

## **DAMAGES IN FIRST PARTY CASES**



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**DAMAGES IN FIRST PARTY CASES**

**I. UNDERSTANDING FIRST-PARTY CLAIMS**

“[A] first-party claim is stated when 'an insured seeks recovery for the insured's own loss, whereas a third-party claim is stated when 'an insured seeks coverage for injuries to a third party.’”<sup>1</sup> In addition to the contractual claims brought in first-party situations, another common first party claim is a “bad faith” claim alleging violation of settlement practices.<sup>2</sup> The Texas Insurance Code provides:

(a) It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to engage in the following unfair settlement practices with respect to a claim by an insured or beneficiary:

(1) misrepresenting to a claimant a material fact or policy provision relating to coverage at issue;

(2) failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of:

(A) a claim with respect to which the insurer's liability has become reasonably clear; or

(B) a claim under one portion of a policy with respect to which the insurer's liability has become reasonably clear to influence the claimant to settle another claim under another portion of the coverage unless payment under one portion of the coverage constitutes

evidence of liability under another portion. . . .<sup>3</sup>

**A. Underinsured/Uninsured Motorists**

A common first-party claim situation involves underinsured/uninsured motorist claims. A case out of Dallas federal court applying Texas law illustrates this type of claim.<sup>4</sup> In *Stoyer*, plaintiff claimed State Farm breached the contract by failing to pay her underinsured motorist claim under the policy's provisions.<sup>5</sup> The plaintiff's “policy contained a provision for uninsured/underinsured motorists (“UIM”), providing coverage for ‘damages which a covered person is legally entitled to recover from the owner or operator of an uninsured motor vehicle because of bodily injury sustained by a covered person, or property damage caused by an accident.’”<sup>6</sup> State Farm contended in a motion to dismiss that plaintiff had failed to establish her legal right to recover by failing to prove a condition precedent to establishing a legal right to pursue her UIM claim—the third party's liability through a judgment.<sup>7</sup> A condition precedent is an act or event that must exist or occur before a duty to perform something promised arises.<sup>8</sup> If the condition does not occur and is not excused, the promised performance need not be rendered.<sup>9</sup>

The court observed that in the *Brainard* case, the Texas Supreme Court stated that neither filing suit against the UIM insurer nor demanding UIM benefits will trigger a contractual duty of the insurer to pay.<sup>10</sup> The Texas Supreme court held in *Brainard*, “that an insurer in Texas has

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<sup>3</sup> See *id.*

<sup>4</sup> *Stoyer v. State Farm Mut. Auto. Ins. Co.*, 2009 U.S. Dist. LEXIS 15571, at \*4 (N.D. Tex. February 24, 2009)(mem. op.).

<sup>5</sup> See *id.*

<sup>6</sup> See *id.*

<sup>7</sup> See *id.* (citing TEX. INS. CODE ANN. § 1952.106 (Vernon Supp. 2007); *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006).

<sup>8</sup> See BLACK'S LAW DICTIONARY 289 (7TH ed. 1999).

<sup>9</sup> See *id.*

<sup>10</sup> See *Stoyer*, 2009 U.S. Dist. LEXIS 15571, at \*5 (citing *Brainard*, 216 S.W.3d at 818).

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<sup>1</sup> *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54 n.2 (Tex. 1997).

<sup>2</sup> See TEX. INS. CODE ANN. § 541.060(a) (Vernon 2009).

‘no contractual duty to pay benefits [on a UIM claim] until the insured obtains a *judgment* establishing the liability and underinsured status of the other motorist.’<sup>11</sup>

The court stated that it could find no previous determination of the driver's liability and plaintiff did not direct the court to any such evidence.<sup>12</sup> The court, relying on the *Brainard* opinion, noted that no contractual duty can arise for the insurer until an insured obtains a judgment proving the other motorist's liability and underinsured status.<sup>13</sup> Because there is no such judgment here, the court could not conclude that State Farm breached a contractual duty that never was triggered.<sup>14</sup>

The plaintiff also alleged State Farm knowingly failed to act in good faith to effectuate a prompt, fair, and equitable settlement of their claim once liability became reasonably clear.<sup>15</sup> State Farm moved the court to dismiss these claims on the basis that the plaintiff failed to prove the condition precedent to establish her legal right to pursue a UIM claim.<sup>16</sup> “Texas law provides that an insurer is liable for bad faith in denying or postponing a claim the insurer was reasonably clear was covered under the policy.”<sup>17</sup> A bad faith claim cannot survive absent the insurer's liability under the policy; however, if the insurer's conduct is extreme and causes injury in tort independent of the claim against the policy, the insurer's conduct may be deemed to be in bad faith.<sup>18</sup>

The court found that the plaintiff might still be entitled to and recover UIM damages under the

policy.<sup>19</sup> As such, the court concluded State Farm's liability under the policy for UIM damages should be determined first, then the bad faith claims should be addressed.<sup>20</sup> The Court noted that with its granting of the motion to abate<sup>21</sup>, State Farm represented that it waived its right to a judicial determination of the motorist's negligence for causing the collision and that the parties agreed to a trial on the issue of damages, if any, to determine the third party's status as an underinsured motorist.<sup>22</sup>

## B. Worker's Compensation

Another first-party situation deals with worker's compensation claims. In *Texas Mutual Insurance Company v. Ruttiger*, the First District court of appeals in Houston analyzed a situation involving first-party claims related to worker's compensation coverage.<sup>23</sup> Texas Mutual challenged the trial court's judgment, entered after a jury trial, in favor of plaintiff, in plaintiff's suit for violations of the Texas Insurance Code, breach of the duty of good faith and fair dealing, and violations of the Texas Deceptive Trade Practices Act ("DTPA"). Texas Mutual raised several issues on appeal, including its contention that the evidence was legally insufficient to support the jury's findings that Texas Mutual violated the Insurance Code by engaging in unfair and deceptive acts or practices, breached the common law duty of good faith and fair dealing, violated the DTPA, and "knowingly" engaged in unfair and deceptive acts or practices and that no cause of action exists in Texas for breach of the duty of good faith and fair dealing in the context of a workers' compensation claim.<sup>24</sup>

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<sup>11</sup> See *id.* (citing *Brainard*, 216 S.W.3d at 818; *Henson v. Southern Farm Bureau Cas. Ins. Co.*, 17 S.W.3d 652, 653 (Tex. 2000)) (emphasis added).

<sup>12</sup> See *id.*

<sup>13</sup> See *id.* (citing *Brainard*, 216 S.W.3d at 818).

<sup>14</sup> See *id.* at \*5-6.

<sup>15</sup> See *id.* at \*6 (citing TEX. INS. CODE ANN. § 541.060(a)(2)(A) (Vernon 2008); TEX. BUS. & COM. CODE ANN. §§ 17.46(b), 17.50 (Vernon 2008)).

<sup>16</sup> See *id.* (citing *Brainard*, 216 S.W.3d at 818).

<sup>17</sup> See *id.* (citing *Giles*, 950 S.W.2d at 56).

<sup>18</sup> See *id.* at \*7 (citing *Progressive Cty. Mut. Ins. Co. v. Boyd*, 177 S.W.3d 919, 922 (Tex. 2005)).

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<sup>19</sup> See *id.*

<sup>20</sup> See *id.*

<sup>21</sup> Abatement is the suspension of a pending action (or part of a pending action) for a reason unrelated to the merits of the claim. See BLACK'S LAW DICTIONARY 2 (7TH ed. 1999).

<sup>22</sup> See *Stoyer*, 2009 U.S. Dist. LEXIS 15571, at \*6.

<sup>23</sup> 265 S.W.3d 651, 655 (Tex.App.—Houston [1st Dist.] 2008, pet. filed).

<sup>24</sup> See *id.*

As part of its common law duty, and as codified in the Insurance Code, an insurer has an obligation to conduct an adequate investigation before denying a claim.<sup>25</sup> “An insurer will not escape liability merely by failing to investigate a claim so that it can contend that liability was never reasonably clear.”<sup>26</sup> The court reasoned that an insurer does not act in bad faith when a reasonable investigation reveals the claim is questionable, and an insurer maintains the right to deny questionable claims without being subject to liability for the erroneous denial of the claim.<sup>27</sup> “There can be no claim for bad faith when an insurer has denied a claim that is, in fact, not covered and the insurer has not otherwise breached the contract.”<sup>28</sup>

The court observed that the Texas Supreme Court highlighted the appropriate legal sufficiency standard of review to be applied in insurance bad-faith cases.<sup>29</sup> The court stated that, based on the *Vasquez* opinion, appellate courts should look at all the evidence, crediting favorable evidence if reasonable jurors could, and disregarding contrary evidence unless reasonable jurors could not.<sup>30</sup> The court went on to espouse that “[w]hether there is a reasonable basis for denial, . . . must be judged by the facts before the insurer at the time the claim was denied.”<sup>31</sup> However, the court recognized that Texas Mutual’s post-denial evidence may be relevant because there can be no claim for bad faith when an insurer has denied a claim that is,

in fact, not covered and the insurer has not otherwise breached the contract.<sup>32</sup>

### C. Commercial Property

Yet another first-party scenario involves commercial property coverage. In *In Re Acceptance Indemnity Insurance Corporation*, plaintiff sued Acceptance for breach of contract, breach of the duty of good faith and fair dealing, violations of the Texas Insurance Code, and DTPA.<sup>33</sup> The plaintiff claimed commercial property damage for two properties under his commercial lines insurance policy with Acceptance.<sup>34</sup> After an investigation, Acceptance issued two checks for the two properties.<sup>35</sup> On two separate occasions, plaintiff informed Acceptance that the estimates were too low, and each time, Acceptance obtained estimates and issued supplemental payments for each property.<sup>36</sup> Plaintiff requested an additional amount of money and Acceptance denied the claim.<sup>37</sup> The trial court ordered separate, or bifurcated, trials of the contractual claim and the extra-contractual matters.<sup>38</sup> The court refused to abate discovery or sever the claims into separate lawsuits, and plaintiff filed for a writ of mandamus.<sup>39</sup>

The court found that the Texas Supreme Court held that in certain circumstances a severance may be required when a policyholder asserts a breach of contract claim and extra-contractual claims against an insurer who has made a settlement offer on the disputed contract claim, or when there are other compelling

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<sup>25</sup> See *id.* at 661 (citing *United Servs. Auto. Ass'n v. Croft*, 175 S.W.3d 457, 472 (Tex. App.—Dallas 2005, no pet.); *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444, 449 (Tex. 1997)).

<sup>26</sup> See *id.* (citing *Giles*, 950 S.W.2d 48, 56 n. 5 (Tex. 1997)).

<sup>27</sup> See *id.* (citing *Croft*, 175 S.W.3d at 471; *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210, 213 (Tex. 1988)).

<sup>28</sup> See *id.* (citing *Lundstrom v. United Servs. Auto. Ass'n-CIC*, 192 S.W.3d 78, 96 (Tex. App.—Houston [14th Dist.] 2006, pet. denied)).

<sup>29</sup> See *id.* (citing *Minnesota Life Ins. Co. v. Vasquez*, 192 S.W.3d 774, 777 (Tex. 2006)).

<sup>30</sup> See *id.* (citing *Vasquez*, 192 S.W.3d at 777).

<sup>31</sup> See *id.* at 666 (citing *Viles v. Security Nat. Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990)).

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<sup>32</sup> See *id.* (citing *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 340-41 (Tex. 1995)).

<sup>33</sup> 2008 Tex. App. LEXIS 1795, at \*1 (Tex.App.—Corpus Christi March 13, 2008, pet. denied)(mem. op).

<sup>34</sup> See *id.*

<sup>35</sup> See *id.*

<sup>36</sup> See *id.*

<sup>37</sup> See *id.*

<sup>38</sup> See *id.*

<sup>39</sup> See *id.* A mandamus is an order issued by a superior court to compel a lower court to perform mandatory duties correctly—in this case to abate discovery or sever the claims into separate suits. See BLACK’S LAW DICTIONARY 973 (7TH ed. 1999).



circumstances.<sup>40</sup> The Supreme Court “explained that an insurer may be unfairly prejudiced by having to defend the contract claim at the same time and before the same jury that would consider evidence that the insurer offered to settle the entire dispute.”<sup>41</sup> When the insurer merely pays the portion of the claim it does not dispute, severance is not necessarily required.<sup>42</sup>

Acceptance argued that each time payments were issued to the plaintiff, the payments were offers of settlement on the entire disputed contract claim, and plaintiff accepted the settlements by signing sworn proofs of loss.<sup>43</sup> The plaintiff argued that the payments were on claims the insurer did not dispute, were not settlement offers, and only a portion of the contract claim remained in dispute.<sup>44</sup> Acceptance alleged that while bifurcation would ensure that settlement offers Acceptance made to plaintiff would not be introduced to the jury on the contractual claims but that bifurcation and refusal to abate discovery does not remedy the prejudice, expense, and effort on the extra-contractual claims.<sup>45</sup>

Abatement of the discovery on a bad faith claim necessarily accompanies severance because the scope of permissible discovery differs in the two types of claims, this is true when the extra-contractual claim is based solely on an alleged bad faith denial.<sup>46</sup> The record in this original proceeding is unclear, however, as to whether plaintiff's extra-contractual claims are based solely on an alleged bad faith denial of his claim, on some other conduct, or both.<sup>47</sup> The court held that, based on this record before it, it

did not appear that a judgment for Acceptance on the breach of contract claim would necessarily render the extra-contractual claims moot.<sup>48</sup>

#### D. Homeowner's

The final common scenario for first-party claims in Texas involves homeowner's insurance. In *State Farm Lloyd's v. Hamilton*, Lloyds appealed the trial court's judgment in favor of its insureds.<sup>49</sup> In four issues State Farm challenged the sufficiency of the evidence to support the jury's findings of breach of contract, cost of repair damages, extra-contractual violations, and mental anguish damages.<sup>50</sup> The key dispute in the case involving dueling expert opinions over whether foundation damage was caused by a plumbing leak.<sup>51</sup> That policy provided coverage to the plaintiffs for foundation damage if and only if the damage was caused by a plumbing leak.<sup>52</sup> The court agreed that State Farm breached its contract with the plaintiffs.<sup>53</sup> The court then turned to the extra-contractual claims noting that an insurer does not breach its duty of good faith merely by erroneously denying a claim.<sup>54</sup> “[A]n insurer's reliance on an expert report, standing alone, will not necessarily shield the carrier if there is evidence that the report was not objectively prepared or the insurer's reliance on the report was unreasonable.”<sup>55</sup> The court found that:

[i]n this case, the fact-finder concluded that State Farm acted in bad faith by failing to attempt in good faith to effectuate a prompt, fair, and equitable

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<sup>40</sup> See *In Re Acceptance*, 2008 Tex. App. LEXIS 1795, at \*2 (citing *Liberty Nat'l Fire Ins. Co. v. Akin*, 927 S.W.2d 627, 630 (Tex. 1996)).

<sup>41</sup> See *id.* (citing *Akin*, 927 S.W.2d at 630).

<sup>42</sup> See *id.* (citing *Akin*, 927 S.W.2d at 630).

<sup>43</sup> See *id.* at \*2-3.

<sup>44</sup> See *id.* at \*3.

<sup>45</sup> See *id.* at \*5.

<sup>46</sup> See *id.* at \*5-6 (citing *Akin*, 927 S.W.2d at 631 (noting that while a judgment for an insurer on a coverage claim may prohibit recovery premised only on the bad faith denial of a claim, it does not necessarily bar all claims for bad faith)).

<sup>47</sup> See *id.* at \*6.

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<sup>48</sup> See *id.*

<sup>49</sup> 265 S.W.3d 725, 727 (Tex.App.—Dallas 2008, pet filed).

<sup>50</sup> See *id.*

<sup>51</sup> *Id.* at 728-29.

<sup>52</sup> See *id.* at 730.

<sup>53</sup> See *id.* at 734.

<sup>54</sup> See *id.* (citing *U.S. Fire Ins. Co. v. Williams*, 955 S.W.2d 267, 268 (Tex. 1997); *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex. 1994)).

<sup>55</sup> See *id.* (citing *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444, 448 (Tex. 1997)).

settlement of a claim when its liability had become reasonably clear. State Farm argues the evidence is both legally and factually insufficient to support the jury's findings of extra-contractual liability. According to State Farm, the [plaintiffs'] extra-contractual claims are based on a single allegation: that State Farm hired a biased and non-independent engineer...to investigate the claim. State Farm, of course, disputes that [the expert] was biased in favor of State Farm when he performed his investigation. It points to the testimony of [the claims representative], [the expert], [the expert's employee], and [State Farm's claims team manager], all of whom testified to [the expert's] independence and to the fact that they did not keep track of 'outcomes' or 'percentages' when it came to [the expert's] opinions. The jury could have believed or disbelieved any part of that testimony. There was also evidence that: [the expert] was on the list of State Farm's approved engineers; more than fifty percent of [the expert's] business came from State Farm; [the expert] investigated 1440 claims for State Farm; State Farm had paid [expert's] company more than \$ 3 million between January 1999 and December 2003; [the claim representative] had been using [the expert] for ten years; and [the expert] had never testified against State Farm's interests. All of the witnesses who were asked testified that independence was important in this kind of investigation. Thus, if jurors believed [the expert] was not

independent, they could have reasonably concluded his report was not objectively prepared and that it was not reasonable for State Farm to rely on it.<sup>56</sup>

The court further found that the jury could have perceived conflict within the expert's report and perceived an incomplete basis for some of the report's conclusions.<sup>57</sup>

## II. HURRICANE IKE AND FIRST PARTY LITIGATION

### A. Background

Hurricane Ike is one of the most destructive hurricanes to ever make landfall in the United States. By the early morning hours of September 5, Ike was a Category 4 hurricane, with maximum sustained winds of 145 mph.<sup>58</sup> That made it the most intense storm in the 2008 Atlantic hurricane season. Ike also had the highest IKE (Integrated Kinetic Energy) of any Atlantic storm in history. Integrated Kinetic Energy is a measure of storm surge destructive potential, and on a scale of 1 to 6, Ike reached a 5.6.<sup>59</sup> Ike made U.S. landfall at Galveston, Texas, on September 13 at 2:10am CDT as a very strong Category 2 hurricane with winds of 110 mph.<sup>60</sup>

Hurricane Ike hit the communities along the upper Texas Gulf Coast, including the large

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<sup>56</sup> See *id.*

<sup>57</sup> See *id.* at 735.

<sup>58</sup> Leland Under Hurricane Watch as Hanna Takes Aim at N.C. Coast, *available at* <http://www.lelandtribune.com/default.asp?dismode=article&artid=1527>.

<sup>59</sup> *Available at* [ftp://ftp.aoml.noaa.gov/hrd/pub/hwind/2008/AL092008/0911/1330/AL092008\\_0911\\_1330\\_contour08.png](ftp://ftp.aoml.noaa.gov/hrd/pub/hwind/2008/AL092008/0911/1330/AL092008_0911_1330_contour08.png).

<sup>60</sup> Rob Gutro and Mike Taylor, Landsat Satellite Images Show How Texas was Scarred from Hurricane Ike, *available at* [http://www.nasa.gov/mission\\_pages/hurricanes/archives/2008/h2008\\_ike.html](http://www.nasa.gov/mission_pages/hurricanes/archives/2008/h2008_ike.html).

suburban areas of Galveston where it made landfall, and Houston. Thirty Four Counties were declared disaster areas.<sup>61</sup> Specifically, in the five counties hardest hit (Orange, Harris, Galveston, Chambers, and Jefferson), the total real property losses were estimated to be over 100,000 properties, assessed as of December 3, 2008. There were over 100 total deaths (direct and indirect) from the hurricane. Hurricane Ike will likely go down as the most costly and destructive storm to ever hit Texas, and it is estimated to be the third costliest storm in United States history, behind only Hurricanes Andrew (1992) and Katrina (2005).<sup>62</sup>

The Property Claim Services of the Insurance Services Office estimates that the insured damage (not including inland flooding or storm surge) from Ike in Texas, Louisiana, and Arkansas is \$9.7 billion dollars. Using preliminary figures, it is estimated that the total damage estimates are around \$19.3 billion dollars.

The primary forms of damage were those typical of hurricanes: wind, flood, and surge.<sup>63</sup> The highest storm surge measured by any NOS (National Ocean Service) tide gauge was at Sabine Pass North, Texas, which was 12.79 ft.<sup>64</sup> In areas where tide gauge records were unavailable due to destruction of measurement devices, it is thought that the surge was even higher than this.<sup>65</sup> In Galveston Bay on the east side, it is thought that the surge reached somewhere between 15 and 20 feet, and on Galveston Island somewhere between 10 and 15 feet<sup>66</sup>. Coming in with the surge were huge amount of mud and debris, which caused further damage.

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<sup>61</sup> FEMA-1791-DR, Texas, Disaster Declaration as of 11/21/2008

<sup>62</sup> Tropical Cyclone Report: Hurricane Ike. Robbie Berg, National Hurricane Center, 23 January 2009, updated March 18, 2009 for amended storm surge values.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> *Id.*

<sup>66</sup> *Id.*

## B. Ike Litigation

Numerous lawsuits were filed in connection with coverage disputes arising in relation to Hurricane Ike. The most common issues include allegations of violation of the Texas Insurance Code provision on Unfair Settlement Practices.<sup>67</sup> Other allegations by insureds include violations of the Prompt Payment of Claims provision of the Insurance Code.<sup>68</sup> Some insureds are also bringing the common law cause of action for breach of the duty of good faith and fair dealing and breach of contract.<sup>69</sup>

Bad-faith liability in the insurance context — also known as the breach of the duty of good faith and fair dealing— arises from the contractual relationship between the insured and the insurer.<sup>70</sup> The duty of good faith and fair dealing is separate and distinct from the insurer's settlement duties that arise under Insurance Code Chapter 541.<sup>71</sup> Because the duty of good faith and fair dealing arises from , but is independent of, the insurance policy, causes of action for breach of contract and breach of the duty of good faith and fair dealing are also separate and distinct actions.<sup>72</sup>

### 1. Duty of Good Faith and Fair Dealing, Texas Insurance Code Section 541.060(a) Unfair Settlement Practices and DTPA

An insurer breaches its duty of good faith and fair dealing by denying or delaying a claim when the insurer's liability has become

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<sup>67</sup> See TEX. INS. CODE ANN. §§ 541.060(a)(1), (a)(2), (a)(3), (a)(4), (a)(7), and 541.151 (Vernon 2009).

<sup>68</sup> See TEX. INS. CODE ANN. §§ 542.055, 542.056, 542.058 (Vernon 2009).

<sup>69</sup> Special thanks to Marc Gravely of Gravely & Pearson, L.L.P. for providing pleadings from Hurricane Ike related cases.

<sup>70</sup> *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210, 212 (Tex.1988).

<sup>71</sup> *Lane v. State Farm Mut. Auto. Ins. Co.*, 992 S.W.2d 545,553-54 (Tex.App.—Texarkana 1999, pet. denied).

<sup>72</sup> *Union Bankers Ins. Co. v. Shelton*, 889 S.W.2d 278, 283 (Tex.1994).

reasonably clear.<sup>73</sup> The focus is not on whether the insured's claim was valid, but on the reasonableness of the insurer's conduct in rejecting the claim.<sup>74</sup> This inquiry is a fact issue.<sup>75</sup> As long as the insurer has a reasonable basis to deny or delay payment of a claim—even if that basis is eventually determined by the fact-finder to be erroneous--the insurer is not liable for the tort of bad faith.<sup>76</sup>

Note that a "defense to an insured's common law bad faith claim also serves to defeat each of its other extra-contractual causes of action only if 'each cause was nothing more than a re-characterization of the bad faith claim.'" <sup>77</sup>Absent legally sufficient evidence of bad faith, however, [a plaintiff's] claims under the common law, Insurance Code chapter 541, and the DTPA are subject to summary judgment.<sup>78</sup>

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<sup>73</sup> *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 55-56 (Tex. 1997).

<sup>74</sup> See *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 601 (Tex. 1993); *Oram v. State Farm Lloyds*, 977 S.W.2d 163, 166-67 (Tex.App.-- Austin 1998, no pet.).

<sup>75</sup> See *Giles*, 950 S.W.2d at 5.

<sup>76</sup> *Lyons*, 866 S.W.2d at 600.

<sup>77</sup> *Mid-Continent Cas. Co. v. Eland Energy, Inc.*, 2009 U.S. Dist. LEXIS 89359, 2009 WL 3074618, at \*26 n.28 (N.D. Tex. Mar. 30, 2009) (Fitzwater, C.J.) (emphasis in original) (quoting *Escajeda v. Cigna Ins. Co. of Tex.*, 934 S.W.2d 402, 408 (Tex. App. 1996, no writ)). See *Vought Aircraft Indus. v. Falvey Cargo Underwriting, Ltd.*, 2010 U.S. Dist. LEXIS 63658 (N.D. Tex. June 25, 2010) (Two of Vought's statutory allegations are recharacterizations of the common law claim. Vought asserts that defendants failed to effectuate a prompt, fair, and equitable settlement once its liability became clear, and that defendants refused to pay the claim without a reasonable investigation. These claims fail for the same reason as do their common law analogues.).

<sup>78</sup> See *U.S. Fire Ins. Co. v. Williams*, 955 S.W.2d 267, 268-69 (Tex. 1997) (summary judgment dismissing common law claim proper where no evidence of bad faith); *Douglas v. State Farm Lloyds*, 37 F. Supp. 2d 532, 544 (S.D. Tex. 1999) ("[W]hen an insured joins claims under the Texas Insurance Code and the DTPA with a bad faith claim, all asserting a wrongful denial of policy benefits, if there

a. Coverage

Evidence establishing only a "bona fide coverage dispute," without more, does not rise to the level of bad faith.<sup>79</sup> Damages in an extra-contractual claim must be different than simply claiming the benefits of the policy, because these damages are recoverable in a breach of contract claim.<sup>80</sup>

The *Aranda v. Insurance Co. of North America* test cited in *Stoker* provides that breach of the duty of good faith and fair dealing is established when:

- (1) there is an absence of a reasonable basis for denying or delaying payment of benefits under the policy; and,
- (2) the carrier knew or should have known that there was not a reasonable basis for denying the claim or delaying payment of the claim.<sup>81</sup>

Whether there is a reasonable basis for denial of a claim must be judged by the facts before the

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is no merit to the bad faith claim, there can be no liability on either of the statutory claims.").

<sup>79</sup> *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42, 44 (Tex. 1998); *Williams*, 955 S.W.2d at 268.

<sup>80</sup> See *Provident Am. Ins. Co. v. Castaneda*, 988 S.W.2d 189, 198-99 (Tex. 1998) (holding that insurer's allegedly deceptive acts or practices "did not cause any injury independent of the denial of policy benefits"); *United Servs. Auto. Ass'n v. Gordon*, 103 S.W.3d 436, 442 (Tex. App.--San Antonio 2002, no pet.) ("An insured is not entitled to recover extra-contractual damages unless the complained of actions or omissions cause injury independent of the injury resulting from a wrongful denial of policy benefits."); *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 341 (Tex. 1995). See also *Chrysler Ins. Co. v. Greenspoint Dodge of Houston, Inc.*, 297 S.W.3d 248 (Tex. 2009, reh'g den.).

<sup>81</sup> *Stoker*, 903 S.W.2d at 340 (citing *Aranda*, 748 S.W.2d 210, 213, 31 Tex. Sup. Ct. J. 279 (Tex. 1988)).

insurer at the time the claim was denied."<sup>82</sup> It is an "objective determination" involving whether "a reasonable insurer under similar circumstances would have delayed or denied the claimant's benefits."<sup>83</sup> So long as a reasonable basis for denial of the claim exists—even if it is not the actual reason the insurer relied on in denying the claim—the insurer will not be subject to liability for an erroneous denial of a claim.<sup>84</sup> Failure to perform the terms of a contract, without more, is not a misleading, false, or deceptive act under the DTPA. When the "essence of the allegations is that: (1) defendants represented that they would perform under the contract, and (2) nonperformance means that they misrepresented that they would perform under the contract," the DTPA has not been violated and the proper recourse is a breach of contract cause of action.<sup>85</sup>

As a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered.

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<sup>82</sup> *Stoker*, 803 S.W.2d at 340 (citing *Viles v. Sec. Nat'l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990)).

<sup>83</sup> *Id.*

<sup>84</sup> *Id.* at 340-41 (holding insurer was not liable for denying claim for an incorrect reason when there was a correct reason for denial).

<sup>85</sup> *Gen. Star Indem. Co. v. Sherry Brooke Revocable Trust*, 243 F. Supp. 2d 605, 648 (W.D. Tex. 2009); *Helms v. Southwestern Bell Tel. Co.*, 794 F.2d 188, 191 (5th Cir. 1986) (claim of errors in yellow pages advertisement did not state DTPA cause of action because "'misrepresentation' alleged by the Helmses was nothing more than Southwestern Bell's failure to perform its promise to correctly print the ad."); *Crawford v. Ace Sign, Inc.*, 917 S.W.2d 12, 14, 39 Tex. Sup. Ct. J. 296 (Tex. 1996) (same); *Ashford Dev., Inc. v. USLife Real Estate Serv.*, 661 S.W.2d 933, 935, 27 Tex. Sup. Ct. J. 118 (Tex. 1983) (failure to find satisfactory lender, as promised, was not DTPA violation).

## b. Investigation

It is well established that an insurer has a duty to conduct a timely and fair investigation of an insured's claims.<sup>86</sup> Within the duty of good faith is an insurer's obligation to conduct an adequate investigation of the claim.<sup>87</sup> "[A]n insurer cannot insulate itself from bad faith liability by investigating a claim in a manner calculated to construct a pre-textual basis for denial."<sup>88</sup>

Similarly, an insurer cannot escape liability by "failing to investigate a claim so that it can contend that liability was never reasonably clear."<sup>89</sup> In *Simmons*, for instance, the court faulted the insurer's investigation for unreasonably concluding that the insureds set the fire that led to the loss and for unreasonably failing to investigate whether others may have started the fire.<sup>90</sup>

Recently, in *Great Am. Ins. Co. v. SMX 98, Inc.*,<sup>91</sup> GAIC's adjuster, Donald Graham, initially investigated SMX's property damage claim. Graham produced four reports, but SMX presented an affidavit of expert Philip Barnard that contested GAIC's investigation by noting that GAIC's own retained expert agreed that those reports were "superficial" because it did not assist in determining where the damage was, how much damage there was, and how much it would cost to repair. Barnard claimed GAIC's retained expert testified that water damage was the most critical thing to investigate, and he would have investigated the water damage and worked with environmental consultant TGE to

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<sup>86</sup> *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 341 (Tex. 1995) (noting that general rule that there can be "no claim for bad faith when an insurer has promptly denied a claim that is in fact not covered" does not retreat from "the established principles regarding the duty of an insurer to timely investigate its insureds' claims"); *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 56 n.5 (Tex. 1997).

<sup>87</sup> *United Servs. Auto. Ass'n v. Croft*, 175 S.W.3d 457, 469 (Tex. App. 2005, no pet.).

<sup>88</sup> *Simmons*, 963 S.W.2d at 44.

<sup>89</sup> *Universe Life*, 950 S.W.2d at 56 n.5.

<sup>90</sup> *Simmons*, 963 S.W.2d at 45.

<sup>91</sup> 2010 U.S. Dist. LEXIS 44351, 7-8 (S.D. Tex. May 6, 2010).

do so, but that there is no indication that Graham did so. GAIC's expert also would have detailed the location and extent of the damage room by room, but Graham's superficial report did not do that, either. The Court held that, premised upon the affidavit of Philip Barnard, a genuine issue of material fact with regard to SMX's allegations of bad faith by GAIC was raised, precluding GAIC's success on summary judgment on the bad faith claims.

Therefore, and pursuant to Section 541.152 of the Texas Insurance Code

(a) A plaintiff who prevails in an action under this subchapter may obtain:

(1) the amount of actual damages, plus court costs and reasonable and necessary attorney's fees;

(2) an order enjoining the act or failure to act complained of; or

(3) any other relief the court determines is proper.

(b) On a finding by the trier of fact that the defendant knowingly committed the act complained of, the trier of fact may award an amount not to exceed three times the amount of actual damages.<sup>92</sup>

### c. DTPA Damages

In an action for a violation of the DTPA, the plaintiff can recover economic damages plus mental-anguish damages.<sup>93</sup> The plaintiff can recover economic damages if the damages arise from the plaintiff's reliance on false, misleading, or deceptive acts or practices.<sup>94</sup> Further, the plaintiff can recover mental-anguish damages if

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<sup>92</sup> See TEX. INS. CODE ANN. § 541.152 (Vernon 2009).

<sup>93</sup> TEX. BUS. & COM. CODE § 17.50(b)(1); *Tony Gullo Motors I, L.P. v. Chapa*, 212 S.W.3d 299, 304 (Tex.2006).

<sup>94</sup> TEX. BUS. & COM. CODE § 17.50(a); *Gill v. Boyd Distrib. Ctr.*, 64 S.W.3d 601, 604 (Tex.App.—Texaskana 2001, pet. denied).

the defendant acted knowingly or intentionally.<sup>95</sup> The recover mental-anguish damages in a DTPA suit, the plaintiff must prove that the defendant knowingly or intentionally engaged any of the following conduct:

(1) A false, misleading, or deceptive act or practice listed in §17.46(b) that the plaintiff relied on.<sup>96</sup>

(2) A breach of an express or implied warranty.<sup>97</sup>

(3) An unconscionable action or cause of action.<sup>98</sup>

(4) An act or practice in violation of Texas Insurance Code chapter 541.<sup>99</sup>

Further, a Plaintiff can recover additional damages of up to three times the amount of economic and mental-anguish damages for a DTPA claim.<sup>100</sup> Economic damages can be trebled if the defendant knowingly violated the DTPA.<sup>101</sup> Mental-anguish damages can be trebled if the defendant acted intentionally.<sup>102</sup>

## 2. Texas Insurance Code, Prompt Payment of Claims

Tex. Ins. Code 542.051 *et seq.*, formerly known as Article 21.55, imposes requirements on an insurer with respect to responding to claims, accepting or rejecting claims, and promptly paying accepted claims.<sup>103</sup> The purpose of the statute is to obtain prompt payment of claims pursuant to insurance policies and its provisions are to be liberally constructed to promote that

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<sup>95</sup> TEX. BUS. & COM. CODE § 17.50(b)(1); *City of Tyler v. Likes*, 962 S.W.2d 489, 498 n.1 (Tex.1997).

<sup>96</sup> TEX. BUS. & COM. CODE § 17.50(a)(1).

<sup>97</sup> *Id.* §17.50(a)(2).

<sup>98</sup> *Id.* §17.50(a)(3).

<sup>99</sup> TEX. BUS. & COM. CODE §17.50(a)(4).

<sup>100</sup> TEX. BUS. & COM. CODE §17.50(b)(1).

<sup>101</sup> TEX. BUS. & COM. CODE §17.50(b)(1); *Bossier Chrysler-Dodge II, Inc. v. Riley*, 221S.W.3d 749, 759 (Tex.App.—Waco 2007, pet. denied).

<sup>102</sup> TEX. BUS. & COM. CODE §17.50(b)(1)

<sup>103</sup> *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 16 (Tex. 2007).

purpose. The statute prescribes penalties for the insurer's noncompliance.

"To successfully maintain a claim under [§542.060], a party must establish three elements: (1) a claim under an insurance policy; (2) that the insurer is liable for the claim; and (3) that the insurer has failed to follow one or more sections of [Prompt Payment Claims statute, Tex. Ins. Code Ann. §§ 542.051-.061] with respect to the claim."<sup>104</sup>

Specifically, Section 542.055 mandates that an insurer shall, not later than the fifteenth day after receipt of notice of a claim, (1) acknowledge receipt of the claim, (2) commence any investigation of the claim, and (3) request from the claimant all items, statements, and forms that the insurer reasonably believes, at that time, will be required from the claimant.<sup>105</sup>

Under Section 542.056, an insurer shall notify a claimant in writing of the acceptance or rejection of a claim not later than the fifteenth business day after the insurer receives all relevant items, statements, and forms required by the insurer in order to secure final proof of loss.<sup>106</sup> If an insurer is unable to accept or reject the claim within the period specified in Section 542.056 (d), the insurer must notify the claimant not later than the period specified in 542.056(d) and accept or reject the claim not later than the 45th day after the date the insurer notified the claimant of its initial inability to accept or reject the claim.

Regarding damages, if an insurer delays payment of a claim following its receipt of all items, statements, and forms reasonably requested and required for more than 60 days, the insurer shall pay damages as provided for in Section 542.060.

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<sup>104</sup> *Allstate Ins. Co. v. Bonner*, 51 S.W.3d 289, 291 (Tex. 2001) (bracketed text reflects current codification of statute); *Protective Life Ins. Co. v. Russell*, 119 S.W.3d 274, 286 (Tex. App.--Tyler 2003, pet. denied).

<sup>105</sup> Section 542.055

<sup>106</sup> Section 542.056(a).

Under Section 542.051, the amount of the "claim" on which a penalty is calculated is the amount ultimately determined to be owed to the claimant, less any partial payments made. *Republic Underwriters Ins. Co. v. Mex-Tex, Inc.*, 150 S.W.3d 423, 426-28 (Tex. 2004); *Fire Ins. Exchange v. Sullivan*, 192 S.W.3d 99, 109 (Tex. App.--Houston [14th Dist.] 2006, pet. denied). Thus, an insured is entitled to the penalty interest on the difference between the amount of the claim as determined to be owed and the amount the insurer unconditionally tendered. *Mex-Tex*, 150 S.W.3d at 427-28. Conversely, the interest penalty may be assessed against the insurer on the full amount of the claim if an insurer's partial payment to the insured was not unconditional. *Guideone Lloyds Ins. Co. v. First Baptist Church of Bedford*, 268 S.W.3d 822, 831-832 (Tex. App. – Fort Worth 2008, no pet.).

To the extent that a jury determines that the carrier properly paid and denied portions of the Insured's claim, there is no liability for violation of Section 542.060. However, to the extent that a jury/court determines that there is a wrongful denial, a carrier would be subject to the 18% penalty on the portion wrongfully denied should it be determined that there is coverage for all or part of the damages denied by said carrier.

### 3. To Summarize...

The insurer's breach of its duty of good faith and fair dealing is a cause of action that sounds in tort and is completely distinct from a contract action for the breach of the terms of the underlying insurance policy.<sup>107</sup> Therefore, for **breach of contract**, an insured would be entitled to regain the benefit of the bargain, which is the **amount of the claim, together with attorney's fees**.

To establish the independent tort of bad faith, the plaintiff's damages must be different from

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<sup>107</sup> *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663, 666 (Tex.1995).

the benefits the plaintiff would receive under the insurance contract.<sup>108</sup>

A plaintiff would be able to recover **actual damages**— so called “**extra contractual damages**” — for economic or personal injuries. In other words, these are damages that go beyond the terms of the contract.<sup>109</sup>

The plaintiff can also recover damages for **mental anguish**.<sup>110</sup> However, these damages are only recoverable in cases in which the denial or delay in payment of a claim has seriously disrupted the insured’s life.<sup>111</sup>

Additionally, a plaintiff could recover certain **economic damages**, such as loss of credit reputation<sup>112</sup> and increased business costs.<sup>113</sup>

Further, the plaintiff can recover **damages for the loss of benefits** under the insurance policy.<sup>114</sup> However, not every breach of the duty of good faith and fair dealing will give rise to damages for the loss of policy benefits.<sup>115</sup>

**Exemplary damages** may also be recoverable in an action for bad faith if (1) actual damages were awarded for an injury independent of the loss of policy benefits and (2) the insurer’s conduct was fraudulent, malicious, intentional, or grossly negligent.<sup>116</sup>

A plaintiff may also recover **interest**. Pursuant to Section 542.060 (a) if an insurer that is liable for a claim under an insurance policy is not in compliance with this subchapter, the insurer is liable to pay the holder of the policy or the beneficiary making the claim under the policy, in addition to the amount of the claim, interest on the amount of the claim at the rate of 18 percent a year as damages, together with reasonable attorney’s fees.<sup>117</sup> Further, and under the same section, if a suit is filed, the attorney’s fees shall be taxed as part of the costs in the case.<sup>118</sup>

### III. CONCLUSION

It is of utmost importance to keep in mind that the best way to avoid the image of impropriety in the handling of first party claims is to comply with any and all regulatory requirements established by the Texas Insurance Code and to maintain a “clean” and detailed record regarding the handling of the claim.

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<sup>108</sup> *Id.*; see *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210, 214 (Tex.1988).

<sup>109</sup> See *Pena v. State Farm Lloyds*, 980 S.W.2d 949, 958 (Tex.App.—Corpus Christi 1998, no pet.).

<sup>110</sup> *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 24 (Tex.1994).

<sup>111</sup> *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54 (Tex.1997).

<sup>112</sup> *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210, 214 (Tex.1988).

<sup>113</sup> *Dal-Worth Tank*,

<sup>114</sup> *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663, 667 (Tex.1995).

<sup>115</sup> See *Id.* at 666 n.3 (some acts of bad faith do not necessarily relate to insurer’s breach of its contractual duties to pay covered claims, and may give rise to different damages).

<sup>116</sup> *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54 (Tex.1997) (element 2); *Twin City Fire Ins. Co. v.*

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*Davis*, 904 S.W.2d 663, 665-66 (Tex.1995) (element 1).

<sup>117</sup> See TEX. INS. CODE ANN. § 542.060 (Vernon 2009).

<sup>118</sup> *Id.*