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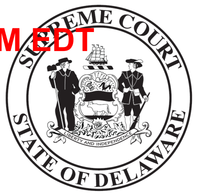


**IN THE SUPREME COURT OF THE STATE OF DELAWARE**

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| AIG SPECIALTY INSURANCE COMPANY f/k/a CHARTIS SPECIALTY INSURANCE COMPANY, ACE AMERICAN INSURANCE COMPANY, and LEXINGTON INSURANCE COMPANY, | ) | Case No. 35,2024 |
| Defendants Below, Appellants, | ) | Court Below – Superior Court of the State of Delaware<br>C.A. No. N18C-12-074 MMJ (CCLD) |
| v. | ) | |
| CONDUENT STATE HEALTHCARE, LLC f/k/a XEROX STATE HEALTHCARE, LLC, f/k/a ACS STATE HEALTHCARE, LLC, | ) | **PUBLIC VERSION** |
| Plaintiff Below, Appellee. | ) | |

**CONDUENT STATE HEALTHCARE, LLC f/k/a XEROX STATE HEALTHCARE, LLC, f/k/a ACS STATE HEALTHCARE, LLC's**
**ANSWERING BRIEF ON APPEAL**

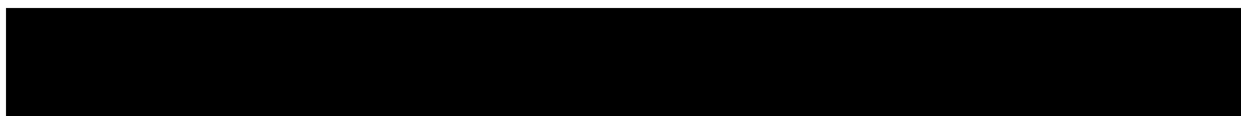
OF COUNSEL:

Lisa S. Blatt
Matthew B. Nicholson
WILLIAMS & CONNOLLY LLP
680 Maine Avenue, S.W.
Washington, DC 20024
Telephone: (202) 434-5000
Facsimile: (202) 434-5029
lblatt@wc.com
mnicholson@wc.com

POTTER ANDERSON & CORROON LLP

Jennifer C. Wasson (No. 4933)
Carla M. Jones (No. 6046)
POTTER ANDERSON & CORROON LLP
Hercules Plaza, Sixth Floor
1313 North Market Street
Wilmington, DE 19801
Telephone: (302) 984-6000
jwasson@potteranderson.com
cjones@potteranderson.com

*Attorneys for Appellee*



Robin L. Cohen
Adam S. Ziffer
Keith McKenna
Orrie A. Levy
COHEN ZIFFER FRENCHMAN
& MCKENNA LLP
1325 Avenue of the Americas
New York, NY 10019
Telephone: (212) 584-1890
Facsimile: (212) 584-1891
rcohen@cohenziffer.com
aziffer@cohenziffer.com
kmckenna@cohenziffer.com
olevy@cohenziffer.com

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## NATURE OF THE PROCEEDINGS

"In almost 20 years on this bench, I have never set aside a jury verdict." A1914. That is how the Superior Court opened its opinion in this case. The court, however, had to set aside the jury's verdict here "to prevent manifest injustice" given Insurers' rampant evidentiary violations and the admission of hearsay the jury could not reasonably evaluate. A1947. The Superior Court also issued two post-trial legal rulings consistent with well-established New York law. This Court should affirm all of those orders.

By way of background, this insurance dispute arises out of an underlying contract dispute between Conduent State Healthcare, LLC and the State of Texas.[1] In 2003 and 2010, Texas contracted with Conduent to process Medicaid claims. In 2014, Texas terminated the contract, alleging that Conduent failed to perform. Texas then sued Conduent, substantively alleging inadequate contractual performance. To obtain settlement leverage, however, Texas dressed up its claim as one for "Medicaid fraud" under the Texas Medicaid Fraud Prevention Act (TMFPA)—a statute which provides for draconian civil monetary penalties and a ten-year ban on doing health-care business in Texas.

During settlement negotiations, Conduent refused to pay to settle Texas' purported fraud claim because Conduent committed no fraud. Rather, consistent

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[1] For ease of exposition, "Conduent" refers to Conduent and its predecessors.

with Texas' allegations that Conduent failed to perform and to protect future business efforts, Conduent insisted it would pay to resolve only contract and negligence-based claims and Texas should amend its petition accordingly. Like any business, Conduent understood that settling on a non-fraud basis could have insurance implications, but insurance coverage was not the driver. Settling a "Medicaid fraud" claim could jeopardize Conduent's ability to obtain future government contracts, and Conduent's exposure, if any, sounded in contract or negligence, not fraud. Texas agreed to amend its petition to reflect the contractual nature of its claims, and the parties settled the lawsuit for an amount roughly equal to Texas' breach-of-contract losses and allocated the entire settlement amount to its breach-of-contract claim.

Meanwhile, Conduent's Insurers refused to pay for Conduent's defense in the Texas lawsuit ("State Action") or to indemnify Conduent for the settlement payment, prompting this suit. On summary judgment, the Superior Court confirmed (in rulings not challenged on appeal) that Insurers breached their duty to defend Conduent in the State Action and that Conduent established a *prima facie* case for indemnity coverage. The case then proceeded to trial on, among other things, Insurers' defense that Conduent fraudulently colluded with Texas to manufacture insurance coverage by allocating the entire settlement to breach-of-contract allegations.

During trial, Conduent abided by the Superior Court's evidentiary rulings while Insurers repeatedly flouted them. Insurers improperly asked the jury to infer from Conduent's privilege log that Conduent discussed manufacturing coverage with counsel despite the court's clear, repeated rulings prohibiting such inferences. Insurers also misled the jury that Insurers had no coverage obligations whatsoever, contrary to the court's ruling. Insurers created the misimpression with the jury that Conduent had to commit fraud to circumvent Insurers' coverage positions, creating a façade that those positions were *correct*. But the court had already ruled that two of Insurers' pre-settlement coverage denials were *wrong*: *i.e.*, Insurers improperly refused to defend Conduent in the State Action, and Conduent established a *prima facie* case for indemnity coverage. Insurers also repeatedly asked witnesses about an excluded press release from the Texas Office of the Attorney General ("OAG") to suggest the settlement was for "Medicaid Fraud."

In addition, over Conduent's objection, Insurers relied heavily on written testimony that included double and triple hearsay, from an OAG attorney who purported to testify about settlement negotiations in which he did not participate. The jury could not properly evaluate that testimony and all its inconsistencies because OAG refused to provide a live witness for cross-examination.

Unsurprisingly, given the hearsay testimony and the misimpressions resulting from Insurers' violations of the court's rulings, the jury rendered a confused and

inconsistent verdict. It found that Conduent engaged in insurance fraud and bad faith while entering a *non-collusive* settlement with Texas that was *reasonably allocated* to contractual liability.

The Superior Court held that allowing this verdict to stand would result in manifest injustice. In hindsight, the court recognized it never should have admitted the OAG attorney's written testimony, which became the centerpiece of Insurers' case. The court also held that Insurers repeatedly violated the court's evidentiary orders, resulting in prejudice apparent from the face of the jury's confused verdict. The court accordingly ordered a new trial on fraud and bad faith.

The court also issued two relevant post-trial rulings. First, the court ruled that Insurers' refusal to pay Conduent's defense costs in the State Action discharged Conduent's obligation to cooperate with Insurers or seek their consent before settling the State Action. Second, the court held that a policy exclusion for "fraud" did not apply to the State Action because the action included covered breach-of-contract allegations to which the entire settlement was allocated.

This Court should affirm the Superior Court's discretionary new-trial order and legal rulings.

## ANSWER TO SUMMARY OF ARGUMENTS

1. Denied. The Superior Court correctly held that Exclusion 3(a) did not bar indemnity coverage for the settlement. Under New York law, to show an exclusion bars indemnity for a loss, an insurer must show the loss falls *entirely* within the exclusion. Insurers cannot make that showing because the State Action included covered breach-of-contract allegations. At most, Exclusion 3(a) would bar coverage for the portion, if any, of the settlement attributable to so-called "Medicaid fraud" claims. But the settling parties allocated the *entire* settlement amount to breach-of-contract allegations, plus legal fees, and the jury found that Insurers *failed* to prove that allocation was unreasonable or collusive. Thus, Exclusion 3(a) does not apply.

Insurers assert they have no duty to indemnify for the breach-of-contract settlement because the "overall gravamen" of the State Action sounds in fraud. But that test contravenes basic tenets of New York law. Moreover, even if "gravamen" were the test, the State Action always sounded primarily in contract.

2. Denied. The Superior Court correctly held that Insurers' breach of their duty to defend relieved Conduent of any cooperation or consent obligations. Under New York law, a policyholder may settle an action without satisfying conditions to coverage such as cooperating or seeking consent "where an insurer unjustifiably refuses to defend a suit." *Isadore Rosen & Sons v. Sec. Mut. Ins. Co. of N.Y.*, 291 N.E.2d 380, 382 (N.Y. 1972); *accord Am. Ref-Fuel Co. of Hempstead v. Res.*

*Recycling Inc.*, 722 N.Y.S.2d 570, 571 (App. Div. 2001). Here, Insurers do not challenge the summary-judgment ruling that they breached their duty to defend. Thus, Conduent was relieved of any cooperation or consent obligations.

3. Denied. The Superior Court did not abuse its discretion in ordering a new trial on fraud and bad faith. After watching firsthand Insurers turn written hearsay into the centerpiece of trial and repeatedly flout the court's rulings, the court provided four reasons for ordering a new trial. While each of these reasons would support a new trial, together they show that the court acted well within its discretion.

i. Denied. The court did not abuse its discretion in holding that written testimony from OAG attorney Raymond Winter should have been excluded as hearsay. Insurers argue Conduent stipulated to admission of Winter's testimony in its entirety, but *both parties* made line-item objections to the testimony. Regardless, trial courts have discretion to independently assess the admissibility of evidence, notwithstanding the parties' positions. Here, to its credit, the court recognized it never should have admitted Winter's hearsay testimony, which the jury could not properly assess and which unfairly prejudiced Conduent.

ii. Denied. The Superior Court acted within its discretion in holding that Insurers violated its rulings by asking the jury to infer from Conduent's privilege log the substance of privileged communications—specifically, that Conduent

supposedly discussed manufacturing insurance coverage with counsel. Conduent could not rebut that misimpression without waiving privilege.

Insurers contend Conduent failed to preserve this issue at trial, even though it was repeatedly discussed and the Superior Court ruled otherwise. Regardless, the court had discretion to consider Insurers' violations of its order *sua sponte*.

iii. Denied. The Superior Court acted within its discretion in holding that Insurers misled the jury about their coverage obligations. Violating the court's orders, Insurers repeatedly suggested to the jury they had no coverage obligations whatsoever. Insurers also suggested that Conduent did not cooperate or seek consent because of a "guilty conscience," exploiting a ruling that barred Conduent from explaining it had no such obligations because Insurers breached their duty to defend.

iv. Denied. The Superior Court did not abuse its discretion in holding that Insurers improperly referred to an OAG press release, which purported to characterize the settlement as one for "Medicaid fraud." Deeming the release inadmissible hearsay, the court held the press release *might* be used for impeachment under limited circumstances. But Insurers improperly referred to the release for its truth.

In sum, the Superior Court—which was in the best position to observe the trial, enforce its rulings, and assess the effect of Insurers' violations—acted well within its broad discretion to order a new trial.

## STATEMENT OF FACTS

### A. Texas Contracts with Conduent.

States commonly hire companies like Conduent to help administer Medicaid, which the federal government largely funds but does not run. A933. Thus, in 2003, the State contracted with Conduent to process "prior authorization" (PA) requests for orthodontic services paid for by Medicaid. A508; B719-20.

In 2008, Texas audited Conduent's contractual performance, including how Conduent reviewed and approved PA requests. A520; A352-53. That sparked a disagreement between Conduent and Texas about whether the contract required Conduent's medical director to independently review orthodontic claims. A352. In 2010, following the audit, Texas renewed the contract. B875-953.

In 2012, OAG began investigating Conduent's approval process. B954-66. After the investigation, Conduent and Texas began settlement discussions, focused on "compensating" Texas for alleged "losses" from Conduent's purported breach of its contractual obligation to approve only qualifying services. B967-74. The parties did not settle, however, because Texas had not quantified its alleged losses and Conduent would not issue a "blank check." A945; A952.

### B. Texas Terminates the Contract and Sues Conduent.

In May 2014, Texas terminated the contract, alleging that Conduent committed "material breaches." A2597. Among other things, Texas alleged

Conduent breached its "promise[]" to provide a "review by a qualified clinical staff with final approval by [Conduent's] Dental Director." A2598.

That same day, Texas sued Conduent in Texas state court, alleging facts concerning Conduent's purported contract breach. A2418-40. For example, Texas alleged that (1) Conduent "bid for, and won, contracts" with Texas; (2) Conduent's responsibilities included "evaluation and proper disposition of prior authorization requests" for orthodontic treatment; and (3) Conduent "failed to adequately review the orthodontic PA requests." A2420-21.

Despite these breach-of-contract allegations, Texas pleaded claims under the TMFPA. A2436. It did so for strategic reasons. A949; A1081-82; A1143-45; A3744; A3756. Under the statute, Texas may seek massive civil penalties and a 10-year ban on doing business in Texas. Tex. Hum. Res. Code §§ 36.005(b), 36.052(a)(3). And unlike common-law fraud, the TMFPA does not require fraudulent intent. *Id.* § 36.0011(b).

### C. Texas and Conduent Allocate the Settlement to Contractual Liability.

In January 2018, Texas' expert quantified the losses from Conduent's alleged failure to properly review PA requests at $431.4 million. B535. Conduent's expert, however, estimated those alleged losses at about $230 million. B536.

Resuming settlement discussions, Conduent made clear any settlement must be for losses from alleged breaches of contract or negligent contractual performance,

not "Medicaid fraud." A956-57; A1259. Settling a purported fraud claim would have decimated Conduent's $2.5 billion government-contracting business because few government entities would contract with a company that recently settled such a claim. A957. Indeed, a fraud settlement would have severely restricted Conduent's ability to even bid on contracts. *Id.* This threat loomed so large that Conduent would have "tak[en] this case to trial" if Texas refused to amend its petition. A1308. Further, Conduent's liability, if any, sounded in contract or negligence, not fraud. A1031. And settling for Texas' actual losses would preclude Texas from seeking the same losses from dental providers "who would then turn around and sue [Conduent]." A957. Conduent, like any reasonable company, also considered insurance, but its reputation remained the "principal focus" given that Conduent's $2.5 billion government-contracting business dwarfed any potential insurance recovery, which would only partially cover the settlement. A139.

On December 14, 2018, Conduent's trial counsel, Robert Walters, and Texas' counsel, Darren McCarty, met to discuss settlement. A1306. Walters reiterated that no evidence supported "Medicaid fraud" and that Texas' petition and any settlement would need to reflect that. A1253; A1307; A1327. In response, McCarty agreed to add contract and negligence counts and to settle for $235.94 million, an amount based on Texas' losses from Conduent's alleged contractual breaches. A1329; A1345.

The parties exchanged draft settlements. OAG attorney Winter, who had not even attended the December 14 meeting, removed language stating Texas "was prepared to amend the State Action to add causes of action for breach of contract…and negligence." A1270-71; A1337-38; A3747. As head of the TMFPA division, Winter wanted to settle only TMFPA claims. A1308; A1340-42; A1533. But after another Walters-McCarty discussion, the State reinserted that language. A3710; A1271; A1341-42.

Texas then filed its Third Amended Petition with materially identical allegations plus breach-of-contract and negligence counts. *Compare* A3673-3705, *with* A2418-40; A2455-81; A3385-3413. The ease of that change confirmed that the TMFPA claim was premised on contractual allegations. For instance, the TMFPA count alleged that Conduent misrepresented or concealed facts about "conducting of [PA] reviews of requests for orthodontic prior authorization." A3696-97. Similarly, the breach-of-contract count alleged that Conduent breached the contracts by "failing to conduct [PA] reviews of requests for orthodontic prior authorization." A3699.

The parties settled for $235 million and allocated the entire amount to "losses claimed to have resulted from alleged failures to comply with obligations…under the [contracts]" plus attorney's fees. A3714-15.

### D. Insurers Repeatedly Deny Coverage and Refuse To Defend Conduent.

Conduent tendered the State Action to Insurers under professional liability policies.[2] In response, Insurers repeatedly denied any coverage obligations, citing, among other things, the policy's "fines and penalties" exclusion. A2441-54; A2879-80; B975-76; B1046-52; B1057-66; *e.g.*, B25-26; B32-36; B111-13.

In October 2018, Conduent alerted Insurers to its settlement discussions. B1049-50. Insurers reiterated that "there is no coverage for the [State Action]." B1049. Despite Insurers' wrongful refusal to defend, Conduent updated Insurers on settlement discussions. On December 15, 2018, Conduent notified Insurers of Texas' settlement demand and plan to amend its petition to reflect its tort and contract claims. A3500-01;[3] A1306-07. Insurers reiterated their denial, noting Conduent did not provide "additional information that would change [their] view." B1057; *accord* B1062-65.

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[2] AIG, ACE, and Lexington (an AIG affiliate) are the only insurers who have not settled.

[3] Insurers claim (at 14) "Conduent's attorneys spent a day word-smithing" this email "to plant the misimpression that Texas told Conduent it intended to amend the action." But Walters—who was not coverage counsel—wrote the relevant portions because he attended the meeting with McCarty, and testified the email accurately described the meeting. A1306-08.

## E. Procedural History

### 1. The Superior Court Rules Insurers Breached Their Duty to Defend.

Conduent sued Insurers seeking coverage for its defense and settlement of the State Action. A114-141; A142-177. On cross-motions for summary judgment, Insurers argued they had no duty to defend or indemnify Conduent for the State Action because it fell within the fines-and-penalties exclusion. A515. Insurers further sought summary judgment on their defenses that Conduent (1) breached its obligations to cooperate with and seek Insurers' consent before settling and (2) fraudulently colluded with the State to manufacture insurance coverage by allocating the settlement to contractual liability. A517.

The court granted the motions in part, holding that the fines-and-penalties exclusion did not apply; Insurers had breached their duty to defend Conduent; and Conduent had established a *prima facie* indemnification case. A516-17; A525. The court further held there were genuine issues of material fact concerning Insurers' cooperation-and-consent and fraud-and-collusion defenses. A519.

The case proceeded to trial on those defenses. The court reserved for after trial the legal question whether Insurers' failure to defend relieved Conduent of any cooperation and consent obligations. A1542; A1548-51.

### 2. Insurers Repeatedly Violate the Court's Evidentiary Rulings.

The Superior Court made four evidentiary rulings relevant here:

- First, the court prohibited Insurers from using Conduent's privilege log to argue "that Conduent's attorneys must have advised Conduent in a certain way." A809.

- Second, the court prohibited either party from mentioning the court's duty-to-defend ruling. Specifically, Insurers could not suggest they had no coverage obligations, and Conduent could not tell the jury Insurers breached their duty to defend. A713; A1929.

- Third, the court excluded as hearsay an OAG press release that purported to characterize the settlement as a "Fraud Settlement." A808.

- Fourth, the court admitted written testimony from Winter, who purported to explain key facts about the settlement. A842-43.

#### i. Insurers Improperly Ask the Jury to Draw Inferences from Conduent's Privilege Log.

To try to prove insurance fraud, Insurers used Conduent's privilege log, which included communications with insurance-coverage counsel. A804-07. In a pre-trial ruling, the court noted that while the content of these communications was privileged, Insurers could use a demonstrative exhibit with information from the log showing "[t]he fact that meetings took place, the dates of those meetings, the general subject matter, and who attended those meetings." A809. However, the court prohibited Insurers from "arguing that Conduent's attorneys must have advised Conduent in a certain way" because that "would improperly place the content of attorney advice at issue." A809.

Insurers repeatedly violated that ruling. From their opening, Insurers argued the log showed "the pattern of what Conduent was talking about…right before it settled." A925. And at closing, Insurers' counsel said, "[y]es, [the log] suggests there was a communication, a written communication about coverage." A1570. Seconds later, counsel doubled down, asserting these communications occurred "in the key time period where they are working on trying to come up with a basis to trigger coverage with the insurers." *Id.*[4]

**ii. Insurers Improperly Suggest They Had No Coverage Obligations.**

Before trial, the court barred Conduent from eliciting evidence that Insurers breached their duty to defend because the court already resolved that legal issue. A713. At the same time, the court prohibited Insurers from suggesting they had no coverage obligations whatsoever. *Id.*; A1929. The court added that, because the interpretation of policy exclusions is a "purely legal question," "no testimony solely related to [an exclusion] will be admitted." A698.

Insurers repeatedly violated these rulings, often emphasizing policy exclusions to suggest (inaccurately) they had no coverage obligations. For example, in opening, Insurers displayed Exclusion 3(a), the so-called "fraud" exclusion to the

[4] Although Conduent did not contemporaneously object to these statements, the court observed that this is "typical in civil trials in Delaware" and ruled that Conduent had preserved objections. A1925.

jury, until the Court intervened. A909-11. The next day, Insurers did the same, again prompting the Court to order it removed. A1024. Invoking Exclusion 3(a), Insurers continually elicited testimony that there was no coverage because the State Action concerned only "fraud fraud fraud." A1235-36; A1468.

The court's rulings quickly became a one-way ratchet. Although a key issue at trial was whether Conduent breached its cooperation and consent obligations, Conduent could not tell the jury those obligations were discharged when Insurers breached *their* duty to defend. *See infra* pp. 31-35. Simultaneously, Insurers exploited Conduent's forced silence by suggesting that Conduent's failure to cooperate or seek consent evidenced fraud. For instance, in opening, Insurers asserted "Conduent didn't tell" them about settlement negotiations "when it was manipulating the settlement behind the scenes." A917. In closing, Insurers claimed Conduent's failure to cooperate revealed a "guilty conscience." A1570. The jury thus heard that, to conceal "fraud," Conduent failed to cooperate and seek consent, but the jury never heard that Conduent had no such obligations.

#### iii. Insurers Improperly Refer to an OAG Press Release.

To further convince the jury that the settlement's allocation was fraudulent, Insurers sought to admit an OAG press release entitled "AG Paxton Recovers Record $236 Million for Texas in Medicaid Fraud Settlement." A786-91; A1930.

Before trial, the court ruled that the press release was "inadmissible hearsay." A808. The court noted, however, that the release might be "used for impeachment" in narrow circumstances where a witness first denied that Texas referred to the settlement as one for Medicaid fraud. *Id.*

Despite the court's instructions, Insurers referred to the release before the jury for non-impeachment purposes. Insurers' counsel asked a witness if he recalled that "the day after the settlement agreement was signed, the Texas Attorney General's Office issued a press release announcing—." A1069. Although Conduent's objection kept Insurers' counsel from saying "fraud," the prior question gave away Insurers' game: Conduent "couldn't be seen as having settled a Texas Medicaid fraud claim for $236 million. Right?" *Id.*

The next day, Insurers' counsel questioned a witness about whether it was "a common practice" for the OAG to "issue a press release" after a "big win." A1124. The court recognized Insurers' questions as "a back-door" attempt to get around its ruling. A1125. Undeterred, Insurers' counsel persisted in asking another witness about the release. A1305. The court reiterated its ruling and warned counsel that he

would be disqualified from trial if he mentioned the release again without permission. A1305-06.

**iv. Insurers Rely on Hearsay from an OAG Attorney**

During discovery, Insurers sought live testimony from an OAG witness, but OAG refused. A843. Instead, Insurers obtained written answers to deposition questions from OAG attorney Raymond Winter. A1920; A3737-4107.

As the court recognized, Winter's entire submission was "hearsay," including "double and triple hearsay." A1920.

A3744-46.

Further, Winter asserted that,

*Id.*

Winter further asserted that

A3744.

Insurers sought to admit Winter's testimony in full, invoking language in a pretrial stipulation that his testimony "shall be admissible by any party for any purpose at trial." A652; A842-43. Conduent agreed that certain testimony was admissible, like that authenticating documents. *E.g.*, A3740-43. But Conduent never agreed that all of Winter's testimony should come in. Indeed, *both* Conduent and Insurers made line-item objections to the testimony in the same stipulation, with Conduent making multiple objections to all questions and answers designated by Insurers. B572; A840-41.

Despite these objections, and acknowledging Winter's testimony as hearsay, the court admitted the testimony in toto based on its reading of the stipulation. A842; A849.

At trial, Winter's testimony became the centerpiece of Insurers' case. During their opening, Insurers asserted the

Similarly, at closing, Insurers repeatedly invoked Winter's testimony. For example, Insurers argued

### 3. The Jury Renders an Inconsistent Verdict.

Following trial, the jury rendered a confused and inconsistent special verdict. A1667-70. On one hand, the jury found that Insurers proved that Conduent engaged in fraud and acted in bad faith, including by allocating the entire settlement to contract liability. A1669. On the other, the jury found that Insurers failed to prove that Conduent colluded with Texas or that the settlement—including its allocation—was unreasonable. A1669-70. In short, the jury found that Conduent somehow fraudulently and in bad faith entered a non-collusive, reasonable settlement.

The jury also found that Conduent breached its duties to cooperate with and seek consent from Insurers, and that Conduent had not proven that doing so was futile. A1667-68. The court, however, reserved the legal question whether Insurers' breach of their duty to defend had relieved Conduent of its cooperation and consent obligations. A1542; A1548-51.

### 4. The Superior Court Orders a New Trial on the Insurers' Defenses of Fraud and Bad Faith.

Following the verdict, the court ordered a new trial on fraud and bad faith. The court noted that "[i]n almost 20 years…, [it had] never set aside a jury verdict," but recognized that "extraordinary circumstances" in this case mandated a new trial for "four principal reasons." A1914; A1916; 1946-47.

First, "the Winter Submission was so replete with evidentiary problems (hearsay, double or triple hearsay, inability to cross-examine the declarant, admitted lack of knowledge by the declarant), that it never should have been admitted," despite what the court took as the "agreement of the parties." A1946.

Second, "[c]ontrary to several explicit written and bench rulings," Insurers' counsel "repeatedly referred" the jury to the inadmissible OAG press release. A1933-41; A1946.

Third, "[d]espite repeated admonitions," Insurers' closing argument was "intended to persuade the jury to draw improper inferences" from Conduent's privilege logs—namely that Conduent discussed "manufacturing insurance coverage" with counsel. A1947.

Fourth, Insurers "inaccurately and improperly" argued they "never had any coverage obligation to Conduent," in contradiction of the court's ruling that Insurers breached their duty to defend. *Id.*

The court added that the prejudice from Insurers' violations appeared on the face of the jury's "contradictory" and "confused" verdict. A1946. For all these reasons, the court granted a new trial. A1947.

#### 5. The Superior Court Rules that Conduent Had No Duty to Cooperate with or Seek Consent from Insurers.

In the same order, the court granted Conduent judgment as a matter of law on cooperation and consent. *Id.* The court first distinguished between the jury's factual finding that cooperation and consent would not have been futile and the legal question whether Insurers repudiated coverage, thereby relieving Conduent of those obligations. A1942.

On the legal question, the court followed New York's highest court: "[W]here an insurer unjustifiably refuses to defend a suit, the insured may make a reasonable settlement or compromise of the injured party's claim, and is then entitled to reimbursement from the insurer, even though the policy purports to avoid liability for settlements made without the insurer's consent." A1943 (quoting *Isadore*, 291 N.E.2d at 382). The court noted it had previously ruled that Insurers breached their duty to defend Conduent, and concluded that Insurers' breach, along with their "continued repudiation of coverage," "relieved Conduent of any duty to cooperate or to seek consent." A1944.

#### 6. The Superior Court Rules that Exclusion 3(a) Does Not Apply

On the eve of trial, Insurers argued that Conduent's settlement payment fell within Exclusion 3(a). As relevant, that exclusion states the policy does not cover "Loss in connection with a Claim made against an Insured: (a) alleging, arising out of, based upon or attributable to a dishonest, fraudulent, criminal or malicious act, error or omission, or any intentional or knowing violation of law." A2350. The court reasoned that Exclusion 3(a)'s application was a legal question and deferred consideration of that issue until after trial. A2246-47. Following the grant of a new trial, the parties cross-moved for summary judgment on the issue.

The court ruled that Exclusion 3(a) did not apply. A2247-54. The court noted that policy exclusions "must be read strictly and narrowly against the insurer." A2248. The court acknowledged that it is "not unusual" for a suit to "allege facts relating to excluded conduct as well as conduct that would not fall within the exclusion" and that it would be "unreasonable for a fraud exclusion to eliminate coverage for a loss relating to contract claims." *Id.* The court then looked to Texas' petition to assess whether the allegations were "solely or primarily" excluded. *Id.*

The court concluded that the Third Amended Petition was "not solely based on excluded conduct" but rather included covered contract claims. A2254. The court further found that the settlement "unequivocally" allocated the entire payment

to contractual liability. *Id.* Accordingly, Exclusion 3(a) did not apply. *Id.* This interlocutory appeal followed.

## ARGUMENT

### I. EXCLUSION 3(A) DOES NOT BAR INDEMNITY FOR THE SETTLEMENT

#### A. Counterstatement of Question Presented

Did the Superior Court correctly hold that Exclusion 3(a) does not bar indemnity coverage for Conduent's settlement, where the underlying suit included covered breach-of-contract allegations and the settling parties allocated the entire settlement to those covered allegations? *See* A1989-2136; A2244-54.

#### B. Scope of Review

This Court reviews *de novo* the Superior Court's legal determination that an exclusion does not apply. *USAA Cas. Ins. Co. v. Carr*, 225 A.3d 357, 360 (Del. 2020).

#### C. Merits of Argument

Insurers contend (at 24-30) that Exclusion 3(a) eliminates their duty to indemnify Conduent for the settlement, even though the State Action included covered breach-of-contract allegations and attorney's fees and even though Texas and Conduent allocated the entire settlement to those covered allegations. This is so, Insurers contend (at 24-25), because the "overall 'gravamen'" of the State Action supposedly sounded in "fraud, dishonesty, or knowing violations of law."

That broad reading of Exclusion 3(a) contravenes New York law. New York courts narrowly construe policy exclusions in favor of coverage. *Pioneer Tower*

*Owners Ass'n v. State Farm Fire & Cas. Co.*, 908 N.E.2d 875, 876-77 (N.Y. 2009). For an exclusion to bar indemnity coverage for a loss, the insurer must "establish that th[e] loss falls *entirely* within the policy exclusion." *Servidone Const. Corp. v. Sec. Ins. Co. of Hartford*, 477 N.E.2d 441, 445 (N.Y. 1985); *accord Waddy v. Genessee Patrons Coop. Ins. Co.*, 84 N.Y.S.3d 271, 275 (App. Div. 2018). If a loss does not fall entirely within an exclusion, at most, the exclusion applies only to the "portion" of the loss within its scope. *Apache Foam Prod. Div. of Millmaster Onyx Grp. of Kewanee Indus. v. Cont'l Ins. Co.*, 528 N.Y.S.2d 448, 449 (App. Div. 1988).[5]

These principles are dispositive here. Insurers do not—and cannot—show that Conduent's settlement of the State Action falls "entirely" within Exclusion 3(a). To start, the settlement itself states that all payments were for breach-of-contract allegations and attorney's fees, A3714-15, which are *not* excluded. Every iteration of Texas' petition included such allegations. A2418-40; A2455-81; A3385-3413; A3673-3705. For example, the original petition alleged (1) Conduent "bid for, and won, contracts" with Texas; (2) Conduent's "contractual obligations" included "evaluation and proper disposition of prior authorization requests"; and (3) Conduent "failed to adequately review" such requests. A2420-21. The Third

[5] Although the Superior Court used the term "gravamen," the court (unlike Insurers) properly asked whether the State's allegations fell "solely" within the exclusion. A2254.

Amended Petition confirmed the contractual nature of Texas' claims by expressly adding a count for "BREACH OF CONTRACT." A3698-700. And even Winter acknowledged Texas had "ample good-faith bases" for that count. A3744.

At most, Exclusion 3(a) would bar indemnity only for the portion, if any, of the settlement attributable to "Medicaid fraud" allegations. However, Texas and Conduent allocated the *entire* settlement amount to breach-of-contract allegations and attorney's fees, agreeing that "no portion" was allocated to fines, penalties, punitive assessments, or disgorgement—*i.e.* remedies available for Medicaid fraud. A3714-15. Moreover, the jury found that Insurers *failed* to prove that the settlement—including its allocation—was unreasonable or collusive. A1669-70. Because no portion of the settlement was allocated to "Medicaid fraud," there is nothing for Exclusion 3(a) to exclude.

Insurers misread *Gibbs v. CNA Insurance Cos.*, 693 N.Y.S.2d 720, 722 (App. Div. 1999), as supporting their "overall 'gravamen'" test. There, a plaintiff sued the policyholder for child sexual abuse, but the plaintiff later withdrew intentional-tort claims and pursued only negligence-based claims. *Id.* To assess the claims, the court looked to "extrinsic facts"—namely, that the policyholder had "pleaded guilty to the [criminal] charge of sexual abuse in the first degree." *Id.* Given those facts, the court found "the gravamen" of the action was the policyholder's "acts of sexual abuse"—which fell "solely within a policy exclusion." *Id.*

Thus, contrary to Insurers' reading, *Gibbs* does not stand for the proposition that an insurer may avoid its duty to indemnify for the *covered* portion of a loss merely by asserting that a suit's "overall 'gravamen'" is excluded. Instead, it stands for the narrower principle that an insurer has no duty to defend where *extrinsic facts* show that the policyholder's conduct falls *solely* within an exclusion.

Here, no "extrinsic facts" show that Conduent's conduct fell solely within the exclusion. To the contrary, as noted, Winter admitted Texas had "ample good-faith bases" for its breach-of-contract and negligence allegations. A3744. Those allegations fall *outside* Exclusion 3(a).[6]

Finally, even if the "overall 'gravamen'" of the State Action were relevant, Exclusion 3(a) still would not apply. Here, the "gravamen" of the State Action sounded in contract. Although Texas pleaded its claims under Texas law, the question whether Texas' allegations sound in "fraudulent" or "dishonest" acts or "knowing violation[s] of the law" under Exclusion 3(a) is a matter of New York law. A512-14 (New York law governs policy interpretation). Under New York law, "a cause of action for fraud does not arise when the only alleged fraud relates to a

[6] Insurers' other authorities are similarly inapt. *Cent. Mut. Ins. Co. v. Willig*, 29 F. Supp. 3d 112, 120 (N.D.N.Y. 2014) (finding no duty to defend or indemnify where "entirety" of complaint fit within exclusion); *Scottsdale Ins. Co. v. RiverBank*, 815 F. Supp. 2d 1074, 1084-85 (D. Minn. 2011) (applying Minnesota law to hold, like *Gibbs*, that extrinsic evidence of a criminal conviction shows a loss arises out of excluded criminal conduct).

breach of contract." *Metro. Transp. Auth. v. Triumph Advert. Prods., Inc.*, 497 N.Y.S.2d 673, 675 (App. Div. 1986). A claim does not sound in fraud merely because a plaintiff alleges breach of a "representation of performance implicit in making [a] bid" or a breach of "a subsequent assurance of performance," as those allegations are not "distinct from those giving rise to [a] breach of contract claim." *Id.*; *accord Springut L. PC v. Rates Tech. Inc.*, 70 N.Y.S.3d 14, 15-16 (App. Div. 2018).

Here, Texas' allegations of "Medicaid fraud" all relate to alleged breaches of contract. The original petition states as much: Conduent's "liability arises from its misrepresentations regarding, and concealment of, material facts regarding *its discharge of contractual obligations*." A2420. Specifically, Texas alleged Conduent "represented" in its contract bid that it would perform and made "assur[ances]" to that effect. A2424. Those allegations relate directly to its breach-of-contract allegations.

Texas further confirmed that its claims sound in contract by expressly adding a breach-of-contract count in its Third Amended Petition. That Texas did so without "meaningfully chang[ing]" its allegations (Ins. Br. 28) only underscores that its suit always sounded primarily in contract. In fact, Texas alleged that Conduent made misstatements or omissions about the very same acts that allegedly breached the contracts. *Compare* A3696-97, *with* A3699-3700. It is no wonder that Insurers

admitted in a 2014 letter that "the State Action…arise[s] out of…alleged non-compliance with the [Conduent] contract(s)." A2447. Thus, even if the "overall 'gravamen'" test governed (it does not), Exclusion 3(a) would not apply.

## II. CONDUENT HAD NO COOOPERATION OR CONSENT OBLIGATIONS

### A. Counterstatement of Question Presented

Did the Superior Court correctly hold that Insurers' undisputed breach of their duty to defend relieved Conduent of any obligations to cooperate with Insurers and seek their consent before settling? *See* A1777-85; A1847-62; A1901-10; A1941-44.

### B. Scope of Review

"This Court reviews *de novo* the Superior Court's decision to grant judgment as a matter of law." *Kados v. Harrison*, 980 A.2d 1014, 1016 (Del. 2009).

### C. Merits of Argument

On appeal, Insurers do not challenge the Superior Court's summary-judgment ruling that they breached their duty to pay Conduent's defense costs in the State Action, A517, thus forfeiting such challenge. *Smith v. Del. State Univ.*, 47 A.3d 472, 479 (Del. 2012).[7] Thus, the only question here is whether Insurers' breach of their duty to defend relieved Conduent of its obligations to cooperate with or seek consent from Insurers before settling the State Action. Under well-established New York law, the answer is yes.

[7] Although Insurers note (at 34) they defended Conduent in a separate lawsuit by orthodontic providers, they nowhere dispute they breached their duty to defend Conduent in the State Action.

Over fifty years ago, the New York Court of Appeals made clear that a policyholder may settle a suit without an insurer's consent if the "insurer unjustifiably refuses to defend [the] suit." *Isadore*, 291 N.E.2d at 382. New York courts thus consistently hold that an insurer's breach of its duty to defend relieves the policyholder of its consent and cooperation obligations. For example, a letter notifying a policyholder that insurers "would not defend it" constituted "a repudiation of the [insurers]' liability" and thus "excused" the policyholder "from further compliance with its obligations under the policy." *Am. Ref-Fuel*, 722 N.Y.S.2d at 571. Similarly, an insurer who "ignored the [policyholder's] repeated requests for counsel" had no right to demand that the policyholder cooperate and seek consent before settling. *City of New York v. Zurich-Am. Ins. Grp.*, 811 N.Y.S.2d 773, 774-775 (App. Div. 2006). As a leading treatise puts it, "[a]n insurer cannot refuse to defend an action…and, at the same time, insist on controlling the defense." 14A *Couch on Insurance* § 202:7 (3d ed. 2024); *accord* 3 *New Appleman on Insurance Law* § 17.07 (Lib. Ed. 2024).

The Superior Court properly applied this rule. Because Insurers "breached [their] contractual duty to pay defense costs under the relevant policies," Conduent was "relieved" of "any duty to cooperate or to seek consent." A1944.

Insurers principally contend (at 32-33) they merely "disclaimed," not repudiated, "coverage for the State Action." But under New York law, a breach of

the duty to defend is a "repudiation" as a matter of law. *Am. Ref-Fuel*, 722 N.Y.S.2d at 571. By breaching its duty to defend, an insurer incorrectly takes the position "there is no possible factual or legal basis" for indemnification "under any policy provision," which constitutes a repudiation of coverage. *Frontier Insulation Contractors, Inc. v. Merchs. Mut. Ins. Co.*, 690 N.E.2d 866, 868-69 (N.Y. 1997).

Insurers assert (at 34) that their duty-to-defend breach is "insufficient" to relieve Conduent of its obligations. But Insurers invoke inapposite cases, ignoring *Isadore* and its progeny. All but two of Insurers' cases (at 31-34) concern the duty to indemnify a judgment or settlement, not the duty to defend, and some do not even apply New York law. Their two duty-to-defend cases are also distinguishable. One concerns the settlement of a criminal case after the insurer (unlike here) *rightfully* refused to defend the policyholder in a *separate* civil suit. *Bear Wagner Specialists LLC v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA*, 2009 WL 2045601, at *6-7 (N.Y. Sup. Ct. July 7, 2009). And the other involved an insurer that (also unlike here) "provid[ed] [the policyholder] a defense." *Empire Fire & Marine Ins. Co. v. Estrella*, 2019 WL 6390193, at *5 (E.D.N.Y. Sept. 13, 2019).

Because Insurers' breach of their duty to *defend* is itself a repudiation, the line between repudiating and disclaiming the duty to *indemnify* does not matter here. But even if it did, Insurers crossed it. An insurer's repeated disclaimer of coverage *is* a "repudiation." *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 58 N.Y.S.3d 38, 39 (App.

Div. 2017). Here, Insurers repeatedly told Conduent "there is no coverage for the [State Action]." B1049; *accord* A2441-54; A2879-80; B975-76; B1046-48; B1051-52; B1057-66. The Superior Court correctly concluded that these denials constituted a "continued repudiation of coverage." A1944.

Insurers observe (at 3-5, 31-32, 34) that the jury found that it would not have been futile to cooperate with Insurers and seek their consent. But futility and repudiation are separate grounds for excusing cooperation and consent. "[A]n insurer…releases its insured from the duty to cooperate by denying coverage *or* taking measures that render cooperation futile." *J.P. Morgan Sec. Inc. v. Vigilant Ins. Co.*, 39 N.Y.S.3d 864, 870 (N.Y. Sup. Ct. 2016). Regardless, the jury's findings have nothing to do with Insurers' duty-to-defend breach. In fact, the court prohibited mention of Insurers' breach of their obligation to pay Conduent's defense costs in the State Action because the court had already resolved that issue as a matter of law. A517; A698-700. The jury thus could not have decided the effect of Insurers' duty-to-defend breach.

Finally, Insurers contend (at 35) the Third Amended Petition somehow reset Conduent's cooperation and consent obligations, requiring Conduent to tender that petition to Insurers. Insurers cite no cases supporting their novel theory, and for good reason. An insurer's breach of the duty to defend relieves the policyholder of

any obligation to cooperate, including any obligation to tender new pleadings. *See Isadore*, 291 N.E.2d at 382; *Am. Ref-Fuel*, 722 N.Y.S.2d at 571.

Nor does Insurers' theory make sense. As noted, an insurer may avoid paying a policyholder's defense costs only if "there is no possible factual or legal basis" for indemnification "under any policy provision." *Frontier*, 690 N.E.2d at 868-69. Insurers claimed they could meet that standard. *E.g.*, A2441-54. In the face of such a categorical denial, it would be irrational to require Conduent to update Insurers with every case development.

Even if there were such an obligation, the Third Amended Petition would not trigger it. On appeal, neither party contends the Third Petition changed the nature of the State Action. Ins. Br. 27-29, 35; *supra* pp. 28-30. Further, when Conduent (despite having no duty to do so) informed Insurers that Texas would amend its petition to include a contract claim, Insurers reiterated their denial, asserting that Conduent had "not provided [them] with any additional information that would change [their] view." A1944. Especially given that prospective denial, Insurers' contention that the Third Amended Petition reinstated Conduent's duties fails.

## III. THE SUPERIOR COURT DID NOT ABUSE ITS DISCRETION IN ORDERING A NEW TRIAL

### A. Counterstatement of Question Presented

Did the Superior Court abuse its discretion in ordering a new trial on Insurers' defenses of fraud and bad faith where the underlying verdict was (1) based on unreliable hearsay, (2) tainted by Insurers' repeated evidentiary violations, and (3) sufficiently confused to demonstrate prejudice? *See* A1772-77; A1826-47; A1893-901; A1916-47.

### B. Scope of Review

This Court reviews "the grant…of a new trial for abuse of discretion." *Chilson v. Allstate Ins. Co.*, 979 A.2d 1078, 1083 (Del. 2009). While a trial court must afford a jury's verdict "great deference" in the first instance, "[a] decision to set aside a jury verdict warrants appellate deference due to the trial judge's presence at trial and his or her duty to see that there is no miscarriage of justice." *Id.*

### C. Merits of Argument

The Superior Court recognized, while "great deference" is afforded to a jury verdict, "justice would miscarry" if the verdict here "were allowed to stand." A1914; A1947. The court gave "four principal reasons" for this conclusion. A1946. First, the written testimony of an OAG attorney "became a central focus" at trial even though it "was so replete with evidentiary problems…it never should have been admitted." *Id.* The remaining three reasons involved Insurers' repeated violations

of the court's "explicit written and bench rulings," "repeated admonishments," and "pretrial holding." A1946-47. Given these reasons, the court acted within its discretion in ordering a new trial.

### 1. Winter's Testimony Was Inadmissible and Prejudicial

The Superior Court acted well within its discretion in ordering a new trial because the written testimony of OAG attorney Winter was inadmissible and unfairly prejudicial. At trial, Insurers heavily relied on Winter's [redacted]

[redacted]

[redacted] As the court observed, Winter's credibility "became a centerpiece" at trial. A1920. Yet, the jury had "no way" to "adequately evaluate the validity of Winter's testimony," given he was not subject to live cross-examination. A1920-21. The court thus concluded that Winter's testimony "never should have been admitted." A1946.

Where, as here, a court grants a new trial to correct an evidentiary ruling, this Court first reviews the underlying ruling. *O'Riley v. Rogers*, 69 A.3d 1007, 1010 (Del. 2013). If erroneous or an abuse of discretion, the Court determines whether the error caused "significant prejudice" and made the trial unfair. *Id.* Here, both prongs are satisfied.

***Admissibility.*** As the Superior Court recognized, Winter's written testimony was "hearsay" and included "double and triple hearsay," A1920, rendering it inadmissible. D.R.E. 802.

Insurers do not argue that Winter's testimony is admissible under the Rules of Evidence. Instead, they contend (at 40) the Superior Court had to admit all of Winter's testimony because the parties allegedly stipulated to its wholesale admission. As an initial matter, there was no such broad stipulation. To be sure, Conduent did not object to Winter's testimony regarding ministerial matters, like document authentication. *E.g.*, A3740-43. But, in the same submission containing the stipulation, *both parties* included line-item objections to Winter's substantive testimony. B566. Thus, at least for objected-to portions of the testimony, the court needed to identify a basis for admission. *Reynolds v. State*, 424 A.2d 6, 7 (Del. 1980). There was none.

Even if there were such a broad stipulation, the Superior Court acted well within its discretion by holding that Winter's hearsay testimony "never should have been admitted." A1946. "The discretion of a judge to object *sua sponte* to inadmissible hearsay evidence is long established in Delaware." *Dupree v. State*, 2023 WL 2783164, at *5 (Del. Apr. 4, 2023). Although "[t]he general practice is to receive evidence when it is offered, unless it is objected to…the trial judge is something more than a mere umpire." *S. Atl. S.S. Co. of Del. v. Munkacsy*, 187 A.

600, 606 (Del. 1936). This Court has long recognized trial courts' "duty" to exclude "[h]earsay testimony," which is "not evidence at all." *Id.* More broadly, courts must apply evidentiary rules "with or without objection by counsel." *O'Riley*, 69 A.3d at 1010-11.

Insurers' cases (at 40) are inapt. One holds that a "pretrial stipulation is not determinative" of admissibility but has "a bearing" on whether the opposing party is "surprised or prejudiced" by stipulated evidence. *Green v. Alfred A.I. duPont Inst. of Nemours Found.*, 759 A.2d 1060, 1064 (Del. 2000). In another, the court refused to grant a new trial based on admission of stipulated, non-hearsay evidence that was admissible regardless of the parties' agreement. *Rush v. Weinstein*, 2023 WL 7381459, at *4 (9th Cir. Nov. 8, 2023). Similarly, in the third, the court abused its discretion by not giving effect to a stipulation concerning *admissible* evidence—namely, evidence of an eve-of-trial payment which "strongly support[ed]" the policyholder's bad-faith claim. *Devaney v. Nationwide Mut. Ins. Co.*, 679 A.2d 71, 75-76 (Del. 1996). Here, in contrast, even assuming there was a stipulation to admit Winter's entire testimony, that testimony was plainly inadmissible. The Superior Court thus had discretion to exclude it *sua sponte*.

Insurers also wrongly assert (at 38, 40) that Conduent agreed to admission of Winter's written testimony to avoid his live testimony. As the Superior Court

observed, written testimony was "the best [Insurers] could do" because the Texas OAG "didn't want to do any better." A841.

***Prejudice.*** The Superior Court also acted within its wide discretion in ruling that Winter's hearsay testimony unfairly prejudiced Conduent. As noted, the credibility of Winter's account of the settlement negotiations became a "central focus" of trial. A1946. Yet "there was no way the jury could adequately evaluate" his credibility without live cross-examination. A1920-21.

Insurers do not dispute that Winter's credibility became central at trial. Rather, they claim (at 39) the jury could make an "informed assessment" of his credibility. But without Winter in the courtroom, any credibility assessment was suspect at best. As a leading treatise explains, a factfinder "is less likely" to correctly assess credibility if the declarant is not "(1) under oath and the stress of a judicial hearing, (2) being observed by an adverse party, and (3) subject to almost immediate cross-examination." 1 *Weinstein's Evidence Manual* § 14.01 (2024). Here, none of those conditions applied.

Unable to show any flaw in the court's ruling, Insurers claim (at 39) they lacked notice and an opportunity to be heard. *See* Del. Super. Ct. Civ. R. 59(c). But in post-trial briefing, Conduent catalogued the problems with Winter's testimony, A1754-55, to which Insurers responded. A1827-29; A1953-54.

### 2. Insurers Ask the Jury to Draw Negative Inferences from Conduent's Privilege Log

The remaining three reasons for a new trial can be summarized simply: Insurers repeatedly violated the Superior Court's evidentiary rulings.

Start with Insurers' abuse of Conduent's privilege log. Over Conduent's objection, the court permitted Insurers to show the jury a demonstrative exhibit containing information from Conduent's log about the dates of meetings with counsel, who attended those meetings, and the general topics of the meetings. A809. The court, however, prohibited Insurers from using "the privilege log as the basis for arguing that Conduent's attorneys must have advised Conduent in a certain way." *Id.* Similarly, Delaware Rule of Evidence 512(a) prohibits counsel from commenting on or inviting inferences from a party's "claim of privilege." Nevertheless, Insurers repeatedly asked the jury to infer that Conduent was discussing insurance with counsel to manufacture coverage.

For example, during their opening statement, Insurers displayed the demonstrative and asked the jury to infer "what Conduent was talking about" with counsel "during that fateful period right before it settled this case." A925. Subsequently, after questioning a Conduent witness about the log, Insurers' counsel admitted to the Court during a sidebar that he was asking the jury to infer "that the only discussion in the context of settlement…was insurance claims," not government contracts. A1064. And at closing, Insurers' counsel asserted the log

showed communications between Conduent and counsel "about coverage" and that these communications occurred "in the key time period where they are working on trying to come up with a basis to trigger coverage." A1570. Conduent was left with no way of rebutting these inferences, lest it waive privilege.

None of Insurers' cited cases suggests their conduct was proper. One holds that a court may not draw inferences about the "content" of privileged discussions—which is precisely what Insurers asked the jury to do. *Ontario Provincial Council of Carpenters' Pension Tr. Fund v. Walton*, 2023 WL 3093500, at *4 (Del. Ch. Apr. 26, 2023). The other case used a privilege log merely to confirm a document's "existe[nce]," not its content. *Medicalgorithmics S.A. v. AMI Monitoring, Inc.*, 2016 WL 4401038, at *23 (Del. Ch. Aug. 18, 2016).

Insurers suggest (at 45) they could ask the jury to draw inferences from the privilege log to rebut "Conduent's central defenses." But *why* Insurers violated the court's order and Rule 512 is irrelevant; what matters is they did. Insurers also argue (at 45) Conduent's use of non-privileged "contemporaneous documents" that "did not mention insurance" somehow justified Insurers' actions. But Rule 512(a) specifically forbids drawing inferences from privileged communications, not from non-privileged documents.

Finally, Insurers incorrectly claim (at 46) Conduent waived any objection to Insurers' references to the privilege log during closing argument. Although

Conduent did not contemporaneously object to those particular references, the Superior Court correctly ruled that Conduent had amply preserved its objection, as "the issue repeatedly had been addressed by counsel and the court." A1925; *e.g.*, A1063-64. Regardless, the court had discretion to consider this issue *sua sponte*. *O'Riley*, 69 A.3d at 1010-11.

#### 3. Insurers Mislead the Jury Regarding Their Coverage Obligations

The Superior Court also acted well within its discretion in granting a new trial based on Insurers' repeated suggestions, in violation of the court's order, that Insurers had no coverage obligations whatsoever.

Before trial, the court excluded any evidence that Insurers had breached their duty to defend Conduent in the State Action, as the court already had granted Conduent summary judgment that Insurers breached that duty. A713. At the same time, however, the court prohibited Insurers from falsely suggesting to the jury that they had no coverage obligations. A1929. The court also forbade Insurers from presenting evidence of policy exclusions to the jury because application of those exclusions was an issue of law reserved for the court. A698.

Undeterred, Insurers introduced both types of evidence. For example, Insurers elicited testimony from AIG's claims handler that AIG's coverage denials were "correct" and that Texas' amended pleadings "reinforced" the correctness of the denials. A1469-70. And even though the court already had held that the fines-

and-penalties exclusion did not apply, A516-17, Insurers elicited testimony from the same claims handler that she "felt comfortable in saying that the fines and penalties exclusion in the policy applied," A1468. Similarly, Insurers elicited testimony from ACE's claims handler that ACE denied coverage for the State Action because it alleged "fraud fraud fraud"—even though the Superior Court later confirmed that the fraud exclusion did not apply. A1235-36; A2253-54.

Although Insurers deny (at 50) their violations caused prejudice, the harm to Conduent was plain and palpable. Insurers left the jury with the false impression that Conduent was motivated to engage in bad faith and insurance fraud to circumvent Insurers' *correct* coverage determinations, even though the court already had ruled that Insurers breached their duty to defend and Conduent established a *prima facie* case for indemnity coverage. Insurers also repeatedly invoked exclusions to suggest they had no coverage obligations, even though the court determined those exclusions did not apply.

Insurers compounded this prejudice by telling the jury that Conduent did not cooperate with Insurers or seek their consent because of a "guilty conscience." A1570. In reality, as the court later ruled, Conduent had no cooperation or consent obligations given Insurers' breach of their duty to defend. *See supra* pp. 31-35. However, to abide by the court's evidentiary rulings, Conduent could not rebut

Insurers' argument. Conduent, in short, had to defend itself with one armed tied behind its back, while Insurers repeatedly flouted the court's rulings.

Insurers suggest (at 50) they cannot be faulted for failing to distinguish between their duty to indemnify and their duty to defend when the court's rulings prohibited them from discussing the latter. But Insurers could have limited their arguments to the duty to indemnify, without "gilding the lily" by suggesting they had no obligations *whatsoever*. A1929. Furthermore, nothing about the court's orders required Insurers to raise policy exclusions or invite the jury to interpret them in a manner contrary to the court's rulings. Far from being in a "Catch 22" (Ins. Br. 50), Insurers simply violated the court's evidentiary rulings.

**4. Insurers Improperly Rely on a Hearsay Press Release**

The Superior Court also acted well within its discretion by citing Insurers' violations of its ruling regarding the OAG press release, which referred to the settlement as a "Medicaid Fraud Settlement."

Before trial, the court ruled that the press release was hearsay and set forth a specific procedure for using it only to impeach a witness. *Supra* p. 17. Instead of following that procedure, Insurers brought up the release for non-impeachment purposes. A1069; A1124. In fact, Insurers' counsel was so determined to place this hearsay before the jury that the court warned that he would be disqualified from trial. A1305-06.

Insurers' repeated violations clearly prejudiced Conduent. For instance, Insurers' counsel asked a witness, Conduent "couldn't be seen as having settled a Texas Medicaid fraud claim for $236 million. Right?" A1069. When the witness answered, "[a] pure fraud claim, yes," Insurers' counsel immediately followed up that "the day after the settlement agreement was signed, the Texas Attorney General's Office issued a press release announcing—." *Id.* Although Conduent's objection kept Insurers' counsel from saying "fraud," counsel's trajectory was clear, especially to the court, observing the episode in real time. And the court was in the best position to determine the effect on the jury. *Chilson*, 979 A.2d at 1083. Insurers' request for this Court to second-guess the Superior Court's real-time determination falls flat.

Insurers also claim (at 47) they brought up the press release only after Conduent opened the door and that they abided by the Superior Court's procedures for impeachment. But the court correctly ruled that Insurers improperly brought up the "press release" "without even giving the witness a chance to" say whether Texas had used the term "fraud." A1073.

Insurers also contend (at 49) they merely sought to use the press release for the non-hearsay purpose of showing that Conduent did not object to the OAG's characterization of the settlement as one for "Medicaid fraud." However, the same court that witnessed Insurers violate nearly every evidentiary ruling surely did not

abuse its discretion in ruling that Insurers instead sought to use the release for its truth—namely, to *prove* that the settlement was for "Medicaid Fraud." A1930. Moreover, even assuming the press release could have been used for a non-hearsay purpose, any probative value was substantially outweighed by the danger of unfair prejudice from introducing a "Medicaid Fraud" press release from an unknown declarant not subject to cross-examination. D.R.E. 403.

Finally, although Insurers argue (at 47) they did not have the opportunity to be heard on whether their improper use of the press release warranted a new trial, they thoroughly addressed the issue in their re-argument motion, which the court denied on the merits. A1954-55; A2242-43.

#### 5. The Jury's Verdict Demonstrates Prejudice

As the Superior Court recognized, prejudice from Insurers' evidentiary violations appears on the face of the verdict. The jury found that Conduent somehow engaged in fraud and bad faith by entering a settlement with Texas that was both reasonable and non-collusive. A1919; A1945-46. The court rightly noted that the verdict "can be viewed as contradictory" and demonstrates Insurers' evidentiary violations "may very well have confused the jury." A1946.

Insurers (at 42) invoke a case holding that a court should not set aside a verdict for inconsistency if there is any "possible method" of finding the jury's answers consistent. But here, the court did not cite the discrepancy in the verdict as a

standalone ground for setting aside the verdict. Rather, the court cited the apparent contradiction as evidence of prejudice resulting from Insurers' repeated evidentiary violations.

Insurers assert (at 43) it is "straightforward" to construe these verdicts consistently because fraud and bad faith focused on Conduent's conduct, whereas reasonableness and collusion focused on the settlement's terms. But Insurers themselves inextricably linked those concepts at trial for their own strategic advantage. Insurers relied on the alleged unreasonableness of the settlement's allocation to argue that Conduent committed fraud and bad faith. *E.g.*, A1582-83; B488-95. Having linked those concepts, Insurers' eleventh-hour effort to untangle the jury's verdict fails.

Nor is this "a case where the Trial Judge drew a conclusion different from the jury on a disputed question of fact." Ins. Br. 39. Instead, this is a case where the Superior Court recognized in real time that Insurers' repeated evidentiary violations likely prejudiced the verdict. Having observed the trial first-hand, the Superior Court was in the best position to make these determinations.

## CONCLUSION

For the foregoing reasons, this Court should affirm the orders under review.

POTTER ANDERSON & CORROON LLP

By: */s/ Jennifer C. Wasson*

Jennifer C. Wasson (No. 4933)
Carla M. Jones (No. 6046)
Hercules Plaza, Sixth Floor
1313 North Market Street
Wilmington, DE 19801
Telephone: (302) 984-6000
jwasson@potteranderson.com
cjones@potteranderson.com

*Attorneys for Appellee*

OF COUNSEL:

Lisa S. Blatt
Matthew B. Nicholson
WILLIAMS & CONNOLLY LLP
680 Maine Avenue, S.W.
Washington, DC 20024
Telephone: (202) 434-5000
Facsimile: (202) 434-5029
lblatt@wc.com
mnicholson@wc.com

Robin L. Cohen
Adam S. Ziffer
Keith McKenna
Orrie A. Levy
COHEN ZIFFER FRENCHMAN
& MCKENNA LLP
1325 Avenue of the Americas
New York, NY 10019
Telephone: (212) 584-1890
Facsimile: (212) 584-1891
rcohen@cohenziffer.com
aziffer@cohenziffer.com
kmckenna@cohenziffer.com
olevy@cohenziffer.com

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