

Texas Supreme Court Clarifies Damages Recoverable for Violations of the Texas Insurance Code

April 27, 2017 Micah Skidmore

PRACTICES Insurance Recovery, Litigation

The Texas Supreme Court recently held that policy benefits can constitute actual damages for violations of the Texas Insurance Code, clearing up confusion over the damages recoverable for statutory "bad-faith."

The Problem

Since 1998, Texas policyholders and insurers have faced uncertainty regarding the damages recoverable when an insurer engages in "unfair or deceptive acts or practices" as set forth in Chapter 541 of the Texas Insurance Code. Section 541.060, for example, prohibits insurers from, among other things, (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 claim with respect to which the insurer's liability has become reasonably clear; (3) failing to promptly provide to a policyholder a reasonable explanation of the basis in the policy, in relation to the facts or applicable law, for the insurer's denial of a claim or offer of a compromise settlement of a claim; and (4) refusing to pay a claim without conducting a reasonable investigation with respect to the claim.

In 1998, the Texas Supreme Court in *Provident American Insurance Co. v. Castaneda*, 988 S.W.2d 189 (Tex. 1998) ruled that, when the policy does not provide coverage for a claim, the insured could not recover "damages equivalent to policy benefits" under the Texas Insurance Code, but instead must show some damage independent of the policy. Despite prior precedent, including *Vail v. Texas Farm Bureau Mutual Insurance Co.*, 754 S.W.2d 129 (Tex. 1988), holding that benefits denied in breach of insurance policy are recoverable under the Insurance Code, some insurers have argued since *Castaneda*, that the only damages recoverable for statutory "bad faith" are those "independent" of the policy benefits owed by the insurer.

The Clarifying Rules

Recognizing the confusion arising out of *Vail* and *Castaneda*, the Texas Supreme Court has provided clarification regarding the relationship between claims for breach of an insurance contract and claims for violating the insurance code by articulating the following five (5) governing principles:

1. An insured cannot recover policy benefits as damages for an insurer's statutory violation if the policy does not provide the insured a right to receive those benefits.
2. 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 insurer's statutory violation causes the loss of benefits.
3. 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 insurer's statutory

violation caused the insured to lose that contractual right.

4. If an insurer'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 the insured a right to benefits.
5. An insured cannot recover any damages based on an insurer's statutory violation if the insured had no right to receive benefits under the policy and sustained no injury independent of a right to benefits.

The Context

The Court's clarification comes in the context of a dispute over damage to a residence caused by Hurricane Ike in 2008. A homeowner, *Menchaca*, submitted a claim for storm damage, which the insurer, USAA Texas Lloyds, denied on the basis that the damage did not exceed the homeowner's deductible. In a subsequent suit alleging both breach of the insurance policy and unfair settlement practices under the Texas Insurance Code, the jury found no breach of the policy but awarded damages under the Insurance Code. *USAA Tex. Lloyds Co. v. Menchaca*, 2017 Tex. LEXIS 361, at *3-4 (Tex. Apr. 7, 2017). Over objections that *Menchaca* could not recover under the Insurance Code absent a breach of the policy, the trial court entered judgment in favor of *Menchaca*, which was affirmed on appeal. *Id.* at *5. The Texas Supreme Court remanded the case for a new trial consistent with the clarifying principles provided in this opinion.

What This Means For Policyholders

Without diminishing the value of the Court's guidance in *Menchaca*, the clarifying rules offered in this opinion can be distilled to one word: causation. In order to recover damages for statutory "bad faith"—whether policy benefits or otherwise—policyholders must demonstrate that the damages were "caused by" a violation of the Insurance Code. In preparing, submitting and documenting claims and the insurer's claims handling practices, corporate insureds should be cognizant of the need to demonstrate the relationship between the insurer's conduct and the policy benefits or other damages claimed. Risk managers and counsel should also know that if "causation" is shown, the Insurance Code may provide an independent basis for recovery of damages and attorneys' fees, including trebled damages for "knowing" violations. TEX. INS. CODE § 541.152 (" . . . [O]n 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.")

If you have questions about the damages recoverable for violations of the Texas Insurance Code or about insurance claims in general, please contact one of the Haynes Boone Insurance Coverage Practice Group partners listed below.