BREAKING UP THE COVERAGE CASE: SEVERANCE AND BIFURCATION CONSIDERATIONS IN COVERAGE AND BAD FAITH LITIGATION

18TH ANNUAL INSURANCE SYMPOSIUM

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I. INTRODUCTION:

Over the course of the past fifteen years there has been a growing body of caselaw dealing with the issue of separating the raw question of whether coverage exists under an insurance policy from allegations of whether the conduct of insurance carrier constitutes bad faith. There are two procedural vehicles that allow for the potential segregation of coverage issues from bad faith allegations, although they are different in their scope and application. The first is the severance of the coverage case from the bad faith claims. The second is the bifurcated trial. This paper discusses each of these acts in connection with the coverage case and the implications of each.

II. SEVERANCE VS. BIFURCATATION:

A. Severance Generally:

The relevant rule governing severance is Texas Rule of Civil Procedure 41 or Federal Rule of Civil Procedure 21. Severance is most commonly used in litigation whenever a party claims that they have been inappropriately joined to a case and would prefer to litigate separately from other claims. However, courts may also sever claims amongst the same parties. Tex. R. Civ. P. 41. Severance physically splits an action into multiple causes, the severed case obtaining a completely new case number. See *Philbrook v. Berry*, 683 S.W.2d 378 (Tex. 1985). Severance divides a lawsuit into two or more separate and independent causes of action. *Hall v. City of Austin,* 450 S.W.2d 836, 837-38 (Tex.1970). When a trial court grants a severance, the separated causes of action typically proceed to individual judgments-judgments that are themselves separately final and appealable. *Id.* at 838. Causes of action that have been severed from each other into independent lawsuits will be heard by different juries. *See Liberty Nat'l Fire Ins. Co. v. Akin,* 927 S.W.2d 627, 630 (Tex.1996).

The general rule is that claims are severable when several causes of action could have been brought as an independent lawsuit and the facts are not so interwoven that they cannot be separated. *Liberty Nat. Fire Ins. Co. v. Akin*, 927 S.W.2d 627, 629 (Tex. 1996).

The severance of claims generally rests within the sound discretion of the trial court. *Id.* at 629; See also *In re Travelers Lloyds of Tex. Ins. Co.*, 273 S.W.3d 368 (Tex.App.-San Antonio 2008, orig. proceeding) (en banc); TEX.R. CIV. P. 41 (providing that "actions which have been improperly joined may be severed ... on such terms as are just. Any claim against a party may be severed and proceeded with separately.").

In federal court, Rule 21 of the Federal Rules of Civil Procedure provides that a Court may sever any claim against a party if it is misjoined or might otherwise cause delay or prejudice. *Applewhite v. Reichhold Chems., Inc.*, 67 F.3d 571, 574 (5th Cir. 1995).

In both state and federal courts, claims are properly severable if (1) the controversy involves more than one cause of action, (2) the severed claim is one that would be the proper subject of a lawsuit if independently asserted, and (3) the severed claim is not so interwoven with the remaining action that they involve the same facts and issues. *In re Travelers*, 273 S.W.3d at 379; *Guar. Federal Sav. Bank v. Horseshoe Oper. Co.*, 793 S.W.2d 652, 658 (Tex.1990). The controlling reasons for a severance are to do justice, avoid prejudice, and promote convenience. *F.F.P. Oper. Partners, L.P. v. Duenez,* 237 S.W.3d 680, 693 (Tex.2007); *id.*

The issue of whether a trial court should or should not grant a severance motion is ultimately a question of law. *See generally Guar. Fed. Sav. Bank,* 793 S.W.2d at 658-59. When considering whether to grant a severance motion, the trial court must generally accept the plaintiff's pleadings as true and then determine whether severance is appropriate. *Jones v. Ray,* 886 S.W.2d 817, 820 (Tex.App.-Houston [1st Dist.] 1994, orig. proceeding). "The controlling

reasons for a severance are to do justice, avoid prejudice and further convenience." *Guar. Fed. Sav. Bank*, 793 S.W.2d at 658 (citing *St. Paul Ins. Co. v. McPeak*, 641 S.W.2d 284 (Tex.App.-Houston [14th Dist.] 1982, writ ref'd n.r.e.)). If the trial court's decision to grant or deny a party's severance motion fell within the wide zone of reasonable agreement, the appellate court reviewing that decision within the context of a mandamus proceeding should not conclude the lower court abused its discretion. Given that the trial court must generally accept the plaintiff's pleadings as true, the only remaining dispute concerns the legal consequences stemming from those accepted-as-pleaded facts. *In re Liu*, 290 S.W.3d 515, 519 (Tex. App. – Texarkana 2009).

B. The Bifurcated Trial Generally

Another vehicle for segregating issues that are part of one cause is the bifurcated trial. Unlike a severance, a bifurcated trial does not result in independent causes of action. Rather, Texas Rule of Civil Procedure 174 (b), allows a trial court to separate trials under the same cause number. Thus, the trial itself is "bifurcated" the case into multiple stages, each dealing with separate issues tried separately to factfinder.

Rule 174 vests the court with discretion to order separate trials to avoid prejudice or to further convenience. See TEX. R. CIV. P. 174(b); *In re Ethyl Corp*., 975 S.W.2d 606, 610 (Tex. 1998); *Womack v. Berry*, 291 S.W.2d 677,683 (Tex. 1956). Rule 174 is not limited in subject matter, but rather allows for separate trials on any claim or issue or any number of claims or issues. See TEX. R. CIV. P. 174.

In federal courts, Federal Rule of Civil Procedure 42(b) invests the federal district courts with discretion to order separate trials of claims "in furtherance of convenience or to avoid prejudice, or when separate trials will be conducive to expedition and economy." However, while bifurcation is a procedural matter governed by federal law, federal courts look to Texas law to aid it in determining whether separate trials should be ordered. *See also Lumbermens Mut. Cas. Co. v. Bell,* 289 F.2d 124, 125-26 (5th Cir. 1961); *Greil v. Geico*, 2001 U.S. Dist. LEXIS 16238, 2001 WL 1148118, at *1 (N.D. Tex. Sept. 18, 2001) ("Texas courts are in the best position to determine when claims arising under Texas law warrant separate trials").

Unlike in the case of a severance wherein the clear rule is that different juries hear severed trials, it is an open question of Texas law as to whether the same jury will consider the bifurcated issues or if a different jury should preside over each distinct segment of the trial. A certain line of cases has held that the separate bifurcated parts of the lawsuit should be submitted to a single jury for all aspects of the case. *Hyman Farm Serv., Inc. v. Earth Oil & Gas Co.*, 920 S.W.2d 452, 457-58 (Tex.App. – Amarillo 1996, no writ). Contrast that with a minority rule that states each bifurcated part should be submitted to a separate jury. *Greater Houston Transp. Co. v. Zrubeck*, 850 S.W.2d 579, 588 (Tex.App. –Corpus Christi 1993, writ denied).

At the end of all the bifurcated trials, there will be only one judgment – unlike a severance which will have multiple judgments. The mere completion of a subpart of a bifurcated case does not result in a final, appealable judgment. For instance, if coverage issues are bifurcated from bad faith claims, the bad faith claims must be litigated prior to appealing the finding on the coverage question. This is not the case when the claims are severed as opposed to merely bifurcated.

III. WHEN CAN A CASE BE SEVERED OR BIFURCATED

A. When Claims are Properly Severable

With respect to when claims are properly severable, the Texas Supreme Court has held that a claim is properly severable only if:

(1) The controversy involves more than one cause of action;

(2) The severed claim is one that would be the proper subject of a

lawsuit independently asserted; and

(3) the severed claim is not so interwoven with the remaining action that they involve the same facts and issues.

Guaranty Fed. Sav. Bank v. Horseshoe Operating Co., 793 S.W.2d 652 (Tex. 1990).

B. Severance or Bifurcation to Prevent Prejudice

Insurance carriers are commonly relying upon the tool of the declaratory judgment action to determine coverage obligations under a contract. Frequently, the policyholders counterclaim with allegations of insurer bad faith and/or breach of contract claims. Moreover, the bad faith claim itself usually includes claims for breach of contract, along with other tort claims. Regardless of the format presented, most bad faith litigation deals with two claims: a breach of contract claim or declaratory judgment to determine if coverage exists and claims regarding whether the insurer's handling of claim rises to the level of bad faith. In instances where both types of claims are present, the insurance carrier should seek a segregation of the contract claims from the bad faith, through at least a bifurcation of the trial or possibly even a total severance of the two.

In insurance matters, the primary basis for segregation of the coverage from bad faith claims through severance or bifurcation is generally based upon the premise that the evidence concerning the bad faith handling or investigation of the claim is not admissible in the breach of contract action and would be unduly prejudicial in the breach of contract action. *State Farm Mutual Auto. Ins. Co. v. Wilborn*, 835 S.W.2d 260 (Tex.App. –Houston [14th Dist.] 1992 no writ).

This is the primary basis behind carrier's desire to segregate coverage claims from bad faith claims. Claims are properly severable if "(1) the controversy involves more than one cause of action, (2) the severed claim is one that would be the proper subject of a lawsuit if independently asserted, and (3) the severed claim is not so interwoven with the remaining action that they involve the same facts and issues." *Guar. Federal Sav. Bank v. Horseshoe Oper. Co.*, 793 S.W.2d 652, 658 (Tex. 1990). The controlling reasons for a severance are to do justice, avoid prejudice, and promote convenience. *F.F.P. Oper. Partners, L.P. v. Duenez*, 237 S.W.3d 680, 693 (Tex. 2007).

Typically, a severance is granted in cases where the insurer has made an offer of settlement, to prevent the assumption that the insurer has admitted liability. *See e.g. In re Allstate Co.*, 2003 Tex. App. LEXIS 4024, 2003 WL 21026877, at *1 (Tex. App.--Houston [1st Dist.], 2003); *In re Progressive County Mut. Ins. Co.*, 2007 Tex. App. LEXIS 889, 2007 WL 416553, at *1 (Tex. App.--Beaumont, 2007). However, these are not the only circumstances in which a severance may be granted. *See e.g. Liberty National Fire Insurance Company v. Akin*, 927 S.W.2d at 629 (Tex. 1996). There, the Court held:

> A severance may nevertheless be necessary in some bad faith cases. A trial court will undoubtedly confront instances in which evidence admissible only on the bad faith claim would ***prejudice the insurer to such an extent that a fair trial on the contract claim would become unlikely***. One example would be when the insurer has made a settlement offer on the disputed contract claim. As we have noted, some courts have concluded that the insurer would 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 had offered to settle the entire dispute. While we concur with these decisions, we hasten to add that evidence of this sort simply does not exist in this case. In the absence of a settlement offer on the entire contract claim, or ***other compelling circumstances***, severance is

not required.

Id. at 630 (citations omitted; emphasis added).

While *Akin* provides the vehicle to litigants to sever or bifurcate based upon prejudice, it still leaves the question of bifurcation or severance to the trial court determination of whether the insurer would be unfairly prejudiced by having to defend the contract claim at the same time. Since *Akin* also approved of the trial court's decision to deny severance but grant bifurcated trials, it is equally apparent that the Supreme Court has granted trial courts a great deal of discretion on which procedural tool to use to segregate the claims.

C. Bifurcation as an Alternative to Severance

The intermediate courts of appeal in Texas have not found this discretion to be limitless but generally provide broad discretion to trial courts in determining whether to sever or merely bifurcate claims. Following *Akin,* numerous intermediate courts of appeals have considered whether it is an abuse of discretion for a trial court to refuse to order a severance of contractual claims from bad faith claims when a settlement offer has been made. In fact numerous courts denied mandamus relief based upon the denial of a severance. *See, e.g., In re Miller,* 202 S.W.3d 922, 925-26 (Tex.App.-Tyler 2006, orig. proceeding [mand. denied]); *In re Allstate Tex. Lloyds,* No. 14-05-00762-CV, 2005 WL 2277134, at * 4 (Tex.App.-Houston [14th Dist] Sept. 2, 2005, orig. proceeding) (mem. op.); *In re Allstate Indem. Co.,* 05-03-01496-CV, 2003 WL 22456345, at *1 (Tex.App.-Dallas Oct. 30, 2003, orig. proceeding) (mem. op.); *In re Trinity Universal Ins. Co.,* 64 S.W.3d 463, 468 (Tex.App.-Amarillo 2001, orig. proceeding [mand. denied]). Eventually, parties began seeking bifurcation of the contractual claims from the bad faith claims as an alternative to severance. *See In re Travelers,* 273 S.W.3d 368, 373-75 (Tex.App.-San Antonio 2008, orig. proceeding) *In re Allstate Tex. Lloyds,* 202 S.W.3d 895, 900 (Tex.App.-Corpus Christi 2006, orig. proceeding [mand. denied]) (concluding plaintiffs failed to meet their burden that they would be prejudiced by the bifurcation of contractual claims under a homeowner's insurance policy and bad faith claims instead of severing and abating the claims).

Two cases involving Travelers have has become the definitive cases on the broad discretion of the trial court to sever or bifurcate. *In re Travelers* involved a suit filed by homeowners against their homeowners' insurance carrier for breach of contract and bad faith for mishandling their claim. *In re Travelers,* 273 S.W.3d at 370. This case from the San Antonio Court of Appeals concluded that "[b]ecause the trial of the [plaintiffs'] extra-contractual claims is unaffected by the outcome of their contractual claim, a single bifurcated trial preceded by unified discovery and pretrial proceedings promotes judicial economy better than severance and abatement." *Id.* at 374. As a result, this court determined the trial court did not abuse its discretion in bifurcating the case because "[u]nder these circumstances, the primary justification for abatement of the extra-contractual claims-avoiding the effort and expense of conducting discovery on claims that may be rendered moot in a previous trial-is non-existent because the disposition of the contractual claim will not moot the extra-contractual claims." *Id.*

Another Travelers case from the Waco Court of Appeals went even further. *In re Travelers Lloyds Ins. Co.*, 58 S.W.3d 321, 322 (Tex.App. –Waco 2001, orig. proceeding) held that severance was not required even though it was likely that the carrier would have to waive the attorney-client privilege or be prevented from using certain evidence important to its defense involving communications with counsel. Citing the *Akin* decision, the Waco Court rejected "an inflexible rule that would deny the trial court all discretion and . . . require severance in every case [involving bad faith insurance claims], regardless of the likelihood of prejudice." *In re Travelers*, 58 S.W.2d at 322 (*citing Akin,* 927 S.W.2d at 630).

Consequently, the prevailing view under Texas law is that even in situtations where Akin

requires segregation of bad faith claims due to prejudical effect or efficiency, the trial court has a very free hand at using bifurcation as an alternative to severance.

D. Severance/Bifurcation of UM/UIM Claims from Bad Faith Claims

The general rule described above does not hold up in the context of a uninsured/underinsured motorist claim. Much of the recent caselaw on this issue is conducted in the context of a UM/UIM claim that also involved claims of bad faith. In the case of *In re United Fire Lloyds*, 327 S.W.3d 250, 256 (Tex. App. – San Antonio 2010), the San Antonio Court of Appeals held that a trial court abused its discretion in failing to sever uninsured/underinsured motorist claims for coverage from attached bad faith allegations. The *United Fire* court held that since the carrier's obligation under the policy failed to arise until such time that that policyholder establishes the liability and underinsured status of the other motorist.. I*d*. Citing to *Brainard v. Trinity Universal Ins.* Co., 216 S.W.3d 809, 818 (Tex.2006)

Similarly, the Amarillo Court of Appeals held that the UM/UIM breach of contract claims must be severed from bad faith claims made by the insured. *In re Trinity Universal Ins. Co.*, 64 S.W.3d 463 (Tex.App. –Amarillo 2001, orig. proceeding). The court in Trinity also held that the trial court abused its discretion in failing to sever and abate the extra-contractual claims from the breach of contract claim made by the insured. *Id*. at 468.

E. Bifurcation of Punitive Damage Claims:

Another realm where Texas courts have determined that insurance coverage actions should be subject to severance or bifurcation is in the case where punitive damages are sought. In *Transportation Insurance Co. v. Moriel*, 879 S.W.2d 10, 29-30 (Tex. 1994)., the Texas Supreme Court held an insurer is entitled to a bifurcated trial on the issue of punitive damages. The first subpart of the trial would involve a jury finding on the question of whether insurer's conduct constitutes bad faith that rises to a malicious or grossly negligent standard. The second subpart of the case (if necessary) would involve evidence of carrier's net worth and measuring punitive damage award. *Id*. at 30. Essentially this means that since the carrier's net worth is not disclosed to the jury, unless and until the jury determines the insured is entitled to an award of punitive damages. *Id*.