



# *Menchaca: What's Next?*

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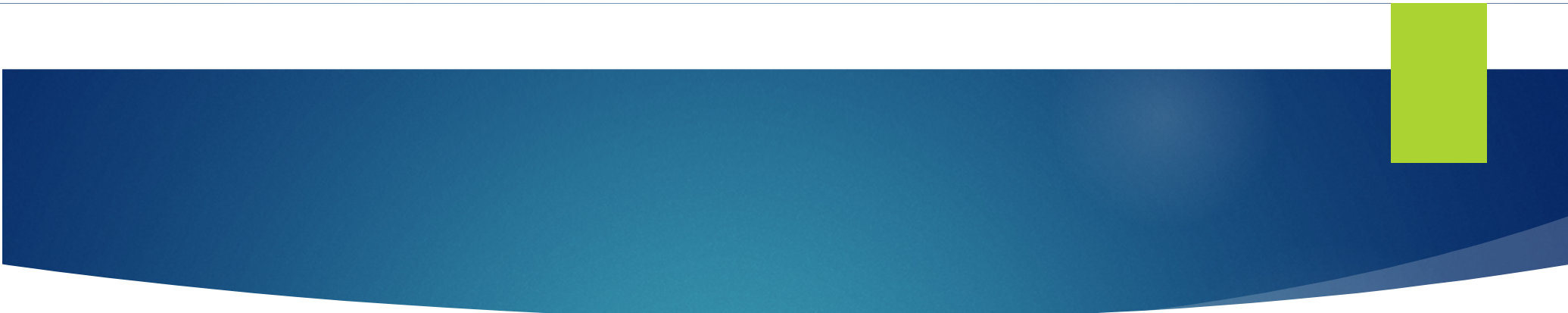
## The Original Opinion (4-17-17)

- ▶ Framed the issue as whether an insured can recover policy benefits when a jury finds the insurer violated the Insurance Code, and the violation resulted in a loss of benefits the insurer “should have paid” under the policy, even though the jury also failed to find the insurer breached the policy.
- ▶ TSC precedent in this area has led to “substantial confusion” among the courts and in this case.
- ▶ Set out five “rules” to address relationship between policy claims and statutory claims.

# Facts

- ▶ Homeowners' claim for damages from Hurricane Ike
- ▶ Adjuster investigated, concluded damage (\$700) did not exceed policy deductible (\$2,020)
- ▶ Second adjuster reached same conclusion
- ▶ Menchaca sued USAA for breach of policy and unfair settlement practices under Insurance Code
- ▶ Jury answered "no" to breach of policy question



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- ▶ Jury answered “yes” to Ins. Code question (violated duty to conduct reasonable investigation before denying claim)
  - ▶ Awarded \$11,350 in damages (difference in sum USAA should have paid for property damage [“policy benefits”] and amount actually paid)
  - ▶ Trial court set aside breach of contract answer and rendered judgment on Ins. Code claim.
  - ▶ Court of Appeals affirmed; TSC granted review.

# The Five Rules

- ▶ 1. General Rule: Insured cannot get policy benefits for a statutory violation in the absence of a right under the policy to receive benefits
  - ▶ *Stoker/Akin*: There can be no bad faith [denial of an insured's claim for policy benefits] when Insurer has promptly denied a claim that is, in fact, not covered

## The Five Rules (continued)

- ▶ 2. Entitled-to-Benefits Rule: If insured proves a right to policy benefits, it can recover those as actual damages if the Ins. Code violation causes loss of those benefits
  - ▶ *Vail*: Insurer's unfair refusal to pay the insured's claim causes damages as a matter of law in at least the amount of the policy benefits wrongfully withheld.
  - ▶ Ins. Code remedies are cumulative of other remedies; insured can elect to recover the benefits under the statute, even though also could have asserted breach of contract claim.

## The Five Rules (continued)

- ▶ 3. Benefits-Lost Rule: If the insured cannot prove a present right to policy benefits, it still can recover those as actual damages under the Ins. Code if the statutory violation caused the insured to lose that right
  - ▶ Misrepresentation (that policy provides coverage it does not in fact provide) can give rise to liability under statute for those benefits, if the insured is adversely affected or injured by reliance on the misrepresentation



## The Five Rules (continued)

- ▶ 4. Independent-Injury Rule: Insurer's extra-contractual liability is "distinct" from its liability for benefits under the insurance policy
  - ▶ If the insurer's statutory violation causes injury independent of the Insured's right to recover policy benefits, the Insured may recover damages for that injury, even if the policy does not entitle the Insured to receive benefits.
  - ▶ Insurer's statutory violation does not permit the insured to recover any damages beyond policy benefits unless violation causes injury independent from loss of benefits.

## The Five Rules (continued)

- ▶ 5. No-Recovery Rule: Insured cannot recover any damages for an Ins. Code violation if the insured had no right to receive policy benefits and did not suffer any independent injury
- ▶ HELD: these are the rules. In this case, trial court erred in setting aside breach of contract finding. Because of “our confusing precedent,” court remands for new trial in interests of justice.

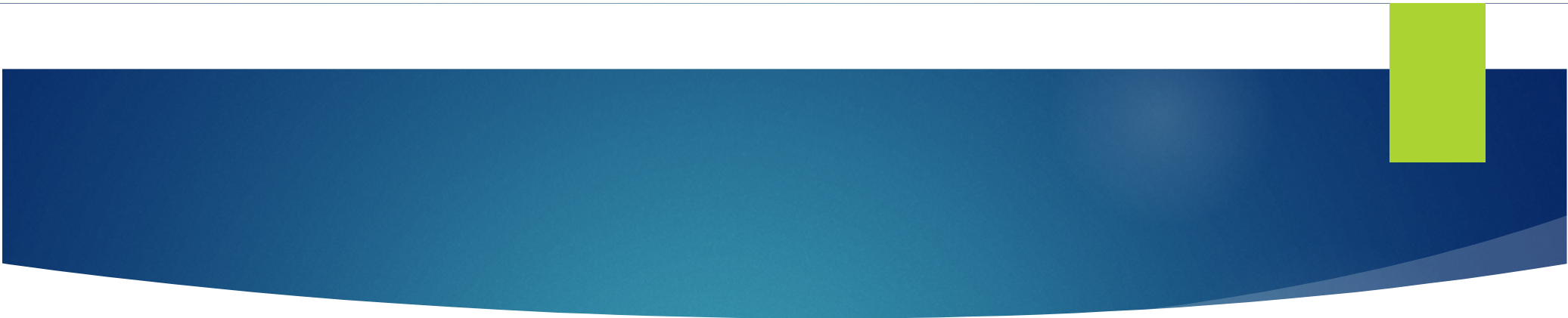


Motion for  
Rehearing

AND SEVERAL  
AMICUS BRIEFS

# USAA's Motion for Rehearing

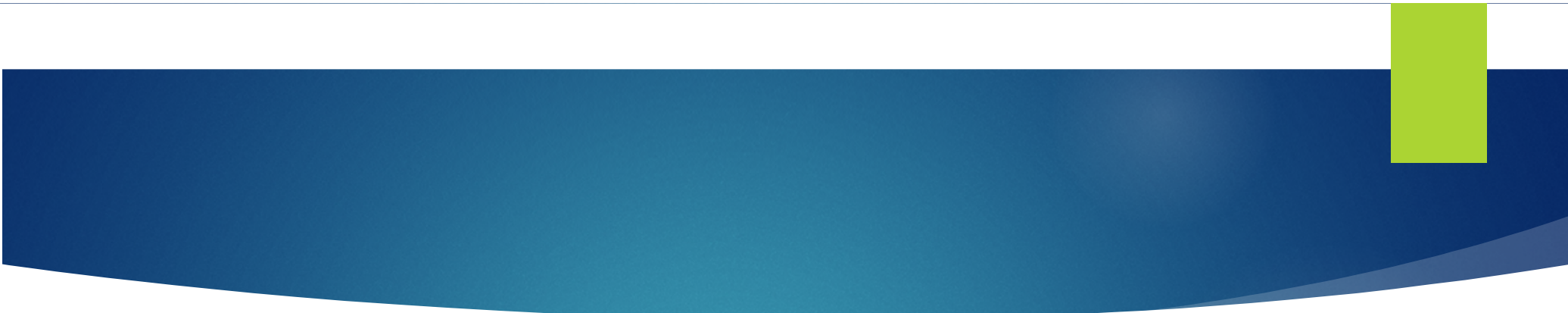
- ▶ The opinion generated even more confusion
- ▶ Opinion presents seemingly contradictory standards:
  - ▶ To recover policy benefits, under contract or statute, does the insured have to prove breach? Opinion says yes and no.
  - ▶ Court never explains whether breach differs from entitlement to benefits and, if so, how.
- ▶ “Breach” and “entitlement to benefits” are two sides of the same coin – cannot prove entitlement to benefits without proving breach

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- ▶ USAA is entitled to rendition of judgment because Menchaca did not prove a right to policy benefits or a breach (because damages less than deductible), under Court's discussion of either *Castañeda* or *Vail*.
  - ▶ Because Menchaca did not seek damages other than policy benefits, the jury's finding showed no uncompensated loss. If no contract damages, no damages for a statutory violation.
  - ▶ Court rewrites *Castañeda* when it should not.



# Menchaca's Response

- ▶ USAA's confusion does not warrant rehearing
- ▶ The "no" answer to the policy breach question did not affirmatively establish compliance or payment of all damages proper investigation would have revealed
- ▶ In any event, the basis for recovery is the Ins. Code, and it does not require a finding of breach as a predicate for recovery
- ▶ The jury here concluded Menchaca was entitled to benefits, USAA's violation caused loss of those benefits, and, thus, Menchaca entitled to damages

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- ▶ USAA never challenged the jury's answers to Q2 (Ins. Code) and Q3 (damages), and they are supported by evidence.
  - ▶ USAA admits that Ins. Code duties are in addition to those under contract. Court properly applied plain language of Ins. Code.
  - ▶ Proper remedy is to affirm.

## USAA's Reply

- ▶ *Menchaca* wrongly brushes aside criticisms of original opinion; even judges say it muddied waters.
- ▶ Fifth rule – no-recovery rule – applies because jury answered “no” to breach of policy and *Menchaca* failed to prove any independent injury.
- ▶ *Menchaca* says insured can recover policy benefits without showing breach; but, it is wrong.
- ▶ Court needs to clarify breach vs. entitlement to benefits
- ▶ It would not be “advisory” opinion to explain reasons for decision



TSC Grants  
Motion for  
Rehearing

DEC. 15, 2017

# Amicus Brief – Lexington Insurance Co.

- ▶ Court leaves open 2 questions:
  - ▶ Can the insured recover additional damages for “knowing” breaches of the policy when the only damages are loss of policy benefits?
    - ▶ Under C/L, even intentional breaches of contract are not punishable beyond actual damages. If additional damages are available for “knowing” breach, every claim will be brought under the Insurance Code. Court should clarify that separate damages are required to award statutorily enhanced damages.



# Amicus Brief – Lexington Insurance Co.

- ▶ USAA policy is 1<sup>st</sup> party. Does the opinion apply to third-party cases?
  - ▶ The Court previously refused to recognize extra-contractual obligations on third-party liability cases. Court relies on *Ulico Cas. Co. v. Allied Pilots Ass'n*, 262 S.W.3d 773 (Tex. 2008) in discussion of “benefits lost.” Practitioners will likely point to this to extend this case’s holding to third-party liability cases. Court should clarify that holding applies to first-party cases, or clarify extent it applies to third-party cases.

# Amicus Brief – Insurance Council of Texas

- ▶ Court's discussion of "breach," "coverage," and "right to benefits" underlying the five rules is a source of confusion.
  - ▶ If an insured has a right to benefits, an insurer necessarily breaches the policy, regardless of reason. If an insured is not entitled to benefits, a statutory violation cannot cause loss of benefits – they are not owed.

# Amicus Brief – Insurance Council of Texas

- ▶ Court should clarify relationship between *Vail* and *Castañeda* and the negative answer on “breach” as to *Menchaca*:
- ▶ *Vail* (2<sup>nd</sup> Rule): insured who establishes right to receive benefits under policy can recover those benefits as actual damages under Insurance Code if insurer’s statutory violation causes loss of benefits.
- ▶ *Castañeda*: (1<sup>st</sup> and 5<sup>th</sup> Rules): insured cannot recover policy benefits as damages for statutory violations if policy does not provide right to receive benefits, and an insured cannot recover any damages based on an insurer’s statutory violation if the insured had no right to receive benefits.
- ▶ Applied: Unless statute subsumes breach itself, *Menchaca* was required to establish breach and did not. Thus, *Menchaca* was required to prove independent injury or that the injury caused her to lose policy benefits to which she would have otherwise been entitled.

# Amicus Brief – U.S. Chamber of Commerce

- ▶ Court should clarify to disentangle overlapping concepts of “coverage,” “policy benefits,” and what damages are available—whether contract or statutory—where jury finds no breach of policy.
- ▶ Court should hold that policy benefits are not available as damages under the Ins. Code when the jury finds no breach.
- ▶ This has been law for decades. Contract benefits are only what insured paid for—no more, no less.

# Amicus Brief – U.S. Chamber of Commerce

- ▶ Jury agreed the damages were less than the deductible; thus, it found no breach of policy. To recover for Ins. Code violation, insured should be required to prove damage other than policy benefits.
- ▶ Here, Menchaca abandoned claim for extra-contractual damages.
- ▶ Court should hold, under its five rules, that Menchaca is barred from recovering policy benefits and affirm the independent injury rule for extra-contractual damages.
- ▶ Court should render take-nothing judgment for USAA.



What's Next?



# Impact on pending litigation

- ▶ *Menchaca* has been cited/relied upon in 36 federal and state opinions pre- and post-granting of rehearing
- ▶ Many appraisal cases
- ▶ Many holding that *Menchaca* held that an insured must establish an independent injury to recover for damages beyond/in addition to policy benefits

# Post-*Menchaca* Interpretation

- ▶ *Lyda Swinerton Builders v. Oklahoma Surety Co.*, 877 F.3d 600 (5<sup>th</sup> Cir. 2017) (case abated pending *Menchaca* opinion on rehearing)
  - ▶ Finding of breach of duty to defend gives rise to recovery of actual damages (defense costs insured paid) under the theory of breach of contract
  - ▶ If insured shows statutory violation (misrepresentation alleged) caused loss of policy benefits, insured may recover amounts it expended on defense fees as actual damages under the Ins. Code (*i.e.*, no independent injury required)

## What's Next?

- ▶ If no breach, what is required to show independent injury that would entitle Insured to Ch. 541 recovery?
  - ▶ Court will not speculate what a successful injury independent of policy benefits looks like – and states it has not yet encountered one
  - ▶ What it is not: independent injury may not “flow” or “stem” from denial of policy benefits
  - ▶ Likely because Chapter 541 provides procedural protections against misconduct that might lead to improper denial of benefits (*i.e.*, demanding federal tax returns)?

## What's Next?

- ▶ If breach, is independent injury required to recover for statutory violation?
- ▶ If breach, are policy benefits recoverable under contract and Ins. Code (Ch. 541) as “actual damages?” Or, must insured elect between recovery under contract versus Ins. Code theories?



# What's Next?

- ▶ If breach, do certain Ins. Code violations trigger independent injury while others may not?
  - ▶ Misrepresenting to Claimant Material Fact or Policy Provision Relating to Coverage at Issue
  - ▶ Attempt to Effectuate Prompt, Fair & Equitable Settlement
    - ▶ Ex: Of the Claim when Liability Becomes Reasonably Clear
  - ▶ Failing to Promptly Provide Reasonable Explanation of Denial
  - ▶ Failing w/in Reas. Time to Affirm or Deny Coverage or ROR
  - ▶ Refusing to Pay Claim Without Conducting Reas. Investigation

Thank You!

