

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.*

- A. **Failure to Investigate.** An insurer may also breach its duty of good faith and fair dealing when it fails to reasonably investigate a claim in order to determine whether its liability is reasonably clear.⁷⁵ An insurer will not escape liability merely by failing to investigate a claim so that it can contend that liability was never reasonably clear.
- B. **Use of Experts as basis for denial.** Evidence of the insurer's investigation, including the preparation of an objective, expert report, may demonstrate the existence of a reasonable basis for denying a claim.⁷⁶ Even a simple disagreement among experts about whether the cause of the loss is one covered by the policy will not alone support a judgment for bad faith.⁷⁷ But the mere fact that an insurer relies on an expert's report will not shield the insurer from liability if there is evidence that the insurer's reliance was "merely pretextual,"⁷⁸ or if there is evidence that the expert's report was not objectively prepared, or if there is evidence that the insurer's reliance on the report was unreasonable.⁷⁹ Such evidence raises concerns that the carrier's investigation was an "outcome-oriented investigation," and in such a case, the Court must consider in detail the circumstances surrounding the carrier's reliance on the expert's report.
- 1) One piece of evidence that can assist the insured in showing a result oriented investigation is the connection and past history between the carrier and any expert retained by the carrier to give an opinion on a coverage issue. For example, has the expert been used previously by the carrier to deny a claim; has the expert been overused by the carrier? How much business does the carrier give that expert? Other factors that may affect the reasonableness of the carrier's reliance on the expert's report include the reliability of the experts' methodology and investigation. Did the expert conduct an objective investigation to determine causation?
 - 2) These issues are especially prominent in property damage claims, where experts are routinely retained to determine whether the claimed damage was the result of a covered peril or not. An example of this type of claim is a residential foundation claim. In Texas, the HO-B homeowner's insurance policy has been determined to cover foundation damage caused by an underground plumbing leak.⁸⁰ Because of the shifting sands in several areas of Texas, foundation movement is not unusual, even without any plumbing leak. Carrier's hire engineers to investigate these claims and determine if an underground plumbing leak caused the claimed foundation damage. Not surprisingly, the carrier-retained engineer frequently opines that the foundation damage was not caused by a covered peril, and the carrier uses

⁷⁵ See Giles, 950 S.W.2d at 56 n. 5.

⁷⁶ See Lyons, 866 S.W.2d at 601.

⁷⁷ See Lyons v. Millers Cas. Ins. Co. of Tex., 866 S.W.2d at 601.

⁷⁸ See Nicolau, 951 S.W.2d at 448.

⁷⁹ See State Farm Lloyds v. Nicolau, 951 S.W.2d 444, 448 (Tex.1997).

⁸⁰ See Balandran v. Safeco Ins. Co. of America, 972 S.W.2d 738, 742 (Tex. 1998).

that opinion to deny the claim. If the insured decides to challenge the denial of the claim, they usually find an engineer that will say the opposite and attribute the foundation movement to a covered peril such as a plumbing leak. When these claims go to trial, it is the insured that prevails most of the time on the coverage issue, and the insured recovers the costs of repair, attorneys' fees, costs, plus the penalties under article 21.55 of the Texas Insurance Code. On some occasions, Plaintiffs even obtain judgments against the carrier for knowing violations of the Insurance Code and DTPA, and recover treble and mental anguish damages.

- 3) **Recommendations.** Carriers should strive to do a thorough and objective investigation of every first party claim. Carriers need to be aware of the use and overuse of experts in the determination of coverage issues. Carriers should not give all of their investigation work to the same engineer, but should actively try to retain multiple independent and competent engineers in a particular area. Insurers need to make sure that their retained engineers and experts have the skill and experience necessary to render an opinion on the matter, and should be suspect of engineers, who routinely provide reports that are not objectively based. If an expert loses his objectivity on claims issues, the expert should not be used.

- C. **Good Faith Duty to Insureds For Third-party Liability Claims.** Courts employ an objective standard to determine whether a reasonable insurer under similar circumstances would have delayed or denied payment of the claim.⁸¹ An insurer will be liable if the insurer knew or should have known that it was reasonably clear that the claim was covered.⁸² In the third-party claim context, liability may not be imposed against an insurer, and an insurer's liability is not reasonably clear unless it is shown that: 1) the policy covers the claim; 2) the insured's liability is reasonably clear; (3) the claimant has made a proper settlement demand within policy limits; and (4) the demand's terms are such that an ordinarily prudent insurer would accept it.⁸³ In establishing these guidelines for liability in this context, the Texas Supreme Court linked to, and borrowed from, the common law requirements to establish a Stowers claim, which is discussed later in this publication.⁸⁴

- 9 **PROSCRIBED CONDUCT UNDER THE TEXAS INSURANCE CODE.** This section discusses conduct relating to claims handling that is specifically required of insurers by Texas Statute.

- A. **Records of Complaints.** An insurer is required to maintain a complete record of all complaints received by the insurer during the preceding three years or since the date of the insurer's last examination by the department, whichever period is shorter. The

⁸¹ See *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210, 213 (Tex.1988); *Vandeventer v. All Am. Life & Cas. Co.*, 101 S.W.3d 703, 722 (Tex. App.-Fort Worth 2003, no pet.).

⁸² See *Universe Life Ins. Co. v. Giles*, 950 S.W.2d at 56; *Vandeventer*, 101 S.W.3d at 722.

⁸³ See *Rocor Int'l Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 261, 262 (Tex. 2002)

⁸⁴ See *id.*