TADC Commercial Litigation Newsletter

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This newsletter is intended to summarize significant cases and issues impacting Texas commercial litigation in the past six months. It is not a comprehensive digest of every case involving commercial litigation issues during that time period or a recitation of every holding in the cases discussed. This newsletter was not compiled for the purpose of offering legal advice.

While "strike-throughs" in a draft contract do not always indicate the parties' intent, they do when they are part of the "customary negotiation process"—

Houston Exploration v. Wellington Underwriting

Opinion delivered Aug. 26, 2011
54 Tex. Sup. J. 1683 (Tex. 2011)

In this case, the Texas Supreme Court has concluded that while deletions from a draft agreement do not always indicate the parties' intent, strike-throughs can be considered when they are made as part of the negotiation process in the London market, because this market relies heavily on parties reaching agreement by lining through provisions in a form policy.

Summary:
This dispute arose when Offshore Specialty Fabricators, Inc. ("Offshore") agreed to construct a drilling platform in the Gulf of Mexico for The Houston Exploration Company ("Houston"). The contract between the two parties required Offshore to obtain builder's risk insurance naming Houston as an additional insured.

To accomplish this task, Offshore used a local broker, who in turn contacted Lloyd's of London for insurance. As required by Lloyds, the broker requested an approved London broker, Tysers International, to obtain insurance for Offshore and Houston (the "Assureds"). Tysers negotiated with Wellington Underwriting Agencies Ltd. ("Wellington") as lead for a group of underwriters (the "Underwriters") and an insurance contract was negotiated in the London market. During the negotiations, the parties relied on a form policy with multiple "strike throughs."

After the contract was signed, work was delayed and substantial losses incurred in standby charges. The Assureds submitted a claim to the Underwriters, which they refused to pay.

When the Assureds sued, the trial court granted partial summary judgment for the Assureds, construing the policy to require payment of the stand-by charges, *even though such payment had been expressly deleted from the contract.*

In an interlocutory appeal, the Fourteenth Court of Appeals disagreed with the trial court's interpretation, concluding that it was not the intent of the parties to include standby charges as a covered expense, because the paragraph referencing standby charges had been deleted.

The Texas Supreme Court has concluded it agrees with the Court of Appeal's interpretation.

Despite the parol evidence rule (which normally considers deleted language as extrinsic evidence), the Court concluded that the Lloyd's process of negotiation is unique. Indeed, in London, the custom of deleting text is so intrinsic to the contract-writing process that the court determined that, here, standby charges had to be construed as an exclusion.

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Facts:

When Offshore and Houston executed their contract to construct a new drilling platform, they utilized London broker Tysers, who negotiated a contract of insurance with the Wellington Underwriters.

During the negotiations, Tysers and Wellington worked from a 33-page WEL-CAR 2001 Offshore Construction Project Policy form, lining through several provisions. Five of the provisions that were struck through called for reimbursement of expenses associated with certain losses, including expenses associated with additional work; tests, leaks and damage search costs; standby charges; terrorist buy-back clauses; and forwarding charges.

Following the lined-through terms were almost two pages of exclusions. As altered, the form became the policy to which Tysers and the Underwriters agreed, and Tysers notified Offshore's local broker that coverage had been bound.

A few weeks later, the drilling platform Offshore was constructing for Houston became unstable, requiring immediate repairs. Work was delayed by severe storms in the Gulf, during which time Offshore kept repair vessels standing by so that they could resume repairs as soon as the weather improved. The Assureds submitted a claim for $3 million, which included $1 million for weather "stand-by" charges. The Underwriters paid $2 million, acknowledging that the platform damage was a covered occurrence, but refused to pay the weather stand-by charges. Paragraph 13, which was struck through in the policy, would have required indemnity for those charges.

The Assureds sued the Underwriters on the policy, and the Underwriters counterclaimed, alleging that the Assureds had submitted a false claim. The trial court granted partial summary judgment for the Assureds, construing the policy to require payment of the weather stand-by charges. Disregarding the stricken language as "parol evidence," it concluded that the policy was unambiguous.

Later, the trial court signed an agreed order for interlocutory appeal on two questions: (1) did the policy at issue provide coverage for weather standby charges?; and (2) if so, did the Underwriters' counterclaims for fraud and breach of contract have merit?

The Court of Appeals answered the first question "no," thereby mooting the second question. Relying on a previous Texas Supreme Court decision, the court of appeals determined that deletions remaining within an insurance policy *can* be considered in construing an unambiguous insurance policy. By striking out paragraph 13, the appellate court concluded, the parties must have intended that weather stand-by charges *not* be reimbursable.

Although the Texas Supreme Court initially denied the Assureds' petition for review, it ultimately granted the petition on rehearing. On August 26, 2011, the Supreme Court affirmed the court of appeals' holdings.

The Texas Supreme Court's holdings:

The Assureds made five arguments, all of which the Supreme Court rejected:

- First, the Assureds contended that indemnification for weather standby charges was required by policy provisions *other* than paragraph 13 and so, if the deletion of that paragraph was to be construed as an exclusion, its effect would have to be strictly construed in favor of the insured. The Supreme Court agreed that strict construction was required, but determined that the effect of the exclusion was the same.

- Next, the Assureds argued that payment of weather standby charges was required by the policy's "general provision" that insured against *all* risks of physical loss and damage. The Supreme Court disagreed, concluding that the general provision was expressly subject to the terms that followed it in the policy, which included paragraph 13, which had been deleted. Treating paragraph 13's deletion as an exclusion made it an express exception to the general all-risks insurance provision, the Court found.

- The Assureds also argued that weather standby

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charges were payable because they were costs "necessarily incurred and duly justified in repair or replacement of lost or damaged property." The Supreme Court rejected this argument, however, finding that weather standby charges did *not* necessarily have to be incurred to repair property damage. (For example, the Assureds could have released the vessels and labor until the storms that delayed the repairs had passed.)

- Additionally, the Assureds argued that weather stand-by charges were part of the usual "cost of equipment and labor" used in repairing covered property. The Supreme Court, however, found just the opposite to be true: the charges were for equipment and labor that was "standing by" – *awaiting use when the weather cleared*. If standby charges were included in the normal cost of equipment, reasoned the Court, there would be no need for the paragraph related specifically to standby charges. Such paragraph would be surplusage in a policy that contained it with no strike-through.)

- Finally, the Assureds argued that because the policy provided for a deductible for weather standby charges, the charges must have been intended to be payable under the policy. Again, the Supreme Court disagreed—this time pointing out that the deductible provision was in another section of the printed form. Having struck paragraph 13, the parties might well have struck the deductible provision as well, "but failing to do so simply left it inoperative."

Moral of the story: If you plan to negotiate an insurance contract anytime soon, and anticipate that you may have to defend yourself against a breach of contract claim using parol evidence, negotiate your contract in London.

(Editor's Note: There was a Concurrence filed by Justice Johnson and a Dissent filed by Chief Justice Wallace B. Jefferson in this case. The Concurrence argued that the policy at issue was unambiguous and denied coverage, regardless of the presence of the stricken language, because it provided for coverage of repairs and vessels engaged in "or about" repairs and did not provide for vessels on standby for extended periods when not actively preparing for, supporting, or engaging in repairs.

The Dissent opined that the Majority incorrectly based its opinion on "the custom of the Lloyd's market" and, as such, improperly engaged in a "speculative analysis" of what the parties intended. Such consideration of the content of the deleted provision—like the negotiation surrounding the contract's execution—was extrinsic evidence, it said, and to consider such deleted language or negotiation destroyed the parol evidence rule.)

# # #

Not including separate "limiting language" in a covenant not-to-solicit puts a certified public accountant into "pickle" of a spot—

Pickle v. Johnson

Opinion delivered Sept. 15, 2011
2011 Tex. App. LEXIS 7564

In this case, the Fort Worth Court of Appeals concluded that a five-year limitation contained in a contract of sale's *non-compete* clause applied equally to the contract's *non-solicitation* clause because the parties unambiguously intended for the agreement's competition and solicitation clauses to be treated as *one* covenant rather than *two*.

The trial court's decision to dismiss the plaintiff's cause of action against a rival accounting firm was therefore affirmed.

Summary:

In this case, a certified public accountant sought reversal of a trial court's ruling that the accountant's non-solicitation agreement with an ex-employee contained a five-year limitation period.

The Second Court of Appeals held that the trial court was correct in treating the non-solicitation portion of the non-compete clause as part of a "larger whole" and, as such, upheld the decision of the lower court to grant summary judgment in favor of the accountant's ex-employee.

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Facts:

This case concerns the sale of a certified public accounting business.

Traci D. Johnson, her father, and her uncle had a partnership in a CPA firm. Ricky J. Pickle, individually and d/b/a RJ Pickle & Associates ("Pickle") purchased the partnership on December 23, 2002. Included in the contract of sale was Section 1.3, which read:

> **1.3 Covenant Not to Compete or Solicit**. Upon the purchase of the Partnership's Assets covered by this Agreement and for a period ending on the fifth (5th) anniversary of the Closing Date, the Partnership, John L. Hodgkiss, Traci D. Johnson, and William R. Hodgkiss, jointly and severally, hereby each agree that they will not directly or indirectly within the Texas counties of Tarrant, Dallas, and Denton, enter into, or engage generally in, competition with Buyer in the accounting, auditing, tax preparation, or other similar . . . businesses in which the Buyer is engaged on the Closing Date . . .
>
> In addition, the Partnership, John L. Hodgkiss, Traci D. Johnson, and William R. Hodgkiss, jointly and severally each agree that they will not solicit any client or customer listed among the Assets being sold.
>
> This covenant . . . is an independent agreement, and the existence of any claim or cause of action of the Partnership . . . against Buyer will not constitute a defense to the enforcement by Buyer of this covenant . . . [and] the Partnership . . . hereby agree[s] to the sum of . . . $4,000.00 . . . as consideration for this covenant . . .

At the end of Section 1.3, the following paragraph was included:

> If a court determines that the foregoing restrictions are too broad or . . . restrictive . . . with respect to time or space, the court is hereby requested and authorized . . . to revise the foregoing restrictions to include the maximum restrictions allowed under the applicable law . . .

Following the close of sale, Pickle employed Johnson. Johnson remained an employee of Pickle until the fall of 2007, at which time she resigned. Sometime after she resigned, Johnson began competing with Pickle. In her course of business, Johnson sent notices to some of the accounts she had formerly serviced as a partner in the original business and as an employee of Pickle.

On December 19, 2008, Pickle filed a breach of contract suit seeking damages and injunctive relief. He contended the agreement to purchase the original partnership from Johnson included two separate covenants: a "non-compete covenant" with a time limit of five years, and a separate "non-solicitation" agreement with no time limit, which Johnson allegedly breached.

Johnson filed a motion for summary judgment, contending that there were not two separate covenants, but rather only *one* covenant—a convenant not to compete *or* solicit—and that one covenant was governed by a five-year limitation agreement that expired December 23, 2007.

The trial court agreed with Johnson and dismissed Pickle's case. Pickle appealed.

The appellate court's holdings:

In arguing reversal, Pickle contended that the five-year limitation period contained in Section 1.3 was intended only to apply to the *non-compete* portion of the covenant, not to the *non-solicitation* portion.

According to Pickle, the first paragraph related to competition and the second paragraph related to solicitation of existing clients. The first paragraph contained the five-year limitation and the second paragraph did not, Pickle argued, so Section 1.3 was intended to be unlimited in time as it pertained to the solicitation of Johnson's former clients.

Johnson countered that portions of Section 1.3 would be meaningless under Pickle's interpretation, and that Section 1.3 unambiguously expressed that the parties intended *the entire section* to be treated as *one* covenant, with the five-year limitation applying to the section as a whole.

The appellate court agreed with Johnson. It found that throughout 1.3 there were instances where the term "covenant" was used to address Section 1.3 as a *single* covenant.

Moreover, the paragraph at the end of Section 1.3—

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the one that authorized the court to revise the covenant in the event it found the "foregoing restrictions" too broad—demonstrated that it was the intent of the parties to define "time or space" restrictions at the beginning of Section 1.3 and have them apply to the *entire* section.

Moral of the Story: If you want a Covenant-Not-to-Solicit-Customers to operate independently from a Covenant-Not-to-Compete, then you had better not combine them under a single heading in your contract. By combining them, you can land you in quite a "pickle."

# # #

Failure to show that employees worked for an international parent results in"grave" consequences for plaintiffs in respondeat superior case—

Service Corp. Internat'l vs. Guerra, Ramirez, Little & Martinez

Opinion delivered June 17, 2011
54 Tex. Sup. J. 1191 (Tex. 2011)

Where both a subsidiary corporation and its parent shared the same three-letter acronym in their names, the Texas Supreme Court found that inclusion of the acronym on the subsidiary's stationery and testimony from the subsidiary's employees that they worked for the acronym were legally insufficient to prove the subsidiary's employees were employees *of the parent.*

As such, there was legally insufficient evidence to support a *respondeat superior* claim against the parent—and the $4 million judgment issued against the parent had to be reversed.

Summary:
When Marcos Guerra was buried at Mont Meta Memorial Park cemetery in a plot sold to someone else, his family refused the cemetery's request that it be allowed to move the body to another burial plot. The cemetery did so anyway.

When family members discovered the removal, they sued SCI Texas Funeral Services Inc. d/b/a Mont Meta Memorial Park ("SCI Texas"), the corporation that owned and operated the cemetery, and SCI Texas' parent corporation, SCI International Corporation ("SCI International").

After a jury verdict, the trial court rendered judgment against SCI Texas and SCI International for actual and exemplary damages. Although the court of appeals modified the judgment as to exemplary damage, it otherwise affirmed.

When the Texas Supreme Court heard the case, it addressed two issues. First, it addressed whether the evidence was sufficient to support jury findings that *both* SCI Texas and SCI International were liable for the actions of the cemetery's employees. Next, it looked at whether the daughters and widow of the decedent suffered compensable mental anguish because the decedent's body was disinterred and moved to another grave without permission.

After a thorough review of the evidence, the Court held there was legally insufficient evidence to support either the liability findings against SCI International or the mental anguish findings in favor of the daughters. It reversed and rendered in part and remanded for a new trial in part.

This article addresses only the first issue regarding proof of liability against the parent corporation.

Facts:
SCI Texas owns and operates several cemeteries in Texas, including Mont Meta Memorial Park in San Benito, Texas. Through an intermediary corporation, SCI Texas is wholly owned by SCI Inter-national.

When Mr. Guerra died unexpectedly in 2001, his family decided to have him buried at Mont Meta and arranged for the purchase of two burial plots. The first plot was to be used for Mr. Guerra; the second was to eventually be used by Mrs. Guerra.

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SCI Texas requires that before a burial takes place, a "blind check" of the arrangements must be performed by an employee other than the employee who made the original arrangements. The blind check is to verify (1) the location of the burial plot to be used; (2) that the plot has not been previously sold, and (3) that no one is already buried in the plot.

A Mont Meta employee performed the blind check on the day of Mr. Guerra's burial as part of her duties at Mont Meta. She concluded that the cemetery's records showed the plot where Mr. Guerra was to be buried had been previously sold. She brought this to the attention of her supervisor, who concluded that the burial could proceed as planned because the plot had been "quitclaimed" to the Guerras. The burial proceeded without incident.

After the funeral, another Mont Meta employee reviewed the paperwork and determined that the plot had *not* in fact been quitclaimed to the Guerras.

When the Guerras were informed that the plot where Mr. Guerra was buried belonged to someone else, they met with Mont Meta's general manager and declined his request that the cemetery be allowed to move Mr. Guerra's body to another plot.

Sometime after the meeting with the general manager, the Guerras noticed that grass on Mr. Guerra's grave appeared to have been disturbed. They contacted Mont Meta and were told that resodding had taken place in the cemetery and that a passageway next to where Mr. Guerra was buried had been converted to a plot to ensure that a place beside Mr. Guerra would be available for Mrs. Guerra.

When the family received deeds for the plots, however, the deeds were for plots 5X and 5XX, rather than 5 and 5X, as originally contracted. The Guerras suspected that Mr. Guerra's body had been moved and they filed a complaint with the Texas Funeral Commission.

Six months later, a new general manager at Mont Meta disclosed to the Guerras that they were correct: Mr. Guerra's body had been moved about 12 to 18 inches laterally into plot 5X.

Mrs. Guerra and her daughters then sued SCI Texas and SCI International, asserting fraud, intentional infliction of emotional distress, negligence, and trespass.

At trial, there was no jury question as to whether the employees involved in the case were acting within the course and scope of their employment with SCI *International* at the time of the alleged negligence.

The jury found in favor of the Guerras on the three liability theories and awarded damages of $2 million for past mental anguish to Mrs. Guerra and $100,000 for past mental anguish to each daughter. The damage allocations were: 70% responsibility to SCI International and 30% to SCI Texas.

The jury also awarded exemplary damages of $3 million against SCI International and $1 million against SCI Texas—allocating 70% to the widow and 10% to each daughter.

Both defendants appealed. The court of appeals modified the judgment and reduced exemplary damages to $750,000 for each defendant in accordance with a statutory cap.

There were seven issued raised on appeal, only two of which were addressed by the Texas Supreme Court. It is the first issue—SCI International's challenge to the legal sufficiency of the evidence against SCI International for respondeat superior—that is addressed here.

<u>The Texas Supreme Court's holding:</u>

The Supreme Court began its analysis by pointing out that a corporation is not vicariously liable for the acts of someone who is *not* an employee.

Indeed, whether the actors involved in this case were SCI International employees was not an independent ground of recovery in this case, the Court said. The actors' status as employees was only an *element* of the Guerras' negligence claim.

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When evidence is conflicting regarding whether an employee has acted in the course and scope of his employment, pointed out the Court, a jury finding is required. Here, there was no jury finding that the employees were SCI International employees.

When, as here, an element of a claim is omitted from the jury charge without objection and no written findings are made by the trial court on that element, then the omitted element is "deemed" to have been found by the court in such manner as to support the judgment, said the Supreme Court.

Nevertheless, even a "deemed finding" must have evidence to support it.

As such, the Supreme Court turned to an analysis of whether there was legally sufficient evidence to support a finding that the employees who committed the acts at issue were employees of *SCI International*.

To support such finding, the Guerras pointed to testimony from several cemetery employees that they worked for "SCI." In response, the Supreme Court pointed out that *both* SCI Texas and SCI International had the initials "SCI" in their names and so could be referred to in this manner.

Statements that the workers were employed by "SCI" only allowed for speculation that they were employed by SCI International, said the Court—and findings based on evidence that allows for no more than speculation—a guess—are *not* based on legally sufficient evidence.

Moreover, there was much evidence to support a contrary finding, said the Court. For example, there was the testimony of SCI Texas' president, who testified (1) that SCI Texas was a wholly-owned subsidiary of SCI International; (2) that SCI Texas, not SCI International, contracted with the Guerras; and (3) that SCI International had no employees, did not operate funeral homes or cemeteries, and only had stock shares for assets. There was also the fact that *all* SCI subsidiaries were authorized to use the SCI logo on their stationery and that such use was as consistent with employment by SCI Texas as with SCI International, the Court said..

Because there was insufficient evidence to suggest that the employees at issue were employees of *SCI International*—and legally sufficient evidence to suggest the opposite—the Supreme Court determined that the liability award against SCI International had to be reversed.

Moral of the story: If you plan to seek vicarious liability against a parent corporation for the acts of its subsidiary employees, then you had better get a finding from the jury that the employees are employees *of the parent*. To do otherwise is to face potentially "grave" consequences.

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When a party fails to show "serious inconvenience" to 30,000 Texas witnesses, the court enforces forum-selection clause requiring suit in Indiana—

In re Zotec Partners, LLC

Opinion delivered Sept. 21, 2011
2011 Tex. App. LEXIS 7622
(Tex. App.—San Antonio)

In this case, the San Antonio Court of Appeals found that "great expense" and "forced travel across several U.S. states" for thousands of witnesses does not constitute "special and unusual circumstances" enough to warrant non-enforcement of a forum-selection clause.

As such, the trial court who denied a Motion to Dismiss based on a forum-selection clause calling for suit in Indiana was ordered to withdraw its order or be the subject of a writ of mandamus.

Summary:
This case involves a Plea in Abatement/Motion to Dismiss filed by defendants in a dispute arising from a medical services contract.

When the plaintiff, a doctor in Texas, filed suit
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against his billing services company in Texas—and the medical services company sought dismissal of the suit based on a forum-selection clause signed by the parties requiring suit in Indiana—the defendants filed a Plea in Abatement/Motion to Dismiss.

The trial court denied the motion. It agreed with the plaintiff that Indiana was a "seriously inconvenient" forum for the 30,000 patients whose medical information had been compromised, all of whom it determined were potential plaintiffs and/or intervenors.

The defendants disagreed with the judge's decision and filed a petition for writ of mandamus—asserting the plaintiff did not in fact meet the burden of proving "serious" inconvenience.

The San Antonio Court of Appeals agreed with the defendants. It held that the court erred in failing to dismiss the case and, as such, conditionally granted the defendants' petition for writ of mandamus.

Facts:

This case arises out of a suit between Dennis Karasek, M.D., PLLC ("Karasek") and Zotec Partners and Zotec Solutions, Inc. (the "Zotec Partners").

In 2008, Zotec Partners entered into a contract with Karasek for medical billing services. The contract between the parties contained the following forum-selection clause:

> **10.5 Governing law and Forum**: This Agreement and performance hereunder shall be governed by, and construed in accordance with, the laws of the state of Indiana.
>
> Any and all proceedings relating to [it] shall be maintained in . . . [the state courts of] Indiana or the Federal District Courts sitting in Indianapolis . . .

A dispute arose between the parties over whether Zotec Partners was in violation of the contract by allegedly outsourcing the billing services to a company in India in violation of federal law under the Health Insurance Portability and Accountability Act (HIPAA).

Karasek sued Zotec Partners on several claims and Zotec Partners subsequently filed a Plea in Abatement/Motion to Dismiss based on the for-um-selection clause.

The trial court denied Zotec Partners' motion and a petition for writ of mandamus ensued.

The appellate court agreed with Zotec Partners, however, and found that—despite there being 30,000 patients whose medical information was disclosed who could potentially be witnesses or intervenors in the suit—the Zotecs had failed to meet their burden of establishing Indiana as an "inconvenient forum for trial."

As such, mandamus relief was conditionally granted.

The appellate court's holdings:

Mandamus relief only issues to correct a clear abuse of discretion for which there is no adequate remedy at law. The Texas Supreme Court has consistently held that mandamus relief is available to enforce forum-selection clauses when a trial court improperly refuses to enforce such clauses and abuses its discretion.

A trial court abuses its discretion in refusing to enforce a forum-selection clause unless the party opposing enforcement of the clause can clearly show that: (1) enforcement of the clause would be unreasonable or unjust; (2) the clause is invalid for reasons of fraud or overreaching, (3) the enforcement of the clause would contravene a strong public policy of the forum where the suit was brought, or (4) the selected forum would be seriously "inconvenient" for trial. The party resisting enforcement of the forum-selection clause bears a heavy burden of proof.

Here, in the trial court's findings of fact and conclusions of law, the trial court concluded that the "selected forum, Indiana, would be seriously inconvenient to the vast majority of witnesses, reportedly more than 30,000 medical patients who

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are potential intervenors, and the Plaintiffs, all of whom reside, receive, or render medical services in, and around Bexar County, Texas, and whose claims arise from conduct by the Zotec parties allegedly committed while conducting business in Bexar County, Texas."

Nevertheless, Karasek contended that the Zotec Partners failed to meet their burden of establishing Indiana as a seriously inconvenient forum for trial and the appellate court agreed.

"When inconvenience in litigating in the chosen forum is foreseeable at the time of contracting," said the appellate court, the challenger must show that trial in the contractual forum will be "so gravely difficult and inconvenient" that he will, for all practical purposes, be deprived of his "day in court."

To do this, the challenger must show "special and unusual circumstances" that developed *after the contract was executed.*

This is a heavy burden to prove and the Court of Appeals determined Zotec Partners failed to provide "any detailed argument or evidence" as to the nature of the potential witnesses' testimony or even as to the necessity of the witnesses at trial.

Even if the Zotecs *had* established that some of the patients affected would be witnesses, said the court, mere inconvenience to witnesses is not sufficient to overcome a forum-selection clause. (Otherwise, there would be no point to contracting such clauses.)

Based on the Zotec Partners' failure to submit any evidence to demonstrate a "seriously inconvenient" forum, the appellate court concluded that the trial court abused its discretion by failing to dismiss the case against the Zotec Partners and conditionally granted the petition for writ of mandamus.

Moral of the story: You had better think twice before signing a contract with a forum-selection clause that is inconvenient for you and your witnesses. If the case results in litigation, it could get costly.

# # #

"Mumbo-Jumbo" fails to convince court to uphold $8 million award in computer-game dispute—

PopCap Games, Inc. vs. MumboJumbo, LLC

Opinion delivered Aug. 31, 2011
2011 Tex. App. LEXIS 7122
(Tex. App.—Dallas)

In this case from the Dallas Court of Appeals, the appellate court reversed an $8 million judgment against a software developer on several grounds.

Two of the primary issues—dealing with the foreseeability of consequential damages and the "good-cause" exception to late-naming an expert—clarify law as it relates to proving up damages and demonstrating "difficult or impossible circumstances" that rise to the level of "good cause."

Summary:

This case arises from commercial litigation in which the parties asserted several claims and counterclaims each against the other. After a jury trial on the merits and a hearing before the trial judge on attorneys' fees, the trial judge signed a judgment awarding MumboJumbo, LLC ("MumboJumbo") roughly $6.7 million in damages and fees against PopCap Games, Inc. ("PopCap").

The judgment also ordered PopCap to take nothing on its claims.

PopCap appealed and four other parties later filed a cross-notice of appeal.

The Dallas Court of Appeals reversed; rendered judgment that MumboJumbo take nothing; rendered judgment that PopCap recover $1.5 million from MumboJumbo; and remanded for determination of PopCap's attorneys' fees, interest, and costs of court.

Only one of PopCap's seven issues will be addressed in this article; only one of MumboJumbo's three issues will be addressed.

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Facts:

PopCap is a developer of computer-game software. MumboJumbo both develops computer-game software and distributes computer games developed by others.

In 2005, the two executed a written retail license agreement, in which PopCap granted MumboJumbo, among other things, an exclusive North American license to manufacture, market, and distribute specified computer games. The agreement went into effect July 1, 2005 and had a three-year term, but also provided that either party could terminate the agreement without cause upon 120 days' written notice.

On May 23, 2006, PopCap sent MumboJumbo a notice terminating the 2005 agreement, effective in 120 days. A short while later, the parties executed a new written agreement that terminated the 2005 agreement and called for MumboJumbo to provide certain services to PopCap with respect to the manufacture, sale, distribution, and invoicing of specified PopCap computer games.

The 2005 agreement specified the fees that PopCap would pay MumboJumbo and required MumboJumbo to pay PopCap on a monthly basis in an amount based on revenues MumboJumbo collected for the sale of PopCap games.

The parties' relationship soured in mid-2007 and PopCap met directly with computer-game retailers and started distributing its games to at least one retailer, Walmart, without MumboJumbo's involvement.

As a result, MumboJumbo sued PopCap for tortious interference with contractual relations, business disparagement, breach of contract, and fraud. MumboJumbo also sought a declaratory judgment as to the parties' duties under the 2006 agreement.

In response, PopCap filed its own lawsuit, ultimately suing MumboJumbo and its affiliates for breach of contract, conversion, quantum meruit, unjust enrichment, and fraud.

At trial, the jury found that MumboJumbo had breached the 2006 agreement, but that MumboJumbo's breach was excused by PopCap's prior breach. Accordingly, the jury made no finding as to PopCap's breach-of-contract damages.

The jury next found that PopCap breached the 2006 agreement, that PopCap's breach was not excused, and that MumboJumbo's breach-of-contract damages were $776,648.

The jury also found that PopCap intentionally interfered with MumboJumbo's contract with Walmart, but awarded MumboJumbo zero damages on this claim.

Finally, the jury found that PopCap committed fraud by misrepresentation and fraud by nondisclosure and awarded MumboJumbo $3.8 million in damages as "sunk costs" (defined as the amount MumboJumbo expended that it would not have expended if the fraud had not occurred).

The signed final judgment awarded Mumbo-Jumbo almost $4.6 million in damages; $2.1 million in attorney's fees; prejudgment interest of $515 thousand; and postjudgment interests and costs of court. The judgment ordered PopCap take nothing.

On appeal, PopCap sought relief on seven issues, only two of which the Dallas court addressed: (1) whether the court should reverse the take-nothing judgment, render judgment in its favor in the amount of $1.5 million, and remand for further proceedings on attorney's fees, and (2) whether the court should reverse the judgment in MumboJumbo's favor and render judgment that MumboJumbo take nothing.

The MumboJumbo parties asserted three issues on appeal, all three of which the Court addressed.

Additionally, PopCap contended that MumboJumbo's cross-appeal was procedurally defective and so could not be addressed by the court, because it did not specifically seek vacatur of the judgment rather than relitigation of the disputed findings.

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In this article, we will cover the court's analysis with regard to the alleged procedural defect of MumboJumbo's cross-appeal, and then address just one issue each of PopCap's and MumboJumbo's multiple complaints.

Effectiveness of the Motion for New Trial:
On appeal, PopCap contended that MumboJumbo did not timely perfect its cross-appeal and that the court lacked jurisdiction to consider Mumbo-Jumbo's issues.

The basis for such argument was that Mumbo-Jumbo's Motion for New Trial on damages did not qualify as a proper "motion for new trial" under Rule 26.1(a)(1) of the Texas Rules of Civil Procedure, and so did not serve to extend the appellate timetable allowing MumboJumbo to file its Notice of Appeal on the eightieth day after the court signed its final judgment.

According to PopCap, in order for Mumbo-Jumbo's motion for new trial to have been effective, it necessarily had to seek "to have an existing judgment set aside and request a relitigation of the issues." *See Mercer v. Band*, 454 S.W.2d 833, 836 (Tex. Civ. App.—Houston [14th Dist.] 1970, no writ).

The foundational nature of a motion for new trial is "not to reform, but to *vacate* the court's judgment," PopCap argued. *In re Brookshire Grocery Co.,* 250 S.W.3d 66, 73 (Tex. 2008)(orig. proceeding).

Here, contended PopCap, Mumbo Jumbo did not ask the trial judge to vacate the judgment, but rather sought a new trial exclusively on damages. As such, MumboJumbo's motion did not meet the minimum requirements to qualify as a "motion for new trial," argued PopCap.

The appellate court disagreed. Because Mumbo-Jumbo expressly sought to relitigate *some* of the issues in the case, it said, the request sufficed as a proper motion for new trial because Rule 320 of the Texas Rules of Civil Procedure expressly authorizes a trial judge to grant a new trial as to fewer than *all* of the issues in a case.

Moreover—even though it was true that MumboJumbo did not specifically say in its motion that it was requesting the judge set aside the final judgment—the relief Mumbo-Jumbo requested (a new trial on damages) implied a request that the existing judgment be vacated at least in part and a new final judgment eventually signed.

As a result, the Court concluded MumboJumbo's failure to request explicitly the vacatur of the existing judgment did not deprive its motion of effect as a motion for new trial.

Consequential damages:
PopCap presented several arguments on appeal that attacked the part of the trial court's judgment awarding MumboJumbo $3.8 million in damages for fraud.

Among other things, it argued there was legally insufficient evidence that MumboJumbo's "sunk-costs damages" were foreseeable to PopCap, and so could not serve as consequential damages.

In analyzing this issue, the appellate court acknowledged that, on proper pleading and proof, a fraud plaintiff may recover consequential damages that are "foreseeable" and directly traceable to, and result from, a fraudulent act. As such, courts speak of a "proximate cause" or "foreseeability showing" in the context of special or consequential actual damages for fraud.

Here, MumboJumbo argued that its "sunk costs" — the amount it allegedly expended that it would not have expended if PopCap's alleged fraud had not occurred—were *direct* damages rather than *consequential* damages. The court disagreed.

Direct damages compensate for a loss that is the necessary and usual result of the defendant's act, said the Court.

By contrast, *consequential* damages are damages that result naturally, but not necessarily, from the defendant's wrongful act.

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Here, MumboJumbo argued that it had to acquire and operate three independent game-development companies (Zono, Ritual, and Hot Lava) as a consequence of the alleged fraudulent misrepresentations and nondisclosure of PopCap.

Whether MumboJumbo acquired these three companies in reliance on representations of PopCap was not determinative, said the appellate court.

What was determinative, it said, was that MumboJumbo incurred the costs "outside of" and "apart from" its relationship with PopCap. As such, the costs were not a "direct" cost (or necessary and/or usual expense for performing the contract)—they were a "consequential" cost.

Because MumboJumbo's sunk-cost damages were "consequential," said the Court, Mumbo-Jumbo had to prove they were foreseeable to PopCap as the result of its alleged fraudulent misrepresentations and nondisclosures.

This it did not do. Indeed, MumboJumbo introduced *no* evidence to suggest its costs in acquiring and operating the three independent game-development companies were foreseeable to PopCap as the consequence of its acts. As a result, the court concluded that MumboJumbo had produced no evidence to support an essential element of its claim for "sunk costs" as consequential fraud damages.

Expert disclosure:
One of MumboJumbo's three issues on appeal was that the trial court abused its discretion by refusing to allow MumboJumbo to supplement its expert disclosures. (MumboJumbo had sought leave to designate a new expert after the deadline for expert designations had expired because the trial judge had struck MumboJumbo's original damages expert as unreliable).

The appellate court did not agree, pointing out that a party's need for an expert to establish its cause of action does not establish that other parties will not be unfairly surprised by the late designation of an expert.

Although the Dallas Court of Appeals acknowledged that a "good-cause exception" allows a trial judge to excuse a party's failure to comply with a discovery obligation in "difficult or impossible circumstances," the court stated it could find no case holding that the trial court's exclusion of an expert witness as unreliable under Texas Rule of Evidence 702 constituted "good cause" for late disclosure of a *new* expert.

As such, MumboJumbo did not meet its burden of demonstrating that its late designation would not cause unfair surprise or prejudice to PopCap.

Moreover, by not making an offer of proof to demonstrate what its late-designated expert would have testified to, the appellate court was left to speculate as to what MumboJumbo's new expert would have furnished in the way of new testimony. By just speculating, the court could not determine if exclusion of the expert was harmful.

Moral of the Story: If you seek consequential damages for fraud, you had better be able to prove they are foreseeable . . . and if you seek permission from the court to name a new expert after the discovery deadline, you had better have a reason other than the sheer incompetence of your first expert for doing so. If you don't, the court might just think your arguments are "mumbo jumbo."

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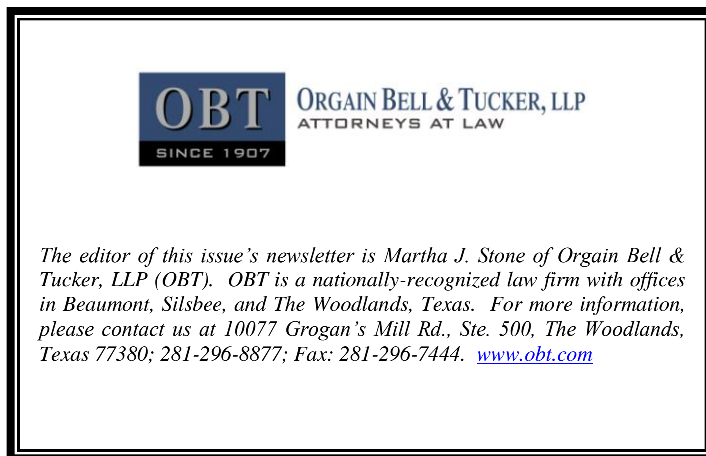

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