FIRST PARTY BAD FAITH CASE UPDATE

By

© Nathan P. Pekar
Cooper & Scully, P.C.

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I. INTRODUCTION

This paper gives a summary of the most recent court rulings regarding Texas cases of first party bad faith. This is done to keep the reader informed on any recent changes in law, as well as, to educate them on the current direction in analysis that the Texas courts are taking in such actions.

A. ***DeLaGarza v. State Farm Mutual Automobile Insurance Company***

175 S.W.3d 29, (Tex.App. – Dallas 2005, no pet.h.); 181 S.W.3d 755 (Tex. App. – Dallas 2005)

Issue:

Whether insurer violated statutory obligations under 21.55 to timely respond to an insured's demand letter, and to make prompt payment of a claim within five business days.

Facts:

Insured made a written claim to recover damages under his uninsured motorist policy on October 18, 2002. On October 25, 2002, State Farm responded to the demand requesting supporting documentation. Six days later State Farm sent a second letter and requested a signed authorization to release information relating to the uninsured motorist claim.

On March 6, 2003, State Farm received a letter enclosing DeLaGarza's medical records and bills, but did not receive the signed authorization. This letter stated that the necessary and reasonable medical charges were $9604, and that Mr. DeLaGarza would require future medical expenses also. Finally the letter demanded that State Farm tender its $25,000 in policy limits to DeLaGarza. State Farm responded to this letter on March 27, 2003, stating that it was unable to settle the matter for $25,000, but could offer $10,000.

On May 23, 2003, Mr. DeLaGarza filed suit against State Farm. Three weeks after the suit was filed State Farm sent a check for $10,000, and followed this with a second check for $25,000, after discovery was conducted. Mr. DeLaGarza alleged violations of 21.55 for delay in handling and paying the claim. He contended that State Farm failed to meet its deadline by not responding to his March 6, 2003, demand letter until twenty-one days later on March 27, 2003. Additionally, he contended that State Farm's March 27th letter offering $10,000, was an outright "acceptance" of his claim, and thus required it to send full payment within five business days which it failed to do since the final $15,000, was not sent until after suit was filed.

Holding:

State Farm did not violate 21.55 because it timely responded to DeLaGarza's March 6th letter within fifteen business days. Additionally, the Court held that State Farm did not violate the violate the prompt payment deadline set by article 21.55 because the deadline to send the payment was never triggered.

It found that State Farm accepted part of DeLaGarza's insurance claim based on the information he provided the company, and offered to pay him that portion of the claim within five days of receiving notice that DeLaGarza was willing to settle for that amount. However, because DeLaGarza never sent State Farm notice that he was willing to settle his claims for $10,000, then the deadline to send payment within five business days did not arise.

Finally, the Court found that State Farm's second payment of $15,000 was not past its five business day deadline because DeLaGarza had already filed suit, and this second payment was to resolve litigation rather than to satisfy an accepted claim.

***Re-Hearing on November 3, 2005*.**

Issue:

Whether insurer violated 21.55 because it required a release for lessor amount in exchange for prompt payment of an undisputed amount.

Facts:

DeLaGarza contended that his case was in conflict with the recent Texas Supreme Court opinion in *Republic Underwriters Ins. Co. v. Mex-Tex, Inc.,* 150 S.W.3d 423 (Tex. 2004) because it found that an insurance company could not delay making a payment under article 21.55 by insisting on a release to which it is ultimately entitled.

Holding:

The Texas Supreme Court's analysis was done to ensure that an insurance company could not force an insured to settle for less than he was legally entitled to receive by conditioning prompt payment on a release of the insurer's liability for further payment. However, in the case at hand, there was no showing that DeLaGarza was legally entitled to more money than the partial payment State Farm offered in exchange for the release. Though State Farm ultimately did pay the full amount of his claim to settle the dispute, DeLaGarza never established that State Farm was legally obligated to pay such under the terms of the policy. Thus Republic Underwriters was not applicable.

B. ***Trahan v. Fire Ins. Exchange***
179 S.W.3d 669 (Tex. App. – Beaumont 2005, pet. denied)

Issue:

Ability of insurer to request an EUO regarding the subject loss, and withhold payment of a claim until the insured swore to EUO.

Facts:

The insureds filed a fire loss claim on February 8, 2001, when their home and automobile were destroyed by a fire. Fire Insurance Exchange requested on February 14, 2001, that the Trahans submit to an Examination Under Oath. The Trahans did not respond to the February 14th request or to FIE's subsequent requests. Finally, on August 29, 2001, the Trahans submitted to the EUOs and signed the transcript on September 20, 2001. FIE accepted the fire loss claim and issued checks on October 8, 2001.

The Trahans brought suit alleging breach of contract, breach of common law duty of good faith and fair dealing, and violations of the Insurance Code. Specifically, they alleged that FIE committed bad faith by delaying in requesting the EUOs, delaying in payment of the loss claims, and conducting the loss investigation in bad faith.

Holding:

While most insurance coverage claims and bad faith claims are by their nature independent, in most circumstances an insured may not prevail on a bad faith claim without first prevailing on a breach of contract claim. The policy imposed a duty on FIE to investigate the loss claim within fifteen days after receiving written notice of the claim, and to accept of deny the claim within fifteen days of receiving all of the information requested during the investigation.

FIE requested the EUOs within the proper time period of the initial fifteen days from written notice. It also sent payment within the fifteen business days period after receiving the sworn EUOs on September 20, 2001. Therefore, FIE requested the EUOs and made payment of the claim in a timely manner under the policy; and did not breach the duty of good faith and dealing.

C. ***United Servs. Auto Ass'n. V. Mainwaring***
No. 05-03-01250-CV, 2005 WL 667683 (Tex. App. – Dallas 2005, no pet.)

Issue:

Viability of insured's breach of the duty of good faith and fair dealing, and violation of article 21.55 claims, based on refusing to pay a claim without first conducting a reasonable investigation.

Facts:

The insureds brought a claim for foundation damage under their homeowner's policy. The insurer hired Michael Porter, as its first investigator for the claim and who it used regularly on these projects. He found that there were three plumbing leaks beneath the house. However, he also determined that seasonal moisture, desiccation of the soil by trees, and natural settling combined to cause the foundation damage. Mr. Porter determined the damage could be repaired by raising the piers, and

accordingly USAA denied the foundation claim but agreed to repair the leaks.

During the repair the insured noticed saturated soil as well as water actually leaking from the plumbing pipe, and requested USAA reinvestigate the matter. Porter reinvestigated the leaks and again determined that they did not cause the foundation damage. Therefore, USAA 's coverage decision remained unchanged.

The insured then hired an engineer to investigate the matter and he found the plumbing leaks did cause the foundation to heave and then crack. However, he also found that there were other contributing factors to the foundation damage that were similar to Porter's findings.

Subsequently, USAA then hired Jim Drebelbis as a second engineer, and another individual that USAA routinely used on these type of claims. They informed the insured that he was an independent investigator. He too found that though the foundation did heave it was not caused by the plumbing leaks, and stated that it was due to the soil disiccation and seasonal changes. Thus, USAA denied the claim for a third time.

The insured then filed suit against USAA alleging breach of contract, breach of the duty of good faith and fair dealing, violation of the Insurance Code, and violation of the Deceptive Trades Practices Act. Specifically, the insureds argued that the insurer's by refusing to pay their claim without first conducting a reasonable investigation violated the insurance code. The insurer argued that there was no evidence that it knowingly refused to pay the claim without conducting a reasonable investigation.

Holding:

The Court found that the insurer's first engineer admitted that he did not perform any tests to determine the actual effects of the trees on the foundation. Additionally, it found that the insurer's second engineer did not take any measurements, review the history of the house, or perform any tests. Finally, the Court held that because USAA routinely used Porter and Drebelbis, informed the insured that Drebelbis was an independent investigator, and conducted an outcome-oriented investigation that it acted with knowledge and actual awareness.

Additionally, the Court held that USAA violated article 21.55 by failing to pay the claim within sixty days after it received all of the necessary information to determine coverage. In following prior rulings, the court found that a wrongful rejection of a claim may be considered a delay in payment for purposes of the 60 day rule and statutory damages.

D. ***Boyd v. Progressive Cty. Mut. Ins. Co.***
177 S.W.3d 919 (Tex. 2005)

Issue:

Does a finding for the insurer negating coverage as to a breach of contract claim, subsequently require a bad faith claim to be negated also.

Facts:

The insured, Barry Boyd, filed suit Progressive County Mutual Insurance Company, when it denied reimbursement for damages sustained by his automobile. He alleged breach of contract, bad faith, and related extra-contractual claims.

The bad faith and extra-contractual claims were severed from the breach of contract claim. Summary judgment was granted to the insurer on the bad faith and extra-contractual claims, and a jury found for the insurer on the breach of contract claim.

The Court of Appeals affirmed the breach of contract claim, but reversed the summary judgment ruling on the bad faith and extra-contractual claims because the jury's findings on the breach of contract were not yet in front of the Court.

Holding:

The Texas Supreme Court found that the trial court's granting of the summary judgment on the bad faith and extra-contractual claims constituted harmless error because of the jury's finding regarding the breach of contract claim negating coverage. However, the Court did leave open the

possibility that "an insurer's denial of a claim it was not obligated to pay might nevertheless be in bad faith if its conduct was extreme and produced damages unrelated to and independent of the policy claim." However, the insured only alleged that the insurer improperly denied the claim and failed to fairly investigate the facts of the accident.

E. ***Royal Maccabees Life Ins. Co. v. James***
146 S.W.3d 340 (Tex. App. – Dallas 2004)

Issue:

The sufficiency of the evidence regarding an insurer's duty of good faith and fair dealing.

Facts:

A group life beneficiary sued insurer for denying the payment of full benefits of decedent's life insurance policy. The insured argued that it did not breach any duty of good faith or fair dealing because an insurer cannot be liable for common law bad faith when it denies a claim that was not covered by the policy.

However, the insured argued that the insurer accepted premium payments from the decedent for supplemental life insurance for over four years, routinely sent statements to the decedent, and showed the decedent as covered for full benefits of life insurance. The insurer alleged that it requested information from decedent's doctor but did not get a response. The custodian of records for the doctor, however, testified that no such request could be found in the doctor's files.

The insurer also claimed that it sent a letter to the insured disapproving the decedent's application for supplemental life insurance, but this letter could not be found. Additionally, the insurer's employee testified that he did not recall writing the letter and that he would not have written such a letter as part of his employment duties at the time.

Holding:

The Court held that this disputed testimony constituted sufficient evidence to support a finding that the insurer violated its duty of good faith and fair dealing.

F. ***Westcott Holdings, Inc. v. Monitor Liability Managers***
No. Civ.A. H-05-1945, 2005 WL 2206196 (S.D.Tex. 2005)

Issue:

Whether a claim under a Directors' and Officers' and Corporate Liability Insurance Policy for defense costs incurred from third party suits, was actually a first party claim and subject to bad faith.

Facts:

Westcott Holdings purchased a Directors' and Officers' and Corporate Liability Insurance Policy from Carolina Casualty Insurance Company covering qualifying claims from March 15, 2003, to March 15, 2008. The Policy included coverage for costs of defending lawsuits filed against plaintiff's directors and officers, as well as the directors and officers of plaintiff's subsidiaries. The Policy provided coverage to plaintiff for "wrongful acts" by plaintiff's directors and officers to the extent that plaintiff indemnified its directors and officers.

On March 17, 2003, Westcott Holdings' subsidiary, Texas Metal Works, and two of its officers were sued by Foroni Metals of Texas. The allegations against defendants in that suit fell within the Policy's definition of wrongful acts. Westcott timely notified Carolina Casualty of the suit. This suit was later non-suited, but Westcott incurred $60,000 in defense costs.

Additionally, on May 29, 2003, Baker Hughes Oilfield Operations brought suit against Westcott, Texas Metal, and Texas Metal's officers and directors. Baker Hughes also alleged wrongful acts by Texas Meta's officers and directors that were covered by the Policy. Again, Plaintiff properly notified Carolina Casualty. This suit settled for $75,000 and Westcott incurred $240,000 in defense costs.

Westcott requested reimbursement of its defense costs in these two suits from Carolina Casualty. Carolina Casualty refused to pay these costs, and Westcott filed suit against Carolina

Casualty and Monitor Liability Managers alleging breach of contract, bad faith, unfair settlement practices, deceptive trade practices, and failure to promptly pay claims.

The insurers argued that the bad faith claim should be dismissed because Texas does not recognize such a tort for a third-party insurance contracts. The insured however, argued that this claim was actually a first party claim.

Holding:

"There is a duty of good faith in first-party cases, but not in third party cases because an insurer's and an insured's interests are not aligned when the insured is claiming on its own behalf as they are or should be in third-party cases where the insurer and insured face a common opponent."

In the case at hand "the interests of the insured insurer are not aligned. The insured's indemnification of its directors and officers is a loss to the insured. It does not flow directly to a third party, but rather covers the insured for monies expended. The loss plaintiff seeks recovery for is its own, not for injuries to a third party. The court concludes that the insurance coverage at issue is first party because the insurer's duty to pay runs directly to the plaintiff as the insured. It protects the plaintiff against loss actually paid (the insured's own loss) rather than a loss arising from liabilities (injuries to a third-party)."

G. ***DeLaurentis v. United Servs. Auto. Ass'n.***
162 S.W.3d 714 (Tex. App. – Houston [14th Dist.] March 31, 2005, no pet.)

The Court on March 31, 2005, withdrew its opinion issued on September 30, 2004, issued the following opinion in its place:

Issue:

Whether the insured's claim for mold damage resulting from a leaking air conditioning unit in her apartment is covered under renter's insurance policy. Also, whether a reversal of a breach of contract claim requires a reversal of an insured's extra-contractual claims including bad faith.

Facts:

The insured filed a claim for damage to various items of personal property damaged by water and mold as a result of an air conditioning leak in her apartment after she determined the apartment complex had not fully remediated the damage. A representative of the carrier advised the insured on multiple occasions that mold damage was not a named peril in the policy and, therefore, the company would only pay for items damaged by water. The insured then sued USAA, alleging claims for breach of contract, bad faith and violations of the DTPA and Article 21.21.

Although mold is not a named peril in the HOB-T policy, under Coverage B (Personal Property) of Section I - Perils Insured Against, the policy provided coverage for "physical loss" to property caused by the accidental discharge, leakage or overflow of water or steam from within a plumbing, heating or air conditioning system or household appliance. Thus, to the extent the insured could prove the mold damage was caused by the air conditioning leak at issue, she was entitled to payment for such damage. The trial court initially granted summary judgment in favor of the insurer, and the case was appealed.

Held:

Originally, the Appellate Court held that "under the unambiguous language of the HOB-T policy, the insurer is obligated to compensate the policyholder for any mold damage she can prove was caused by a leaking air conditioning unit in her apartment." However, it failed to discuss whether its reversal of the breach of contract claim, also called for the reversal of the insured's extra-contractual claims.

On March 31, 2005, the Court followed history, by finding that a simple reversal of a trial court's summary judgment as to a coverage claim does not necessarily mean that the extra-contractual claims must also be reversed. Thus, the reversal of the trial court's summary judgment as to the breach-of-contract claim does not create a fact issue and require a reversal of her extra-contractual claims.

H. ***Munoz v. State Farm Lloyds***

No. Civ.A. B-04-141, 2006 WL 89836 (S.D. Tex. 2006)

Issue:

Insurer's right to summary judgment on bad faith claim when its liability never becomes reasonably clear due to lengthy investigation into arson fire.

Facts:

Insured's home was destroyed by fire on January 1, 2003. They made a claim under their insurance policy which was in effect from December 29, 2002, through December 29, 2003. The Fire Marshall's office found that the fire was intentionally set, although numerous investigations did not reveal who started it. Once the fire was reported the insurer began investigating the circumstances surrounding the fire.

In May of 2004, the insured began to feel that the insurer was dragging out the investigation in an effort to avoid paying the claims, and thus they filed suit asserting claims for breach of contract, bad faith, deceptive trade practices, and slander per se. At the time they filed suit the insurer's investigation was still on-going and it had not made a decision on the insured's claim.

The insurer moved for summary judgment on the bad faith claims arguing that because its liability never became reasonably clear, it cannot be held liable for bad faith. The insured argued that the insurer did not follow up on several important leads that could have cleared them, and also, concentrated its efforts investigating the insured instead of the fire.

Holding:

In arson cases the insurer can conduct a more extensive investigation than in other cases. This is because it must discover whether the insured had motive to set the fire. The Court agreed that the insurer's liability never became reasonably clear and it cannot be held liable for any bad faith claims. However, because of the evidence presented by the insured it found that two material questions remained: (1) whether all relevant information provided to the insurer which would implicate the question of whether the investigation was unreasonably long or delayed, and (2) whether the insurer conducted its investigation in a manner to avoid liability. Thus, the Court denied the insurer's motion for summary judgment.

I. ***Weisman v. State Farm Mut. Auto Ins. Co.*** No. Civ. H-04-1991, 2005 WL 2561507 (S.D. Tex. 2005)

Issue:

Applicability of Article 21.55 penalties to insured's claim for breach of the duty to defend.

Facts:

Insured filed claim under his automobile policy after an accident with two other vehicles. The insurer paid benefits under the policy's collision, rental, and personal injury coverage. The policy also included uninsured/underinsured motorist coverage.

The insurer determined the insured was not entitled to this coverage because according to the policy he was the proximate cause of the accident. The insurer based its decision on inspection of the vehicles, police records, medical records, written statements from the drivers, and a recorded statement from the insured.

The insured filed suit for bad faith asserting that the insurer did not conduct a reasonable investigation because it could have gathered additional evidence such as conducting an accident reconstruction, reviewing the underlying lawsuit's discovery, and gathering more information for the other drivers.

Holding:

There was no evidence that the insurer pursued only one account of the accident, conducted an investigation to justify a preconceived result, and ignored evidence that the insured was not at fault. The insurer simply weighed the evidence and came to a different conclusion than the insured. Therefore, it was a bona fide dispute, and there was no bad faith.

J. ***Allstate Indem. Co. v. Hyman***
No. 06-05-00064-CV, 2006 WL 694014 (Tex.App. – Texarkana 2006)

Issue:

Applicability of Article 21.21 and 21.55 damages when an insurer promptly accepts coverage and makes a settlement offer.

Facts

Insured was involved in an automobile accident on July 26, 2000. She made a claim under her policy which Allstate accepted and offered to settle. The insured felt the offer was inadequate, and filed suit a year later after several unsuccessful negotiations.

The insured asserted claims for breach of contract, and violations of the Texas Insurance Code. The insurer argued that because it promptly accepted coverage and made a settlement offer then it should not be subject to Article 21.21 violations.

The insurer's settlement offer was for $14,425. The insured had appraisals ranging as high as $22,000. Ultimately a jury found the value of the car to be $18,000. Allstate also argued that because the damages sought were due to an alleged delay in payment of policy benefits there was no additional recovery of damages allowable.

Holding:

This was not a questionable case because it did not involve a denial of liability or a claim of mere breach of contract. Here Allstate admitted liability, but disputed the proper amount of payment, and refused to tender payment-even for the undisputed portion. Additionally, Allstate admitted that it stated it had used comparable vehicles to determine market value when it actually had not.

Due to these actions Allstate was exposed to additional damages under 21.21 and 21.55 because its behavior was an attempt to maximize its profits by making an offer that might be marginally acceptable-reasoning that most insureds would take what was offered with only minimal complaint. The statute does not restrict "actual damages" to extra-contractual damages, and when there is evidence of delayed payment and knowing misrepresentations, such additional damages are appropriate.

K. CONCLUSION

There have been several cases in the past year dealing with first party bad faith. Hopefully, this summary has helped to enlighten you in the direction the Texas Courts are taking in such actions, and also educated you on the new developments in this area of law.