence that the funds relied on the 1999 negative assurance statement. It was undisputed that the funds never received or reviewed the negative assurance statement. The funds, however, contended that because the trustee, their escrow agent, received and relied upon the statement, then the funds relied on the statement by proxy. The Court noted, "but when, as here, there is a dual agent, operating with the consent and knowledge of both principals, the agent's knowledge is imputed to its principals." *Id.* The facts proved that the trustee knew that Epic was not following the indemnity agreement regarding the escrow funds. "Because the funds may not substitute U.S. Trust's reliance for their own without also inheriting its knowledge, its claims based on the 1999 negative assurance statement fail." *Id.*

The funds' "holder claims" were not that Grant Thornton's misrepresentations induced them to take action, but rather that the misrepresentations induced them to refrain from doing so. In other words, but for Grant Thornton's misrepresentations, the funds would have sold their bonds sooner, at a time when they would have been more profitable. After an in-depth discussion of how other jurisdictions interpret "holder claims," the Court, without expressly stating that it would approve of a "holder claim," found to the extent such would be viable, it must involve a direct communication between the plaintiff and the defendant. Finding there was no such direct communication between Grant Thornton and the funds, the Court found that the funds' "holder claims" failed.

Finally, the Court held that because the funds' conspiracy and aiding and abetting claims were premised on misrepresentations, and the Court found those misrepresentations were not actionable, the conspiracy and aiding and abetting claims failed as well. The Court rendered judgment that the funds take nothing.

Outside the context of professional liability, this case is important in the context of fraud cases generally. The Court held that evidence that the plaintiff should not have "justifiably" relied on the defendant's misrepresentations barred the plaintiff's claims. Historically, a fraud plaintiff had no duty to investigate representations, and could be naïve or negligent in relying on the defendant's misrepresentations. In fact, historically,

a fraud defendant did not have a contributory negligence defense. Currently, the Texas proportionate liability statute allows for the apportionment of a plaintiff's negligence in the context of intentional tort claims, which would include fraud claims. But the consideration of a fraud plaintiff's negligent reliance would not necessarily bar its claim. In *Grant Thorton*, the Texas Supreme Court held that because the funds could not "justifiably" rely, such barred their claims as a matter of law. *Grant Thorton* may be used as precedent by fraud defendants to defeat a claim, as a matter of law, by a careless plaintiff.

### **VIII. Punitive Damages: Modest Economic Damages May Still Be Substantial Enough To Justify Punitive Damages, Though An Award Will Have To Undergo Due Process/Ratio Analysis.**

In *Bennett v. Reynolds*, Reynolds sued his neighbor Bennett and a corporate landowner, of which Bennett served as president, alleging that they had sold thirteen head of Reynolds's cattle that strayed to a riverbed and onto the corporation's land. No. 08 0074, 2010 Tex. LEXIS 473 (Tex. June 25, 2010). A civil jury found Bennett liable for conversion and assessed \$5,327.11 in actual damages (the cattle's market value) plus exemplary damages of \$250,000 against Bennett and \$1 million against the corporation. The court of appeals affirmed this judgment.

The Texas Supreme Court reversed and remanded based on the due process concern that the exemplary damages exceeded the actual damages by an unjust ratio. The Court first decided whether stealing cattle was sufficiently egregious to meet the definition of malice found in the Texas Civil Practice and Remedies Code Chapter 41. The statute defined malice as "a specific intent by the defendant to cause substantial injury to the claimant." *Id.* The jury heard testimony that Bennett ordered the sale of Reynolds's cattle despite being warned that they belonged to someone else. The jury could have reasonably formed a firm belief or conviction that there was nothing accidental about Bennett's conduct and that he specifically intended to injure Reynolds by taking his property. The Court found that legally sufficient evidence existed that Bennett intended to cause "substantial" injury to Reynolds. It noted that under the Texas Penal Code, the theft of thirteen head of cattle constitutes a third degree felony, punishable by a fine of up to \$10,000 and up to a decade behind bars. The Court held that Texas law, both civil and criminal, reflects the Legislature's policy judgment that stealing cattle inflicts substantial harm and merits harsh punishment. The Court stated: "We have recognized that the term 'substantial' has two basic components: real vs. merely perceived, and significant vs. trivial." *Id.* The Court concluded that the injury in this case was both real and significant.

The Court then discussed the constitutional due process limits for the award of punitive damages. There are three guideposts for an award of punitive damages: (1) the degree of reprehensibility of the defendant's conduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases. The first factor is the most important indicium of the reasonableness of the punitive damages award, and there are

five non-exclusive factors that a court should look to in determining the reprehensibility guidepost: (1) the harm inflicted was physical rather than economic; (2) the tortious conduct showed an indifference to or a reckless disregard for the health or safety of others; (3) the target of conduct had financial vulnerability; (4) the conduct involved repeated actions, not just an isolated incident; and (5) the harm resulted from intentional malice, trickery, or deceit, as opposed to mere accident.

The Court noted that this case posed a critical threshold matter: whether Bennett's actions beyond the conversion itself may factor into the reprehensibility analysis. Reynolds painted a picture of Bennett's corruption, alleging a scheme of deception aimed at tainting the trial by attempting to bring false charges against Reynolds, threatening physical harm to a witness, attempting to bribe witnesses, and encouraging witnesses to lie about the round up and sale of Reynolds's cattle. The Court concluded: "We align generally with Reynolds that Bennett's alleged extra-conversion misdeeds (at least most of them) count properly toward reprehensibility, as they relate back to the underlying theft and sought to extend and exacerbate harm to Reynolds." *Id.* A reprehensibility analysis can therefore consider, to some extent, surrounding circumstances beyond the underlying tort.

The Court determined that one of the five reprehensibility factors – the harm resulting from intentional malice, trickery, or deceit – existed in this case but found that the first four reprehensibility factors did not. The Court discussed its previous *Gullo Motors* opinion that found that a ratio of 4.33 to one was constitutionally excessive in the context of a case where only the fifth factor of the reprehensibility guidepost was present. Similarly, the Court held that both ratios in this case were excessive. The Court noted that ratios greater than those may be upheld and comport with due process "where a particularly egregious act has resulted in only a small amount of economic damage." *Id.* But the Court held that the economic damages in this case were sufficiently substantial and could not be characterized as nominal or trivial. "If courts fail to diligently police the 'particularly egregious' exception, they insulate from due process review precisely those cases where judicial review matters most: those involving unsympathetic defendants where juries are most likely to grant arbitrary and excessive awards." *Id.* The Court therefore reversed and remanded to the court of appeals for that court to suggest an amount for remittitur.

The Court also discussed the guidepost that compared the exemplary damages with legislatively authorized civil sanctions. This factor fortified the notion that legislatures make policy and are well positioned to define and deter undesired behavior. The reviewing court should accord substantial deference to legislative judgments concerning appropriate sanctions for the conduct at issue. Regarding the Texas Civil Practice and Remedies Code's exemplary damages cap in an amount not to exceed the greater of (1) \$200,000, or (2) noneconomic damages (up to \$750,000) plus two times economic damages, the Court held that such a cap does not reflect the legislature's judgment that this amount is necessarily constitutionally permissible. "Lifting the \$200,000 cap in some cases does not demonstrate constitutional propriety in this case. Indeed, even an award well below the statutory ceiling can offend due process." *Id.*

The Court then analyzed whether the corporate landowner was liable for exemplary damages due to Bennett's conduct. Texas Civil Practice and Remedies Code Section 41.005(c) provides that:

in an action arising out of criminal act committed by an employee, the employer may be liable for punitive damages but only if: (1) the principal authorized the doing and the manner of the act; (2) the agent was unfit and the principal acted with malice in employing or retaining him; (3) the agent was employed in a managerial capacity and was acting in the scope of employment; or (4) the employer or a manager of the employer ratified or approved the act.

*Id.* The Court previously focused on the concept of vice-principal in determining whether exemplary damages can be assessed against a corporation. The Court previously held that acts of a vice-principal are deemed to be acts of the corporation for purposes of exemplary damages because the vice-principal represents the corporation in its corporate capacity. Vice-principals include four classes of human agents: (1) corporate officers; (2) those who have authority to employ, direct, and discharge servants of the master; (3) those engaged in the performance of non-delegable or absolute duties of the master; and (4) those to whom the master has confided the management of the whole or a department or division of his business. The Court concluded that Bennett was indisputably a vice-principal of the corporation, and the corporation was liable for the exemplary damages.

The Court remanded to the court of appeals to reconsider the exemplary damages in line with its opinion and the prevailing ratio analysis.

**Contact:** David F. Johnson is one of only fifteen practicing attorneys in Texas that is board certified in civil appellate law, civil trial law, and personal injury trial law by the Texas Board of Legal Specialization. Mr. Johnson is a shareholder in Winstead's Fort Worth and Dallas offices, is a founding member of Winstead's appellate practice group, and is also a member of the insurance industry practice group and commercial litigation group. He can be contacted by emailing [dfjohnson@winstead.com](mailto:dfjohnson@winstead.com) or by calling (817) 420-8223.

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