

6 PRIVACY ISSUES

- A. **Non-Public Personal Financial Information.** Texas law requires the Texas Insurance Commissioner to enact regulations for insurance companies that will safeguard consumer financial information to the extent of Federal privacy laws governing financial institutions.³⁷ The Department issued detailed regulations regarding the disclosure of personal financial information to non-affiliated third parties.³⁸ These regulations primarily concern the use of information gathered in the course of financial transactions with insurance consumers and set forth procedures for providing privacy notices to consumers with respect to use of personal financial information. Carriers now provide, as a matter of course, a privacy policy statement with the issuance of the insurance policy. These issues are not routinely encountered in claims handling context. However, care should be taken when personal financial records, such as tax returns, are produced to the carrier as a part of the claims process. Such records should normally be safeguarded and not disclosed to third-parties who are not involved in the claims process.
- B. **Non-Public Personal Health Information.** The general rule is that carriers must obtain an authorization from the subject person before disclosing any non-public personal health information about the person to a third party.³⁹ However, there are a number of exceptions to this rule, including as necessary for claims administration, adjustment, and management.⁴⁰ But note that a carrier does have a responsibility, before the disclosure of any such information, to have the receiving third-party agree not to disclose the protected information other than as necessary to carry out the purposes for which the covered entity disclosed the information.⁴¹
- 1) The use of health information, such as medical records, is essential to the claims evaluation process in a bodily injury claim. These records contain confidential health information. Carriers routinely use evaluators to review medical records to opine on the appropriateness of treatment, charges, diagnosis, etc. Such activities are permissible under Texas law, without any further authorization from the claimant. But any use of the protected records beyond the claims context, is likely not permissible. Further information on the Texas regulations regarding insurance companies and privacy can be found on the internet at <http://www.tdi.state.tx.us/commish/code.html>.

- 7 **PROHIBITED CONDUCT UNDER THE TEXAS INSURANCE CODE.** With respect to claims handling, there are two basic types of statutory regulations within the Texas Insurance Code, those provisions that prohibit certain conduct, and those provisions that require or proscribe certain conduct. This section focuses on the prohibited conduct. With the newly effective codification of the Texas Insurance Code, adjusters will now have to re-

³⁷ See TEX. INS. CODE ANN. § 601.051.

³⁸ See 28 TAC Chapter 22.

³⁹ See 28 TAC § 22.53.

⁴⁰ See 28 TAC § 22.57.

⁴¹ See 28 TAC § 22.60.

familiarize themselves with new statute numbers. While the codification did not make any substantive changes to the Code, the adjustment to the new numbering system will take some getting used to. The two primary sections relating to prohibited conduct for claims handling will soon be found in Chapters 541 and 542 of the Insurance Code, as opposed to article 21.21 and article 21.21-2. Conduct related to claims handling duties that is specifically prohibited is explained below.

A. **PROHIBITED MISREPRESENTATIONS REGARDING POLICY OR INSURER.** The Texas Insurance Code defines the following actions as unfair methods of competition or deceptive practices by an insurer and prohibits the conduct of:

- 1) Making a statement misrepresenting with respect to a policy issued or to be issued: a) the terms of the policy; b) the benefits or advantages promised by the policy; or c) the dividends or share of surplus to be received on the policy;
- 2) Making a false or misleading statement regarding the dividends or share of surplus previously paid on a similar policy;
- 3) Making a misleading representation or misrepresentation regarding 1) the financial condition of an insurer; or 2) the legal reserve system on which a life insurer operates;
- 4) Using a name or title of a policy or class of policies that misrepresents the true nature of the policy or class of policies; or
- 5) Making a misrepresentation to a policyholder insured by any insurer for the purpose of inducing or that tends to induce the policyholder to allow an existing policy to lapse or to forfeit or surrender the policy.⁴²

B. **PROHIBITED REPRESENTATIONS REGARDING AN INSURANCE POLICY.** The Texas Insurance Code⁴³ defines the following actions as unfair or deceptive acts or practices in the business of insurance to misrepresent an insurance policy by:

- 1) Making an untrue statement of material fact;
- 2) Failing to state a material fact necessary to make other statements made not misleading, considering the circumstances under which the statements were made;
- 3) Making a statement in a manner that would mislead a reasonably prudent person to a false conclusion of a material fact;
- 4) Making a material misstatement of law; or
- 5) Failing to disclose a matter required by law to be disclosed, including failing

⁴² See TEX. INS. CODE ANN. Art. 21.21 §4 (effective April 1, 2005 TEX. INS. CODE ANN. §541.051).

⁴³ See TEX. INS. CODE ANN. Art. 21.21 §4 (effective April 1, 2005 TEX. INS. CODE ANN. §541.061).

to make a disclosure in accordance with another provision of this code.

C. **PROHIBITED SETTLEMENT PRACTICES.** There are two⁴⁴ separate sections within the Texas Insurance Code that define and prohibit unfair claim settlement practices. The prohibitions of Chapter 541, formerly article 21.21, are applicable to any individual or company engaged in the business of insurance, including agents, brokers, and adjusters.⁴⁵ But for there to be individual liability against an insurance company employee, there must be evidence sufficient to sustain a finding that the employee himself committed a violation of Chapter 541's prohibitions and that such violation was a cause of damage or legally recognized harm to the plaintiff.⁴⁶ Chapter 542, formerly article 21.21-2, is applicable only to insurers, not individuals.⁴⁷

- 1) The prohibited acts which originate from Art 21.21 (Chapter 541)⁴⁸ of the Texas Insurance Code apply only to claims made by an insured or beneficiary of the policy.⁴⁹ The unfair claim settlement practices which originate from Article 21.21-2 (Chapter 542), on the other hand do not have any limiting language, and are presumably applicable to any claimant, whether it be a third-party or otherwise. The rules adopted by the Texas Department of Insurance also do not limit their application to just insureds or beneficiaries.⁵⁰ For the sake of simplicity, these unfair settlement practices have been combined in one table below. While there are distinctions between the various provisions with respect to how and who can enforce violations, the best practice is to avoid these prohibited practices regardless of whether the claimant is an insured or a third-party claimant.
- 2) A private cause of action is available for unfair claim settlement practices as contained in Chapter 541 (formerly article 21.21) but not for those contained in Chapter 542 (formerly article 21.21-2). Neither section provides a cause of action to a third party asserting one or more claims against an insured covered under a liability insurance policy. But no one has to be an insured to file a complaint against an adjuster or insurer with the TDI.
- 3) The required elements of an Chapter 541 (formerly article 21.21) cause of action are: 1) actual damages; 2) sustained by any person; 3) caused by another person engaging in an act or practice; which is 4) declared unfair or deceptive in Subchapter B of Chapter 541 of the Texas Insurance Code (formerly Section 4 of Article 21.21).

⁴⁴ See TEX. INS. CODE ANN. Art. 21.21 (effective April 1, 2005 TEX. INS. CODE ANN. §541.051 et seq.) and TEX. INS. CODE ANN. Art. 21.21-2 (effective April 1, 2005 TEX. INS. CODE ANN. §542.001 et seq.).

⁴⁵ See TEX. INS. CODE ANN. Art. 21.21 § 2 (effective April 1, 2005 TEX. INS. CODE ANN. §541.002(2)); see also *Hornbuckle v. State Farm Lloyds*, 385 F.3d 538, 545 (5th Cir. 2004).

⁴⁶ See *Hornbuckle v. State Farm Lloyds*, 385 F.3d 538, 545 (5th Cir. 2004).

⁴⁷ See TEX. INS. CODE ANN. Art. 21.21-2 (effective April 1, 2005 TEX. INS. CODE ANN. §542.001 et seq.).

⁴⁸ See TEX. INS. CODE ANN. Art. 21.21 (effective April 1, 2005 TEX. INS. CODE ANN. §541.051 et seq.)

⁴⁹ See TEX. INS. CODE ANN. Art. 21.21 §4 (effective April 1, 2005 TEX. INS. CODE ANN. §541.060).

⁵⁰ See 28 TAC § 21.203.

- 4) The statutory prohibited unfair claim settlement practices also form the basis for the minimum standards of conduct required of carriers in the claims context. The Texas Insurance Code requires the Texas Insurance Commissioner to adopt a “**minimum standard of performance**” to be used to compare an insurer’s performance in the area of claims handling.⁵¹ The Texas Department of Insurance established the minimum standards in 28 TAC § 21.203, which requires all insurers to maintain their affairs so that no unfair claims settlement practices are committed and that the minimum standards of performance are followed.⁵² The Table below summarizes the list of prohibited unfair claim settlement practices and those prohibited practices **identified in bold type**, are practices established by the Department of Insurance as being part of the minimum standards of performance for any insurer.
- 5) The prohibited unfair claim settlement practices are as follows:

No.	Prohibited Unfair Settlement Practices	Source(s)	Private Cause of Action?
1	Misrepresenting to a claimant a material fact or policy provision relating to coverage at issue;	TEX. INS CODE ANN. 541.060(a)(1) 28 TAC §21.203(1)	yes
2	Knowingly misrepresenting to a claimant a pertinent facts or policy provisions relating to coverage at issue	TEX. INS CODE ANN. 542.003(b)(1)	no
3	Failing to acknowledge with reasonable promptness pertinent communications relating to a claim arising under the insurer’s policy [28 TAC 21.203 adds the following language: “provided that "pertinent communications" shall exclude written communications that are direct responses to specific inquiries made by the insurer after initial report of a claim. An acknowledgment within 15 business days is presumed to be reasonably prompt.]	TEX. INS CODE ANN. 542.003(b)(2) 28 TAC §21.203(2)	no
4	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.	TEX. INS CODE ANN. 541.060(a)(2)(A) TEX. INS CODE ANN. 542.003(b)(4) 28 TAC §21.203(4)	yes no

⁵¹ See TEX. INS. CODE ANN. Art. 21.21-2 § 4(b) (effective April 1, 2005 TEX. INS. CODE ANN. §542.007).

⁵² See 28 TAC §21.203 and §21.205.

No.	Prohibited Unfair Settlement Practices	Source(s)	Private Cause of Action?
5	Failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim under one portion of a policy with respect to which the insurer's liability has become reasonably clear to influence the claimant to settle another claim under another portion of the coverage unless payment under one portion of the coverage constitutes evidence of liability under another portion.	TEX. INS CODE ANN. 541.060(a)(2)(B) 28 TAC §21.203(8)	yes
6	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	TEX. INS CODE ANN. 541.060(a)(3) 28 TAC §21.203(9)	yes
7	Failing within a reasonable time to affirm or deny coverage of a claim to a policyholder. [28 TAC 21.203(10) adds the following language "The reasonable submission of a reservation of rights letter by an insurer to a policyholder within a reasonable time is deemed compliance with the provisions of this paragraph."]	TEX. INS CODE ANN. 541.060(a)(4)(A) 28 TAC §21.203(10)	yes
8.	Failing within a reasonable time to submit a reservation of rights to a policyholder	TEX. INS CODE ANN. 541.060(a)(4)(B)	yes
9.	Refusing, failing, or unreasonably delaying a settlement offer under applicable first-party coverage on the basis that other coverage may be available or that third parties are responsible for the damages suffered, except as may be specifically provided in the policy	TEX. INS CODE ANN. 541.060(a)(5) 28 TAC §21.203(11)	yes
10.	Undertaking to enforce a full and final release of a claim from a policyholder when only a partial payment has been made, unless the payment is a compromise settlement of a doubtful or disputed claim.	TEX. INS CODE ANN. 541.060(a)(6) 28 TAC §21.203(13)	yes
11.	Refusing to pay a claim without conducting a reasonable investigation with respect to the claim	TEX. INS CODE ANN. 541.060(a)(7) 28 TAC §21.203(15)	yes
12.	With respect to a Texas personal automobile insurance policy, delaying or refusing settlement of a claim solely because there is other insurance of a different kind available to satisfy all or part of the loss forming the basis of that claim. [28 TAC § 21.203(17) adds the following "The claimant who has a right to recover from either or both insurers is entitled to choose under which coverage and in what order payment is to be made."]	TEX. INS CODE ANN. 541.060(a)(8) 28 TAC §21.203(17)	yes

No.	Prohibited Unfair Settlement Practices	Source(s)	Private Cause of Action?
13.	Requiring a claimant as a condition of settling a claim to produce the claimant's federal income tax returns for examination or investigation by the person unless: (A) a court orders the claimant to produce those tax returns; (B) the claim involves a fire loss; or C) the claim involves lost profits or income	TEX. INS CODE ANN. 541.060(a)(9) TEX. INS CODE ANN. 542.004 28 TAC §21.203(19)	yes yes -DTPA
14.	Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under the insurer's policies	TEX. INS CODE ANN. 542.003(b)(3) 28 TAC §21.203(3)	no
15.	Compelling a policyholder to institute a suit to recover an amount due under a policy by offering substantially less than the amount ultimately recovered in a suit brought by the policyholder.	TEX. INS CODE ANN. 542.003(b)(5) 28 TAC §21.203(5)	no
16.	Failing to maintain the information relating to records of complaints as required by Insurance Code Section 542.005, and as required under 28 TAC §21.2504 (relating to Complaint Record; Required Elements; Explanation and Instructions) of records relating to complaints for previous three years.	TEX. INS CODE ANN. 542.003(b)(6) 28 TAC § 21.203(6)	no
17.	Committing another act the commissioner (of insurance) determines by rule constitutes an unfair claim settlement practice.	TEX. INS CODE ANN. 542.003(b)(7)	no
18.	Failing to provide promptly, when provided for in the policy, claim forms when the insurer requires such forms as a prerequisite for a claim settlement.	28 TAC §21.203(7)	no
19.	Attempting to settle a claim for less than the amount to which a reasonable person would have believed she/he was entitled by reference to an advertisement, as described in §21.102 of this title (relating to Scope), made by an insurer or person acting on behalf of an insurer.	28 TAC §21.203(12)	no
20.	Failing to establish a policy and proper controls to make certain that agents calculate and deliver to policyholders or their assignees funds due under policy provisions relative to cancellation of coverage within a reasonable time after such coverages are terminated.	28 TAC §21.203(14)	no
21.	Failing to respond promptly to a request by a claimant for personal contact about or review of the claim.	28 TAC §21.203(16)	no
22.	Violating the Prompt Payment of Claims statute.	28 TAC §21.203(18)	yes, under 21.55

- D. The prohibited settlement practices as identified in Chapter 541 (formerly Article 21.21) are actionable by 1) the Texas Department of Insurance through an administrative process that can result in penalties and fines,⁵³ 2) the Texas Attorney General who is authorized to pursue injunctive relief in addition to other remedies,⁵⁴ 3) through class actions,⁵⁵ or 4) through a private civil action by any person who sustains actual damages as a result of a prohibited act, such as those identified above.⁵⁶ The private action is only available for persons who are in privity of contract with the insurer or are an intended beneficiary of the policy.⁵⁷
- 1) The Insurance Code also authorizes a private action for redressing an unlawful deceptive trade practice as defined under the Texas Deceptive Trade Practices Act, but only if the person bringing the action can also show reliance by that person on the act or practice to his detriment.⁵⁸
 - 2) A Plaintiff who prevails in a private civil action can recover: 1) the amount of actual damages, court costs, and reasonable and necessary attorney's fees.⁵⁹ If the trier of fact finds that the Defendant insurer knowingly committed the prohibited act, the trier of fact may also award an amount of damages not to exceed three times the amount of the actual damages.⁶⁰ Knowingly under the statute is defined as actual awareness of the falsity, unfairness, or deceptiveness of the act or practice.⁶¹ Actual awareness may be inferred if objective manifestations indicate that a person acted with actual awareness.⁶²
 - 3) Prior to instituting a private claim under Chapter 541 of the Insurance Code, specific notice provisions must be followed. These notice provisions are identified and mapped out in the Notice and Response Worksheet for Demands Pursuant to The Texas DTPA and Insurance Code, which can be found at the back of this publication. The notice and demand provisions of the Insurance Code and DTPA are identical. Further discussions of these requirements can be found in the discussion of the DTPA toward the end of this publication.
- E. The prohibited settlement practices under Chapter 542 of the Texas Insurance Code are actionable only through the administrative remedies that the Texas Commissioner

⁵³ See TEX. INS. CODE ANN. Art. 21.21 §5 (effective April 1, 2005 TEX. INS. CODE ANN. §541.101 et seq.).

⁵⁴ See TEX. INS. CODE ANN. Art. 21.21 §15 (effective April 1, 2005 TEX. INS. CODE ANN. §541.201 et seq.).

⁵⁵ See TEX. INS. CODE ANN. Art. 21.21 §7 (effective April 1, 2005 TEX. INS. CODE ANN. §541.251).

⁵⁶ See TEX. INS. CODE ANN. Art. 21.21 §16 (effective April 1, 2005 TEX. INS. CODE ANN. §541.151).

⁵⁷ See *Shelton Ins. Agency v. St. Paul Mercury Ins. Co.*, 848 S.W.2d 739, 744 (Tex. App.– Corpus Christi 1993, writ denied); *CNA Ins. Co. v. Scheffey*, 828 S.W.2d 785, 791 (Tex. App.– Texarkana 1992, writ denied); *Chaffin v. Transamerica Ins. Co.*, 731 S.W.2d 728, 731 (Tex. App.– Houston [14th Dist.] 1987, writ ref'd n.r.e.).

⁵⁸ See TEX. INS. CODE ANN. Art. 21.21 §16 (effective April 1, 2005 TEX. INS. CODE ANN. §541.151(1)).

⁵⁹ See TEX. INS. CODE ANN. Art. 21.21 §16(b) (effective April 1, 2005 TEX. INS. CODE ANN. §541.152).

⁶⁰ See TEX. INS. CODE ANN. Art. 21.21 §16 (effective April 1, 2005 TEX. INS. CODE ANN. §541.152(b)).

⁶¹ See TEX. INS. CODE ANN. Art. 21.21 §2(a) (effective April 1, 2005 TEX. INS. CODE ANN. §541.002(1)).

⁶² See *id.*

of Insurance has available to pursue against violators.⁶³ The Texas Supreme Court has held that this section does not create a private cause of action.⁶⁴

8 **BREACH OF THE DUTY OF GOOD FAITH AND FAIR DEALING.** Ever since the 1997 decision in the *Giles* case, when the Texas Supreme Court re-shaped the common law standard for establishing a carrier's bad faith by adopting the statutory standard, there has been more consistency and predictability in the judicial cases looking at the conduct required of a carrier to avoid bad faith. In *Giles*, the Court linked bad faith to the statutory prohibition against unfair claim settlement practices, specifically, "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."⁶⁵ **In Texas, the tort cause of action for breach of the duty of good faith and fair dealing is now established when an insurer has no reasonable basis for denying or delaying payment of a claim, and the insurer knew or should have known that fact.**⁶⁶ Evidence that merely shows a bona fide dispute about the insurer's liability on the contract does not rise to the level of bad faith.⁶⁷ Bad faith is also not established if the evidence shows the insurer was merely incorrect about the factual basis for its denial of the claim, or about the proper construction of the policy.⁶⁸ But, when the underlying claim upon which an insured's bad faith or extra-contractual claims are premised is found to have been properly denied, the extra-contractual claims such as bad faith also necessarily fail.⁶⁹ That is, an insured cannot prevail on a bad faith or other extra-contractual claim without first proving that the insurer breached the insurance contract.⁷⁰ When an insurer proves it had a reasonable basis for denying a claim, even if the finder eventually determines that basis to be erroneous, that insurer is not subject to bad faith liability or liability under the Texas Insurance Code and the Texas Deceptive Trade Practices Act.⁷¹ Whether an insurer acted in bad faith because it denied or delayed payment of a claim after its liability became reasonably clear is a question for the fact-finder.⁷² The duty of good faith and fair dealing as to a particular claim ends when judgment has been rendered on the claim.⁷³ For example, when the insured obtains a judgment against the insurer on a claim, there is no longer a duty of good faith because the relationship of the parties at that point in time is that of judgment creditor and judgment debtor and not insurer and insured.⁷⁴

⁶³ See TEX. INS. CODE ANN. Art. 21.21-2 § 6(b) (effective April 1, 2005 TEX. INS CODE ANN. 542.010).

⁶⁴ See *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 69 (Tex.1997); *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 148-49 (Tex.1994); see also *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 847 n. 11 (Tex.1994) (Article 21.21-2 is "subject to enforcement only by the State Board of Insurance.").

⁶⁵ See TEX. INS CODE ANN. 541.060(a)(2)(A)

⁶⁶ See *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 56 (Tex.1997) (citing *Aranda v. Insurance Co. of N. Am.*, 748 S.W.2d 210, 213 (Tex.1988)); *Betco Scaffolds Co. v. Houston United Cas. Ins. Co.*, 29 S.W.3d 341, 348 (Tex.App.--Houston [14th Dist.] 2000, no pet.).

⁶⁷ See *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42, 44 (Tex.1998); *Nicolau*, 951 S.W.2d at 448; *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex.1994); see also *Giles*, 950 S.W.2d at 54

⁶⁸ See *Moriel* at 18.

⁶⁹ See *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 341 (Tex.1995).

⁷⁰ See *id.*

⁷¹ See *Lyons v. Millers Cas. Ins. Co. of Tex.*, 866 S.W.2d 597, 600 (Tex.1993); *Saunders v. Commonwealth Lloyd's Ins. Co.*, 928 S.W.2d 322, 324 (Tex. App.--San Antonio 1996, no writ).

⁷² See *Giles*, 950 S.W.2d at 56.

⁷³ See *Mid-Century Ins. Co. of Texas v. Boyte*, 80 S.W.3d 546, 549 (Tex. 2002).

⁷⁴ See *id.*