Martin, Stoner in Texas Lawyer: How Extra-Contractual Damages Can Protect Insureds From Obstinate Insurance Companies

June 1, 2018 Ernest Martin, Michael Stoner

PRACTICES Insurance Recovery

The Texas Supreme Court first recognized a cause of action against insurance companies for improper handling of an insurance claim in 1987. The court noted that because of the unequal bargaining power between insured and insurer, “unscrupulous insurers [could] take advantage of their insureds’ misfortunes in bargaining for settlement or resolution of claims” and that “without such an action insurers can arbitrarily deny coverage and delay payment of a claim with no more penalty than interest on the amount owed.” The case was *Arnold v. National County Mutual Insurance*.

Over the next 30 years since *Arnold*, the pendulum in Texas swung from large and frequent verdicts against insurers for their “unscrupulous” behavior to practitioners lamenting that bad faith was effectively dead in Texas. After *Arnold*, insurers worked hard to defang the common law bad faith claim through a series of court decisions. As a result, insureds have turned their attention to two Texas statutes that provide powerful protection against an insurer’s improper handling of claims: Chapters 541 and 542 of the Texas Insurance Code.

Chapter 541 of the Texas Insurance Code sets forth a laundry list of prohibited acts or practices by an insurance company in handling claims. For example, insurance companies cannot misrepresent material facts or policy provisions relating to coverage, refuse to settle claims when the insurer’s liability is reasonably clear, fail to affirm or deny coverage within a reasonable period of time, or fail to conduct a reasonable investigation of a claim. When the insurance company violates one of the prohibited acts, the insured can sue and recover their “actual damages” for that violation, and the damages are trebled if the insurer’s violation was a knowing one.

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