

# Texas Supreme Court Confirms No Independent Injury Needed to Recover Under Texas Bad Faith Statute

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For years, corporate policyholders lacked a clear path to recovery against their insurance companies under the Texas bad faith statute. The reason for this uncertainty was that some courts required a showing of an injury independent from the loss of policy benefits as a means of recovery under the bad faith statute. Unlike individuals, corporate policyholders could not claim mental anguish, loss of credit, or similar types of injuries and so they were prevented from threatening their insurers with the prospect of treble damages allowed by the statute. Now the Texas Supreme Court has cleared the path for all policyholders, including corporate policyholders, to recover under the statute without showing an injury independent of the loss of policy benefits.

Chapter 541 of the Texas Insurance Code prohibits an insurance company from committing “unfair or deceptive acts or practices in the business of insurance.” These “unfair or deceptive acts or practices” include, but are not limited to, acts and practices such as misrepresenting to a claimant a material fact or policy provision relating to coverage at issue; failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim when the insurers’ liability has become reasonably clear; failing to promptly provide a reasonable explanation of the basis in the policy for the insurer’s denial of a claim; failing to affirm or deny coverage within a reasonable period of time; and refusing to pay a claim without conducting a reasonable investigation of the claim.

Chapter 541 also establishes a private right of action for insureds who are damaged by an insurance company’s commission of an “unfair or deceptive act or practice.” The insured can not only recover their “actual damages” under the statute, but may also recover treble damages when the insurance company “knowingly” commits an unfair or deceptive act or practice.

Over the last two decades, insureds and insurance companies argued back and forth over the meaning of the term “actual damages” in Chapter 541. The main disagreement concerned whether unpaid policy benefits constituted “actual damages,” or if the insured had to show some sort of “independent injury.” For corporate insureds, the resolution of that issue was of the utmost significance as it is relatively rare for a corporate insured to suffer an “independent injury” caused by an insurance company’s unfair or deceptive act or practice.

Case law on this issue was all over the map. In April 2017, in *USAA Tex. Loyds Co. v. Menchaca*, 2017 Tex. LEXIS 361 (Apr. 07, 2017), the Texas Supreme Court acknowledged that there was substantial confusion among the courts on how to apply Chapter 541. To resolve this issue, the Texas Supreme Court identified five general rules that govern the relationship between contractual and extra-contractual claims under Chapter 541. Those rules were:

- **The General Rule:** Generally, an insured cannot recover policy benefits as damages for an insurance company’s statutory violation if the policy does not provide the right to receive those benefits.
- **The Entitled to Benefits Rule:** An insured who establishes a right to receive benefits under the insurance policy can recover those benefits as actual damages under the Insurance Code if

the insurance company's statutory violation causes the loss of the benefits.

- The Benefits Lost Rule: Even if the insured cannot establish a present contractual right to policy benefits, the insured can recover benefits as actual damages under the Insurance Code if the insurance company's statutory violation caused the insured to lose that contractual right.
- The Independent Injury Rule: If an insurance company's statutory violation causes an injury independent of the loss of policy benefits, the insured may recover damages for that injury even if the policy does not grant a right to benefits.
- The No-Recovery Rule: An insured cannot recover any damages based on an insurance company's statutory violation unless the insured establishes a right to receive benefits under the policy or an injury independent of a right to benefits.

About eight months after *Menchaca* was issued, the Texas Supreme Court granted the insurer's request for rehearing. In addition to raising issues regarding the remand of the case, the insurance company also reiterated its challenge to the ruling that unpaid policy benefits alone constitute "actual damages" under Chapter 541. On April 13, 2018, the Texas Supreme Court issued its opinion on the rehearing and unanimously re-affirmed the five rules set forth above. *USAA Tex. Lloyds Co. v. Menchaca*, 2018 Tex. LEXIS 313 (Apr. 13, 2018).

With the Texas Supreme Court's resolution of *Menchaca*, a two-decade debate has been settled. Under Texas law, "[i]f an insurer's wrongful denial of a valid claim for benefits results from or constitutes a statutory violation, the resulting damages will necessarily include 'at least the amount of policy benefits wrongfully withheld.'" This means that insurance companies cannot avoid statutory bad faith claims on the grounds that the insured did not suffer an independent injury. Insureds will need only show that they were entitled to, but did not receive, insurance policy benefits to establish their "actual damages." *Menchaca*'s confirmation that an insurance company is subject to bad faith liability for wrongfully withholding policy benefits, without regard to the presence of an independent injury, should revitalize statutory bad faith under Chapter 541 in Texas, especially for corporate insureds.

Notwithstanding the pro-insured ruling in *Menchaca*, the fight between insureds and insurance companies regarding statutory bad faith will continue, just on a different battleground. While insurance companies will not be able to argue that insureds must have suffered an independent injury to avail themselves of Chapter 541, insurance companies are likely to argue that their statutory violations did not cause the damages to the insured. Practically speaking, insureds asserting claims under Chapter 541 should be prepared to lay out exactly how the insurance company's commission of the unfair or deceptive acts or practices led to the insurance company's wrongful withholding of insurance policy benefits.

Now that statutory bad faith has been revitalized in Texas through the Texas Supreme Court's unanimous affirmation of the *Menchaca* rules, insureds have powerful arrows in their quiver for fighting back against wrongful claim handling by insurance companies. With treble damages available to the insured, insurance companies will hopefully think twice before committing unfair or deceptive acts or practices in Texas when handling claims moving forward.

If you have any questions, please contact one of the lawyers listed below.