

2020

Insurance Law

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Recommended Citation

J. Price Collins et al., *Insurance Law*, 6 SMU ANN. TEX. SURV. 167 (2020)
<https://scholar.smu.edu/smuatxs/vol6/iss1/8>

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INSURANCE LAW

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I. INTRODUCTION

This survey period was an active one, with significant decisions in several different areas of insurance law. These include:

- Certification by the U.S. Court of Appeals for the Fifth Circuit to the Texas Supreme Court on the extent to which a court can consider extrinsic evidence in determining an insurer’s duty to defend.
- Decisions by a Texas federal court and a state court of appeals holding that an insured could sustain bad faith claims against an uninsured motorist (UIM) insurer, even if the insurer timely pays UIM benefits after a judgment establishing liability and underinsured status.
- Two decisions by the Texas Supreme Court holding that an insurer’s payment of an appraisal award does not exempt it from the requirements of Section 542.060(a), the Texas Prompt Payment of Claims Act (TPPCA).

While the Fifth Circuit’s certified question afforded the Texas Supreme Court the opportunity to provide some clarity regarding the issue of extrinsic evidence and the duty to defend, the courts’ decisions in the appraisal and UIM context, far from clarifying the issues, appear to have introduced more uncertainty into how courts should apply Chapters 541 and 542 of the Texas Insurance Code.

II. THE DUTY TO DEFEND

A. WHETHER EXTRINSIC EVIDENCE CAN BE CONSIDERED IN DETERMINING THE DUTY TO DEFEND

To determine whether a liability insurer has a duty to defend its insured against an underlying lawsuit by a third-party claimant, both state and

federal courts apply the “eight-corners rule,” which considers only the policy and the claimant’s pleading.¹ While the Texas Supreme Court has never expressly recognized any exception to this rule permitting the consideration of extrinsic evidence beyond the policy and the pleading, numerous intermediate appellate courts and federal courts have employed various exceptions to allow such evidence, particularly where the evidence pertains to “coverage only” issues.² As shown by several decisions this past year, there continues to be inconsistency among the courts regarding whether to recognize, and how to apply, these exceptions.³

Fortunately, the U.S. Court of Appeals for the Fifth Circuit noted this inconsistency and decided that the issue should be certified to the Texas Supreme Court for determination.⁴ In *Richards*, the insureds sought coverage under their homeowner’s policy for a suit brought against them arising out of an ATV accident at their house that resulted in the death of their minor grandson.⁵ The insurer sought a declaration that it had no duty to defend based on two exclusions in the policy and relied on extrinsic evidence to show that the child was a resident of the insureds’ household.⁶ The U.S. District Court for the Northern District of Texas admitted the extrinsic evidence and granted summary judgment for the insurer.⁷ The district court reasoned that the policy at issue differed from the typical policies seen in cases where courts apply the eight-corners rule, which requires the insurer to defend any suit brought against the insured “even if the allegations of the suit are groundless, false or fraudulent.”⁸ Rather, the policy at issue required the insurer to defend only suits to which the policy’s coverage applied.⁹ The district court, relying on its own prior

1. *State Farm Lloyds v. Richards*, 784 F. App’x 247, 250 (5th Cir. 2019).

2. *See id.* at 251–52.

3. *See TIG Ins. Co. v. Woodsboro Farmers Coop.*, No. 5:18-CV-191, 2019 WL 6002235, at *3–4 (S.D. Tex. Sept. 30, 2019) (explaining that “‘fundamental coverage question’ is a term of art which encompasses only a few specific inquiries, such as ‘whether a person has been excluded’” from coverage by name or description or whether the policy exists, and declining to consider affidavits that did not address a “fundamental coverage question” or relate to a “readily determined fact”); *Hudson Ins. Co. v. Alamo Crude Oil, LLC*, No. SA-19-CV-137-XR, 2019 WL 3322867, at *5–6 (W.D. Tex. July 24, 2019) (considering stipulated facts in the parties’ Rule 26 report to determine the use of the vehicle at the time of the accident for purposes of applying the policy’s business-use exclusion, because the underlying pleading’s conclusory allegations made it impossible to determine coverage, and the stipulated facts did not overlap with the underlying petition’s merits); *Cincinnati Specialty Underwriters Ins. Co. v. Preferred Wright-Way Remodeling & Constr. LLC*, No. 6:18-CV-00161-JDK, 2019 WL 172755, at *3 n.1 (E.D. Tex. Jan. 10, 2019) (declining to apply coverage-only exception); *Tex. Political Subdivisions Prop./Cas. Joint Self Ins. Fund v. Pharr-San Juan-Alamo ISD*, No. 13-17-00655-CV, 2019 WL 4678433, at *5 (Tex. App.—Corpus Christi—Edinburg Sept. 26, 2019, pet. filed) (mem. op.) (considering extrinsic evidence from both the insurer and the insured, including advertisements from a golf cart manufacturer to determine whether golf carts are “mobile equipment,” reasoning that such evidence was “immaterial to the merits of the underlying lawsuit.”).

4. *Richards*, 784 F. App’x at 248.

5. *Id.*

6. *Id.* at 248–49.

7. *Id.* at 249.

8. *Id.*

9. *Id.* at 250.

analysis of this issue in *B. Hall Contracting Inc. v. Evanston Insurance Co.*, concluded that the eight-corners rule was not applicable, meaning that the insurer could use extrinsic evidence to supply additional facts showing there was no coverage.¹⁰

On appeal, the Fifth Circuit explained that it had previously suggested that if the Texas Supreme Court were to recognize an exception,

it would do so only when it is initially impossible to discern whether coverage is potentially implicated *and* when the extrinsic evidence goes solely to a fundamental issue of coverage which does not overlap with the merits of or engage the truth or falsity of any facts alleged in the underlying case.¹¹

The Fifth Circuit emphasized that while it had assumed the viability of the exception because the Texas Supreme Court has cited it with approval, the Texas Supreme Court has not expressly adopted or applied the exception.¹² The Fifth Circuit concluded that because there is no controlling case law determining whether there is “a policy-language exception to the eight-corners rule,” the issue “has been, and will likely continue to be, the subject of insurance litigation throughout this circuit” and therefore should be certified to the Texas Supreme Court for determination.¹³ Specifically, the Fifth Circuit certified the following question: “Is the policy-language exception to the eight-corners rule articulated in *B. Hall Contracting Inc. v. Evanston Ins. Co.*, 447 F. Supp. 2d 634 (N.D. Tex. 2006), a permissible exception under Texas law?”¹⁴

This certification gave the supreme court the opportunity to provide much-needed guidance to both insureds and insurers by broadly addressing the eight-corners rule and the various exceptions used by the lower state courts and the federal courts.

As noted, the district court reasoned that the “groundless, false or fraudulent” policy language creates a duty to defend that is broader than the duty to indemnify, thus supporting application of the eight-corners rule.¹⁵ Because the policy at issue did not have this language, the district court found that the policy contractually required the insurer to defend only those claims covered under the policy, indicating that the scope of the duty to defend coincides with the scope of the duty to indemnify.¹⁶ While some practitioners may argue that the eight-corners rule is built into Texas jurisprudence, such that this distinction in policy language should be ignored, the Texas Supreme Court has demonstrated its willing-

10. *Id.* (referencing *B. Hall Contracting, Inc. v. Evanston Ins. Co.*, 447 F. Supp. 2d 634, 645 (N.D. Tex. 2006), *rev'd on other grounds*, 273 F. App'x 310 (5th Cir. 2008)).

11. *Id.* at 251 (quoting *Northfield Ins. Co. v. Loving Home Care, Inc.*, 363 F.3d 523, 531 (5th Cir. 2004)).

12. *Id.* at 251–52 (citing *GuideOne Elite Ins. Co. v. Fielder Rd. Baptist Church*, 197 S.W.3d 305, 309–10 (Tex. 2006)).

13. *Id.* at 253.

14. *Id.*

15. *Id.* at 249–50.

16. *Id.* at 249.

ness to base decisions strictly upon the language of the insurance contract, rather than idioms, historical assumptions, and industry practice.

For example, in *Lamar Homes*, the insurer argued that breach of contract claims for faulty workmanship are not covered under commercial general liability (CGL) policies, because the purpose of such policies is “to protect the insured from tort liability, not claims of defective performance under a contract,” and because extending CGL coverage to such claims would “transform[] [a CGL policy] into a performance bond.”¹⁷ In rejecting this argument, the Texas Supreme Court emphasized that any comparison of a CGL policy to a performance bond was “irrelevant” and the “CGL policy covers what it covers.”¹⁸ The supreme court instead focused solely on the policy language, explaining that the CGL policy makes no distinction between tort and contract damages, either in the insuring agreement or in the definitions of “property damage” or “occurrence.”¹⁹ The supreme court concluded that any “preconceived notion” limiting CGL coverage to only tort liability “must yield to the policy’s actual language.”²⁰ Given this admonition from the supreme court, any preconceived notion that the duty to defend always is broader than the duty to indemnify and must be determined exclusively based on the eight-corners rule arguably should yield to the actual language in the policy at issue in each particular case.

After the end of this Survey period, the supreme court issued its decision in *Richards v. State Farm Lloyds*.²¹ Despite the Fifth Circuit’s discussion of *Northfield* and express statement that it was “disclaim[ing] any intention or desire that the Supreme Court of Texas confine its reply to the precise form or scope of the question certified,”²² the supreme court declined to broadly address the eight-corners rule and any exceptions and instead addressed only the narrow certified question.²³ The court held that the “‘policy-language exception’ to the eight-corners rule articulated by the federal district court in *B. Hall Contracting*—under which the eight-corners rule does not apply unless the policy contains a groundless-claims clause—is not a permissible exception under Texas law.”²⁴ The court specifically noted that it was expressing no opinion on the exception allowing for extrinsic evidence on coverage issues that do not overlap with the merits of the underlying suit and that it was reserving comment on whether other policy language or other factual scenarios may justify the use of extrinsic evidence, as “[t]he varied circumstances under which such arguments for the consideration of evidence may arise are beyond imagination.”²⁵ Given the limited scope of the supreme court’s *Richards*

17. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 7 (Tex. 2007).

18. *Id.* at 10.

19. *Id.* at 13.

20. *Id.*

21. 597 S.W.3d 492 (Tex. 2020).

22. *State Farm Lloyds v. Richards*, 784 F. App’x 247, 253 (5th Cir. 2019).

23. *Richards*, 597 S.W.3d at 497.

24. *Id.* at 500.

25. *Id.*

decision, this issue will continue to generate coverage litigation and will be one to watch for during the next Survey period.

III. COURT OF APPEALS PERMITS INSURED TO PURSUE A STOWERS CLAIM EVEN IN THE ABSENCE OF AN EXCESS JUDGMENT AGAINST THE INSURED

Presented with an issue of first impression, the Fourth San Antonio Court of Appeals addressed whether an insured has a viable *Stowers* claim against its insurer when the insured pays a portion of the amount to settle the liability suit against the insured because the insurer refused to pay the entirety of the settlement amount.²⁶

The insurer initially provided a defense for the insured in the underlying suit; however, after the insurer-appointed counsel failed to designate any experts, the insured retained her own counsel.²⁷ When the claimant indicated he would settle for \$350,000 but the insurer offered only \$250,000, the insured paid the remaining \$100,000 to complete the settlement.²⁸ The insured then sued the insurer for breach of contract and negligent failure to settle.²⁹ The insurer filed motions to dismiss both claims, which the trial court denied, and the insurer brought an original proceeding for mandamus relief.³⁰

Regarding the breach of contract claim, the court of appeals explained that the policy language obligated the insurer only to “settle or defend” a claim as it considered appropriate and thus did not contractually obligate the insurer to pay any specific amount towards a settlement.³¹ The court concluded that the insurer fulfilled its contractual obligation and that the breach of contract claim therefore had no basis in law or fact.³² Regarding the *Stowers* claim, the insurer argued that because the underlying suit settled, there would never be a final judgment against the insured in excess of the policy limits, thereby precluding a claim for negligent failure to settle.³³ The court of appeals explained that “[a]n issue of first impression” may “qualify for mandamus relief when the factual scenario has never been precisely addressed but the principle of law has been clearly established.”³⁴ The court of appeals, however, determined that the legal principle relied on by the insurer—“that a *Stowers* claim always requires

26. *In re Farmers Tex. Cty. Mut. Ins. Co.*, No. 04-19-00180-CV, 2019 WL 2605630, at *4 (Tex. App.—San Antonio June 26, 2019, orig. proceeding [mand. pending]) (citing *G.A. Stowers Furniture Co. v. Am. Indem. Co.*, 15 S.W.2d 544 (Tex. Comm’n App. 1929, holding approved)).

27. *Id.* at *1.

28. *Id.*

29. *Id.*

30. *Id.* at *1–2.

31. *Id.* at *3–4.

32. *Id.* at *4.

33. *Id.* at *1.

34. *Id.* at *5 (quoting *In re State ex. rel. Weeks*, 391 S.W.3d 117, 122 (Tex. Crim. App. 2013) (orig. proceeding)).

an excess judgment—is not so clearly established ‘as to be free from doubt,’” and that the insured’s *Stowers* claim had not been “clearly rejected by Texas law.”³⁵ The court therefore concluded that the insurer was not entitled to mandamus relief, meaning that the insured was allowed to proceed on her *Stowers* claim.³⁶

IV. UNINSURED & UNDERINSURED MOTORIST COVERAGE

A. TWELFTH TYLER COURT OF APPEALS OVERTURNS JUDGMENT FOR INSURED DUE TO TRIAL COURT’S REFUSAL TO ABATE EXTRA-CONTRACTUAL CLAIMS

The Twelfth Tyler Court of Appeals heard one of the earlier 2019 cases on UIM coverage, where the insured brought claims for breach of contract, unfair or deceptive acts or practices, and violations of the duty of good faith and fair dealing regarding the UIM and personal injury protection (PIP) provisions in her policy.³⁷

Holland was involved in an accident while in a vehicle driven by another person at which time she was covered by a personal auto insurance policy with American National, which included UIM benefits.³⁸ A year later, American National consented to Holland’s request to settle with the other driver’s insurer, but conditioned its approval on the settlement being within the other driver’s policy limits and that no payments would be made under the PIP or UIM coverage.³⁹ After settling, Holland sought payment of full UIM and PIP benefits from American National.⁴⁰ American National paid Holland for the full PIP benefits.⁴¹ Holland later sued American National for breach of contract under the policy’s UIM provision for Texas Insurance Code violations.⁴² American National’s motion to sever and abate was not heard until after voir dire and was denied.⁴³

The jury found Holland suffered damages in excess of the \$100,000 UIM limit and “that American National engaged in an unfair or deceptive act or practice and violated [its] duty of good faith and fair dealing” and that it acted “knowingly.”⁴⁴ American National appealed.

American National argued it was prejudiced by the trial court’s failure to sever and abate Holland’s extra-contractual claims, noting that Holland’s introduction of evidence pertaining to her extra-contractual claims

35. *Id.*

36. *Id.*

37. *See* Am. Nat’l Cty. Mut. Ins. Co. v. Holland, No. 12-18-00141-CV, 2019 WL 1272954, at *1 (Tex. App.—Tyler Mar. 20, 2019, no pet.) (mem. op.).

38. *Id.*

39. *Id.*

40. *Id.*

41. *Id.*

42. *Id.*

43. *Id.*

44. *Id.*

ultimately led to the inflation of her UIM damages award.⁴⁵ Texas courts routinely hold that insureds' extra-contractual claims, which are separate and distinct from their breach of contract claims, should be severed and abated from the breach of contract claims.⁴⁶ This is because, as the Texas Supreme Court held in *Brainard*, an insurer is under no contractual duty to pay UIM benefits until an insured proves (1) there is UIM coverage; (2) the other driver was negligent in causing the accident and damages; (3) the total amount of the insured's damages; and (4) that the other driver's insurance coverage is deficient in that case.⁴⁷

Holland responded by arguing that American National had waived its motion to sever and abate by not presenting it until voir dire had finished.⁴⁸ The court of appeals rejected the waiver argument, finding that Rule 41 permits a party to bring such a motion at any time before the case has been submitted to the jury.⁴⁹ Finding no waiver, the court addressed American National's argument that it was prejudiced by the failure to sever.⁵⁰

At trial, Holland testified about the financial hardship and aggravation she experienced because her UIM benefits were not paid, testimony that would not have been admissible in an ordinary UIM claim case.⁵¹ Finding that the extra-contractual claims were therefore used to prejudice the jury, resulting in an inflated award, the court of appeals sustained American National's first issue.⁵²

The court of appeals next addressed whether American National had engaged in deceptive or unfair acts or practices and had violated its duty of good faith and fair dealing.⁵³ Holland alleged that American National had breached its duty of good faith and fair dealing and Section 541.060(a)(2)(B) of the Texas Insurance Code, by (1) "fail[ing] to timely pay her PIP benefits"; and (2) conditioning its consent "to settle on Holland's waiving her PIP and UIM benefits."⁵⁴

Rejecting the first argument, the court of appeals noted that the evidence showed that Holland requested PIP benefits on November 3, 2016, and that American National paid them in full in December 2016.⁵⁵ Addi-

45. *Id.* at *3.

46. *Id.* at *2 (citing *In re Allstate Cty. Mut. Ins. Co.*, 209 S.W.3d 742, 746 (Tex. App.—Tyler 2006, orig. proceeding)).

47. *Id.* at *3 (citing *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006)).

48. *Id.*

49. *Id.* (quoting *Arlitt v. Weston*, No. 04-98-00035-CV, 1999 WL 1097101, at *4 (Tex. App.—San Antonio Dec. 1, 1999, pet. denied)).

50. *Id.*

51. *Id.* at *4–5.

52. *Id.* at *6.

53. *Id.* (noting that even though it sustained American National's first issue, it addressed the legal sufficiency argument because if sustained, it would be bound to reverse and render).

54. *Id.* at *7.

55. *Id.*

tionally, the jury found no delay in payment.⁵⁶

Addressing the second argument, the court of appeals noted that, at the time Holland's counsel requested permission to settle, no settlement offer had been made, and Holland had represented she did not intend to seek PIP or UIM benefits.⁵⁷ The purpose of a consent to settle letter is to protect the insurer's subrogation rights; therefore, the letter did not misrepresent the insured's rights or policy provisions and, in this context, did not constitute an unfair settlement practice.⁵⁸ Because, at the time of the June 2016 letter, American National had no duty to pay or settle, it could not have engaged in an unfair or deceptive settlement practice or violated its duty of good faith and fair dealing.⁵⁹ Additionally, the letter did not prevent Holland from later pursuing her PIP and UIM benefits.⁶⁰ The court reversed and remanded the contractual UIM claim for a new trial and reversed and rendered a take nothing judgment in favor of American National on the claims of deceptive or unfair act or practice and any violation of the duty of good faith and fair dealing.⁶¹

B. TEXAS COURTS HOLD THAT UNIFORM DECLARATORY JUDGMENTS ACT IS A PROPER AVENUE FOR LITIGATING UIM CLAIMS

In *Allstate Insurance Co. v. Irwin*, the Fourth San Antonio Court of Appeals upheld a trial court judgment awarding attorney's fees in a UIM case under the Uniform Declaratory Judgments Act (UDJA).⁶² The insured sought a judicial declaration that he was entitled to recover damages under his UIM policy after a car wreck.⁶³

Allstate argued that the UDJA is not a proper cause of action for recovery of UIM benefits, while the insured argued "that nothing in *Braunard* precludes the use of the UDJA" to establish a UIM claim.⁶⁴ The court of appeals, citing an earlier Texarkana decision (which it noted was the only other Texas case to address the issue), held that the UDJA is a proper avenue for litigating UIM claims.⁶⁵ The court emphasized the purpose of the UDJA, which is to allow a person "whose rights, status, or other legal relations are affected by a . . . contract" to obtain a declaration

56. *Id.*

57. *Id.*

58. *Id.*

59. *Id.* at *7-8

60. *See id.* at *7.

61. *Id.* at *8; *see also In re Colonial Cty. Mut. Ins. Co.*, No. 01-19-00391-CV, 2019 WL 5699735, at *4 (Tex. App.—Houston [1st. Dist.] Nov. 05, 2019, orig. proceeding) (mem. op.). The First Houston Court of Appeals determined that the severed extra-contractual claims were "not yet ripe and could be rendered moot by the underlying liability determination" regarding "the breach of contract case"; thus, the trial court was required to sever and "abate the statutory extra-contractual claims." *Id.*

62. *Allstate Ins. Co. v. Irwin*, No. 04-18-00293-CV, 2019 WL 3937281, at *1 (Tex. App.—San Antonio Aug. 21, 2019, pet. filed).

63. *Id.*

64. *Id.*

65. *Id.* at *3 (citing *Allstate Ins. Co. v. Jordan*, 503 S.W.3d 450, 455 (Tex. App.—Texarkana 2016, no pet.)).

of their rights under the contract.⁶⁶ The court noted that “[t]his is exactly the type of ‘relief from uncertainty’ the UDJA was designed to provide.”⁶⁷ The court therefore held that Irwin may use the UDJA to establish the prerequisites to recovery in his UIM claim.⁶⁸

Allstate then relied on *Brainard* to argue that Irwin was not entitled to attorney’s fees, stating that Irwin’s declaratory judgment action was “nothing more than a[n] . . . attempt to find a basis for recovering attorney’s fees” when there actually is no basis.⁶⁹ The court of appeals disagreed, noting that “nothing in the UDJA requires a matured breach of contract claim,” and therefore held that attorney’s fees were recoverable under the UDJA for UIM claims.⁷⁰

The court of appeals’ ruling in *Irwin* is consistent with *Brainard*, which does not limit the method for establishing a UIM claim to a judgment against the tortfeasor. As the *Irwin* court pointed out, these types of claims are exactly the types of claims that are appropriate for declaratory relief. Additionally, because the UDJA statute allows a court to award attorney’s fees, the court’s fee award also appears appropriate.

In a similar case, the U.S. District Court for the Western District of Texas in *Green v. Allstate Fire & Casualty Insurance Co.* took the reasoning employed by *Irwin* a step further.⁷¹ In *Green*, the insured alleged another driver had negligently caused a motor vehicle accident and sought declaratory judgment under the UDJA on the underinsured motorist’s negligence, her rights and duties under the policy, and a valuation of the incurred damages.⁷² *Green* also alleged claims against Allstate, including breach of contract, breach of good faith and fair dealing, and statutory violations of Chapters 541 and 542.⁷³

Allstate argued that the breach of contract claim should be dismissed because there was no judgment establishing liability and damages.⁷⁴ The district court found that, while an insurer’s duty does not arise until the liability of the third party and damages are determined, “an insured can litigate the issue of UIM coverage with the insurer without first obtaining a judgment against the tortfeasor.”⁷⁵ The court noted that “[h]ow the issue of UIM coverage is litigated is unsettled, however.”⁷⁶ Because *Brainard* did not clarify what causes of action should be brought to address the liability and damages issues, the district court held that the insured

66. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 37.004(a)).

67. *Id.* (citing TEX. CIV. PRAC. & REM. CODE ANN. § 37.002(b)).

68. *Id.*

69. *Id.* at *4 (citing *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006)).

70. *Id.*

71. *Green v. Allstate Fire & Cas. Ins. Co.*, No. SA-19-CV-360-XR, 2019 WL 2744183, at *3–4 (W.D. Tex. July 1, 2019).

72. *Id.* at *1.

73. *Id.*

74. *Id.* at *2.

75. *Id.*

76. *Id.*

could proceed under both the UDJA and a breach of contract theory to establish the required underlying tort elements.⁷⁷

In response to Allstate's argument that Green's claims for bad faith should be dismissed because Green failed to state a claim for relief, the district court instead held that the extra-contractual claims should instead be abated "pending resolution of the underlying UIM claim."⁷⁸

In *Green*, as in *Irwin*, the district court appropriately held that an insured could use the UDJA to litigate its UIM claim.⁷⁹ However, noting concerns with the statute of limitations, the *Green* court also allowed the insured's breach of contract claim to proceed, despite the fact that the insured had not established the insurer's liability on the contract.⁸⁰ Presumably because it did not dismiss the breach of contract claim, the court also refused to dismiss the extra-contractual claims, abating them instead.⁸¹ It is not clear from the opinion on what basis the insurer could be found to have breached the contract given the fact that its contractual obligation to pay had not yet been triggered under *Brainard*. Likewise, if the insurer's contractual obligation to pay had not yet been triggered, dismissal, rather than abatement, of the extra-contractual claims may have been proper.

C. SAN ANTONIO COURTS HOLD THAT WAITING TO PAY A UIM
CLAIM UNTIL AFTER THE JUDGMENT ESTABLISHING LIABILITY
AND UNINSURED STATUS DOES NOT INSULATE AN INSURER
FROM POTENTIAL BAD FAITH LIABILITY

The U.S. District Court for the Western District of Texas in San Antonio and the Fourth San Antonio Court of Appeals both held that, notwithstanding *Brainard*, a UIM insurer could be liable for bad faith for failing to pay a claim when liability became "reasonably clear" before the insured obtained a judgment establishing liability and uninsured status.⁸²

In *Trejo v. Allstate Fire & Casualty Insurance Co.*, the U.S. District Court for the Western District of Texas addressed an insured's bad faith claims in the UIM context.⁸³ After being involved in a three-vehicle accident, Velma "Trejo filed a claim for UIM benefits with Allstate . . . which was denied."⁸⁴ Trejo filed suit against Allstate and the claims adjuster, Tonja Hess, asserting contractual and extra-contractual causes of action.⁸⁵

Allstate argued that Trejo "failed to state a bad-faith claim against Hess because she ha[d] not obtained a judgment establishing the liability

77. *Id.* at *3.

78. *Id.*

79. *Id.*

80. *Id.*

81. *Id.* at *4.

82. See *Trejo v. Allstate Fire & Cas. Ins. Co.*, No. SA-19-CV-00180-FB-ESC, 2019 WL 4545614, at *8-9 (W.D. Tex. Sept. 19, 2019); *State Farm Mut. Auto. Ass'n v. Cook*, 591 S.W.3d 677, 679 (Tex. App.—San Antonio 2019, no pet.).

83. *Trejo*, 2019 WL 4545614, at *1.

84. *Id.*

85. *Id.*

and underinsured status of the other motorist.”⁸⁶ The district court noted, however, that the U.S. Court of Appeals for the Fifth Circuit had rejected this argument in *Hamburger v. State Farm Mutual Automobile Insurance Co.*⁸⁷ There, the Fifth Circuit noted that if bad faith claims are available only after an insured’s legal entitlement to recovery is established, an insured “could never successfully assert a bad faith claim against his insurer for failing to attempt a fair settlement of a UIM claim,” because an insurer’s common law and statutory duties of good faith and fair dealing do not extend beyond the entry of judgment in favor of the insured.⁸⁸

The district court attempted to reconcile *Hamburger* with *Brainard*, noting that “*Hamburger* was decided two years before *Brainard*,” which did not “address or call into doubt *Hamburger*’s holding.”⁸⁹ Rather, construing the phrase “legally entitled to recover,” “*Brainard* held only that a plaintiff may not be awarded pre-judgment interest on a breach-of-contract claim against her insurer for failure to pay benefits before securing a judgment establishing . . . liability.”⁹⁰ Conversely, “to prevail on a bad-faith claim, a plaintiff need demonstrate only that an insurer wrongfully withheld payment” when its “obligation to pay was ‘reasonably clear.’”⁹¹ Because the standards for “legally entitled to recover” and “reasonably clear” are different, the district court found that *Brainard* did not overrule *Hamburger*.⁹² Thus, while a judgment against the tortfeasor is necessary to trigger the insurer’s contractual obligation to pay, liability under the insurance code requires that a plaintiff show the UIM payment was wrongfully withheld when the obligation to pay becomes reasonably clear.⁹³

The Fourth San Antonio Court of Appeals addressed similar issues in *State Farm Mutual Automobile Association v. Cook*.⁹⁴ There, the insured brought a negligence action against the other driver, and asserted breach of contract, extra-contractual bad faith, and TPPCA claims against an insurer for failing to pay the full policy limit for UIM benefits.⁹⁵ After a judgment against State Farm awarding policy limits, State Farm paid the judgment and moved to dismiss the extra-contractual claims which had been severed and abated.⁹⁶ The court of appeals denied the motion, but allowed a permissive appeal of the following two controlling questions, starting with the *Brainard* proposition that a UIM insurer “is under no

86. *Id.* at *7.

87. *Id.* (citing *Hamburger v. State Farm Mut. Auto. Ins. Co.*, 361 F.3d 875, 880–81 (5th Cir. 2004)).

88. *Hamburger*, 361 F.3d at 880–81 (citing *Mid-Century Ins. Co. of Tex. v. Boyte*, 80 S.W.3d 546, 549 (Tex. 2002)) (explaining that, after judgment, “there are no longer duties of good faith and the relationship becomes one of judgment debtor and creditor.”).

89. *Trejo*, 2019 WL 4545614, at *8.

90. *Id.* (citing *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006)).

91. *Id.*

92. *Id.*

93. *Id.*

94. 591 S.W.3d 677, 679 (Tex. App.—San Antonio 2019, no pet.).

95. *Id.* at 679.

96. *Id.*

contractual duty to pay benefits until the insured obtains a judgment establishing the liability and underinsured status of the other motorist”.⁹⁷

[1] Can a[n] UM insured nonetheless sustain a common law or statutory bad faith claim against a[n] UM insurer that withholds payment of UM benefits until such a judgment is obtained? [2] Can a[n] UM insured sustain a prompt payment claim against a[n] UM insurer that timely pays UM benefits after such a judgment is obtained?⁹⁸

The court of appeals held the answer to question (1) is “yes” and to question (2) is “no.”⁹⁹

Regarding the bad faith claims, State Farm argued that an insurer’s liability cannot be “reasonably clear” until a judgment establishes the other driver’s negligence and uninsured status, and, until such judgment is entered, an insurer has a reasonable basis for delaying payment.¹⁰⁰ Citing *Hamburger* and federal cases following *Hamburger*, the court of appeals disagreed that “such a holding flows from the analysis and holding in *Brainard*.”¹⁰¹ Rather, referring back to the U.S. Court of Appeals for the Fifth Circuit’s statement in *Hamburger* that no Texas cases have “held that liability can never be reasonably clear before there is a court determination of proximately caused damages,” the court of appeals found it possible that liability under a UIM policy can be reasonably clear before legal entitlement to the benefits is established.¹⁰² Citing *Accardo*, the court further explained the Fifth Circuit’s reasoning as follows:

In *Hamburger*, the Fifth Circuit implicitly recognized that there may be cases in which an insurer’s liability to pay UM/UIM benefits is reasonably clear despite the fact that no judicial determination of the UM/UIM’s liability has been made. When a reasonable investigation reveals overwhelming evidence of the UM/UIM’s fault, the judicial determination that triggers the insurer’s obligation to pay is no more than a formality. In such cases, an insurer may act in bad faith by delaying payment and insisting that the insured litigate liability and damages before paying benefits on a claim.¹⁰³

The court followed the reasoning in *Hamburger*, holding that insurers may still “act in bad faith by failing to reasonably investigate or delaying payment on” a UIM claim until after the insured has obtained judgment establishing the other motorist’s liability and uninsured status.¹⁰⁴

Regarding the second question, the court of appeals held that, on the other hand, Cook could not sustain a prompt payment claim after State

97. *Id.* at 680 (citing *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006)).

98. *Id.* (citing *Brainard*, 216 S.W.3d at 818).

99. *Id.* at 679.

100. *Id.* at 681.

101. *Id.*

102. *Id.* (quoting *Hamburger v. State Farm Mut. Auto. Ins. Co.*, 361 F.3d 875, 880–81 (5th Cir. 2004)).

103. *Id.* at 682 (quoting *Accardo v. Am. First Lloyds Ins. Co.*, No. H-11-0008, 2012 WL 1576022, at *5 (S.D. Tex. May 3, 2012)).

104. *Id.* at 683.

Farm timely paid the claim nine days after the trial court's judgment establishing the other driver's liability and uninsured status, because the insurer's liability does not arise until the date of the judgment.¹⁰⁵ "When an insurer promptly pays a [UIM] claim after the date the trial court enters such a judgment, the insurer does not violate the Code's prompt payment provisions."¹⁰⁶

The court of appeals' ruling that an insurer could be subject to bad faith liability for waiting to pay until a judgment established liability, based on its attempt to distinguish liability being "reasonably clear" from an insured's being "legally entitled to recover," appears inconsistent with both *Brainard* and *USAA Texas Lloyds Co. v. Menchaca*,¹⁰⁷ as it effectively imposes a tort duty on an insurer to pay a claim prior to a time when the insurer is contractually obligated to pay, before the process for determining liability and damages has been completed.¹⁰⁸ We note that the ruling also appears inconsistent with the Texas Supreme Court's decision in *Ortiz v. State Farm*, where the supreme court, in an analogous situation, held that an insurer which follows the appraisal process and pays the appraisal award cannot be found liable for bad faith in the absence of actual damages other than the policy benefits.¹⁰⁹ The rulings in *Trejo* and *Cook* could possibly be reconciled with *Ortiz* to the extent that the courts acknowledged that, under *Menchaca*, a bad faith finding is possible if the insurer's violation causes damages independent from the loss of the benefits.¹¹⁰ However, the Fourth San Antonio Court of Appeals' opinion in *Cook* is not so limited and does not mention *Menchaca*.¹¹¹ The U.S. District Court for the Western District of Texas in *Trejo*, conversely, expressly overruled Allstate's reliance on *Menchaca* on the basis that "Trejo's bad-faith claims against Hess are not premised on an independent-injury theory."¹¹² The district court further noted that *Menchaca* did not "discuss § 541.060 claims containing the phrase 'reasonably clear.'"¹¹³ It is difficult to see how these courts' findings that an insurer can be subject to bad faith if it fails to pay once liability is "reasonably clear." Before an insurer is contractually obligated to pay, it should align with *Menchaca*'s conclusion that an insurer is not liable for extra-contractual liability in the absence of evidence of actual damages other than the policy limits.

105. *Id.* at 684.

106. *Id.*

107. 545 S.W.3d 479, 484 (Tex. 2018).

108. *See id.* at 489; *Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809, 818 (Tex. 2006).

109. *Ortiz v. State Farm Lloyds*, 589 S.W.3d 127 (Tex. 2019); *see discussion infra* Part V.B.

110. *Menchaca*, 545 S.W.3d at 499.

111. *See Cook*, 591 S.W.3d at 678–684.

112. *Trejo v. Allstate Fire & Cas. Ins. Co.*, No. SA-19-CV-00180-FB-ESC, 2019 WL 4545614, at *8 (W.D. Tex. Sept. 19, 2019).

113. *Id.*

V. APPRAISAL

As the Texas Supreme Court has recognized, “appraisal clauses are included in most property insurance policies” because, in every property damage claim, someone must define the amount of loss the insurer should pay.¹¹⁴ “Appraisal clauses are a means of determining the amount of loss and resolving disputes about the amount of loss for a covered claim.”¹¹⁵ Parties generally resort to appraisal when they “reach an impasse,” or “mutual understanding that neither will negotiate further,” and both “are aware of the futility of further negotiations.”¹¹⁶

A. THE TEXAS SUPREME COURT HOLDS THAT AN INSURER’S
PAYMENT OF APPRAISAL AWARDS DOES NOT EXEMPT IT
FROM THE TPPCA STATUTORY DEADLINES

In June 2019, the Texas Supreme Court considered whether an insured might prevail on a claim for damages under the TPPCA for delayed payment when the insurer invoked the policy’s appraisal process provision and paid the insured the appraisal amount.¹¹⁷ In *Barbara Technologies Corp. v. State Farm Lloyds*, State Farm Lloyds (State Farm) issued a property insurance policy to Barbara Technologies Corporation (Barbara Tech).¹¹⁸ Barbara Tech filed a claim with State Farm on October 17, 2013, after the property sustained wind and hail damage.¹¹⁹ After an initial investigation, State Farm denied coverage, finding that the property sustained damages worth less than the policy deductible.¹²⁰ Barbara Tech requested a second inspection, and State Farm rejected the claim again, finding no additional damage.¹²¹

Barbara Tech filed suit alleging, among other things, TPPCA violations.¹²² Following State Farm’s invocation of the appraisal provision, “the appraisers agreed to a[] . . . value of \$193,345.63,” and after subtracting depreciation and the deductible, State Farm paid \$178,845.25 four business days later.¹²³ Barbara Tech “accepted the payment and amended its petition to include only claims for violations of . . . [C]hapter 542 for State Farm’s alleged failure to comply with statutory deadlines.”¹²⁴

On cross-motions for summary judgment, Barbara Tech argued State Farm had violated the TPPCA for “failing to pay the claim within the

114. *Barbara Techs. Corp. v. State Farm Lloyds*, 589 S.W.3d 806, 814 (Tex. 2019).

115. *Id.*

116. *See Miranda v. Tex. Lloyds Allstate*, 2019 WL 6208563, at *5 (S.D. Tex. Nov. 21, 2019) (citing *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404, 409–10 (Tex. 2009)).

117. *Barbara Techs.*, 589 S.W.3d at 809.

118. *Id.*

119. *Id.*

120. *Id.*

121. *Id.*

122. *Id.*

123. *Id.* at 809–810.

124. *Id.* at 810.

TPPCA's sixty-day time limit," and State Farm asserted that its timely payment of the appraisal award foreclosed TPPCA damages as a matter of law.¹²⁵ The trial court agreed with State Farm, granting summary judgment in its favor, and the Fourth San Antonio Court of Appeals affirmed.¹²⁶ On appeal, the Texas Supreme Court framed the issue before it as follows: "whether an insured's claim for prompt pay damages under the TPPCA survives the insurer's payment in full after the amount of loss was determined through an appraisal process provided for in the parties' insurance policy."¹²⁷

The supreme court began by discussing the purpose of Chapter 542, which "relates specifically to prompt *payment* of claims," but also to "requirements and deadlines for responding to, investigating, and evaluating insurance claims."¹²⁸ The supreme court noted that damages can be imposed for violations of both payment and non-payment deadlines.¹²⁹ Regarding the non-payment deadlines, "TPPCA deadlines are triggered when 'the insurer receives all items, statements, and forms required . . . to secure final proof of loss.'"¹³⁰ If an insurer delays a payment for more than sixty days, it is subject to damages of 18% interest per year, plus attorney's fees, as provided in Section 542.060.¹³¹ According to the supreme court, "the TPPCA has three main components—non-payment requirements and deadlines, deadlines for paying claims, and enforcement"—the latter two being "at issue here."¹³²

"Barbara Tech argue[d] that although State Farm paid the appraisal value, . . . [it] owes damages under the TPPCA because it delayed payment of the claim beyond the applicable [sixty-day] statutory period."¹³³ State Farm argued that its initiation of the contractual appraisal process amounted to a request for additional information and extended the deadline to accept or reject a claim, and that its time for acceptance or rejection began when it received the appraisal award.¹³⁴ Because it paid four business days later, its payment was timely.¹³⁵

The supreme court rejected State Farm's argument for two reasons. First, "State Farm's appraisal demand was based on its contractual right to . . . [the] dispute resolution process" rather than "a request for items, statements, or forms from Barbara Tech to secure final proof of loss";

125. *Id.*

126. *Id.*

127. *Id.* at 810–811.

128. *Id.* at 812.

129. *Id.*

130. *Id.* (citing *Lamar Homes, Inc. v. Mid-Continent Cas. Co.*, 242 S.W.3d 1, 28 (Tex. 2007)) ("Additional TPPCA deadlines are triggered when 'the insurer receives all items, statements, and forms required . . . to secure final proof of loss,' whether the insurer receives this information in response to its initial request or in response to additional requests.")

131. *Id.* (citing TEX. INS. CODE ANN. § 542.060).

132. *Id.* at 813.

133. *Id.* at 815.

134. *Id.* at 816.

135. *Id.*

thus, “State’s Farm’s use of the appraisal process [fell] outside the scope of 542.055.”¹³⁶ Second, an insurer’s rejection or acceptance of a claim under Section 546.056(a) is an acknowledgement that the insurer had all the information necessary to determine the insured’s entitlement to policy benefits.¹³⁷ Because “rejection of a claim is based on all information the insurer deemed necessary” the appraisal process is not part of the investigation nor does it start the investigation all over again.¹³⁸ An insurer’s rejection of the claim thus indicates an investigative conclusion that no benefits under the policy are owed, that it is not liable for the claim, and that no additional information is necessary.¹³⁹ For these reasons, the supreme court concluded that the initiation of the appraisal process was not a request for information under the statute.¹⁴⁰

The supreme court next determined that “nothing in the TPPCA exempts appraisal payments from the TPPCA’s payment deadlines or enforcement.”¹⁴¹ The supreme court addressed the courts of appeals’ opinions on which State Farm relied, which held that “use of the appraisal process to fully resolve a dispute as to the amount” of the loss, if any, precludes TPPCA damages, and cautioned that

to the extent these opinions could be read to excuse an insurer liable under the policy from having to pay TPPCA damages merely because it tendered payment based on an appraisal award, or to foreclose any further proceedings to determine the insurer’s liability under the policy, we disapprove of these opinions.¹⁴²

Per the terms of the statute, where an insurer is “liable” under the policy and delays payment beyond the statutory deadlines, even if it utilizes the appraisal process, it will be subject to liability for TPPCA damages.¹⁴³ Until the insurer is determined to be liable—“either by accepting the claim and notifying the insured that it will pay, or through an adjudication of liability—the insurer is required to pay nothing, is subject to no payment deadline, and is not subject to TPPCA damages for delayed payment.”¹⁴⁴

Here, State Farm initially denied the claim and thus did not acknowledge liability.¹⁴⁵ Further, State Farm’s initiation of the appraisal process represented a willingness to resolve a dispute outside of court—akin to a settlement—and did not constitute an acknowledgment of liability.¹⁴⁶ As

136. *Id.*

137. *Id.*

138. *Id.* at 816–17.

139. *Id.*

140. *Id.* at 817.

141. *Id.* at 817, 822 (“To be clear, nothing in the TPPCA suggests that the invocation of a contractual appraisal provision alters or suspends any TPPCA requirements or deadlines.”).

142. *Id.* at 819 (citing TEX. INS. CODE ANN. §§ 542.058, 542.060).

143. *Id.*

144. *Id.* at 822 (citing TEX. INS. CODE ANN. § 542.060(a)).

145. *Id.*

146. *Id.* at 822–23.

such, the supreme court held that a payment pursuant to appraisal is not an acknowledgment of liability.¹⁴⁷ Thus, State Farm's liability, and Barbara Tech's entitlement to damages under the statute, was not established, and TPPCA damages were not necessarily triggered.¹⁴⁸

The supreme court cautioned that it was not suggesting that rejected claims may never trigger TPPCA damages, or that an insurer could avoid TPPCA damages by "simply deny[ing] claims . . . and pay[ing] them later."¹⁴⁹ Rather, if an insurer has complied "with the TPPCA in responding to the claim, requesting necessary information, investigating, evaluating, and reaching a decision . . . [the] use of the contract's appraisal process does not vitiate the insurer's earlier determination on the claim."¹⁵⁰ The supreme court concluded that "payment of an appraisal award on a rejected claim does not subject the insurer to prompt pay damages under [S]ection 542.060 unless and until the insurer either accepts liability under the policy or is adjudicated liable."¹⁵¹ Because State Farm did not conclusively establish it was not liable, it was not entitled to summary judgment.¹⁵²

"Barbara Tech further argue[d] that the appraisal value constituted an award of actual damages," and that pursuant to *Menchaca*, "it could recover those benefits as 'actual damages,' because State Farm's wrongful denial of [its] valid claim caused the loss of those benefits."¹⁵³ By extension, if "policy benefits can be actual damages for the purpose of determining the availability of statutory and other extra-contractual damages, they can also be actual damages . . . under the TPPCA."¹⁵⁴ The supreme court disagreed, holding that, consistent with its reasoning above, the amount of the award did not constitute "actual damages" because State Farm had neither accepted liability nor been adjudicated liable.¹⁵⁵ Concluding that neither party met its burden of establishing entitlement to summary judgment, the supreme court remanded the case for further proceedings regarding State Farm's "liability."¹⁵⁶

147. *Id.* at 823.

148. *Id.*

149. *Id.*

150. *Id.*

151. *Id.* at 825.

152. *Id.* at 828.

153. *Id.* at 826 (quoting *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479, 495 (Tex. 2018)) ("[A]n insured who establishes a right to receive benefits under an insurance policy can recover those benefits as 'actual damages' under [the Insurance Code] if the insurer's statutory violation causes the loss of the benefits.").

154. *Id.*

155. *Id.* at 826–27.

156. *Id.* at 828.

B. CONTEMPORANEOUS WITH *BARBARA TECHS.*, THE TEXAS SUPREME COURT HELD THAT, ALTHOUGH AN INSURER'S PAYMENT OF AN APPRAISAL AWARD DOES NOT INSULATE IT FROM TPPCA DAMAGES, IT PRECLUDES CLAIMS FOR BREACH OF CONTRACT AND BAD FAITH

In a decision issued the same day as *Barbara Techs.*, the Texas Supreme Court addressed “the effect of an insurer’s payment of an appraisal award on an insured’s claims for breach of contract, bad faith insurance practices, and violations of the [TPPCA].”¹⁵⁷

Ortiz submitted a claim under his homeowner’s insurance policy for wind and hail damage to his house.¹⁵⁸ After State Farm’s first adjuster found damage related to the wind and hail that fell below the policy’s \$1,000 deductible, Ortiz had a public adjuster estimate the damage, resulting in an estimate of \$23,525.99.¹⁵⁹ “State Farm conducted a second inspection with the public adjuster present and revised” its initial estimate up, although still below the policy deductible.¹⁶⁰ Ortiz sued for breach of contract, violation of the TPPCA, and statutory and common law bad faith insurance practices.¹⁶¹ State Farm’s answer two months later included a demand for appraisal pursuant to the policy language.¹⁶² State Farm paid Ortiz seven business days after receiving the appraisal award.¹⁶³ State Farm was subsequently granted summary judgment on the basis that the appraisal award payment resolved and disposed of all claims in the lawsuit.¹⁶⁴ The court of appeals affirmed.¹⁶⁵

1. *Breach of Contract*

Ortiz argued that if an appraisal award is higher than the estimate offered by the insurer, the insurer necessarily breached the policy, and thus State Farm breached the policy.¹⁶⁶ The supreme court, however, agreed with Texas courts of appeals that “have unanimously rejected this argument and held that an insurer’s payment of an appraisal award in the face of similar allegations of pre-appraisal underpayment forecloses liability on a breach of contract claim.”¹⁶⁷ According to the court, “appraisal awards do not serve to establish a party’s liability (or lack thereof),” rather, they resolve the dispute among insurers and insureds as to the amount of the covered loss, and are thus binding on the parties.¹⁶⁸

157. Ortiz v. State Farm Lloyds, 589 S.W.3d 127, 129 (Tex. 2019).

158. *Id.*

159. *Id.*

160. *Id.*

161. *Id.* at 129–30.

162. *Id.* at 130.

163. *Id.*

164. *Id.* at 130–131.

165. *Id.* at 130.

166. *Id.* at 132 (referencing *In re Allstate Cty. Mut. Ins. Co.*, 85 S.W.3d 193, 195 (Tex. 2002)).

167. *Id.*

168. *Id.*

It simply does not follow that an appraisal award demonstrates that an insurer breached by failing to pay the covered loss. If it did, insureds would be incentivized to sue for breach every time an appraisal yields a higher amount than the insurer's estimate . . . thereby encouraging litigation rather than "short-circuit[ing]" it as intended.¹⁶⁹

The supreme court also addressed the significance of "the contractual nature of the appraisal process," pointing out that State Farm "invoked the . . . procedure for determining the amount of loss, and . . . paid [the] binding amount, [thereby] comply[ing] with its obligations under the policy."¹⁷⁰ For these reasons, the supreme court affirmed summary judgment for State Farm on the breach of contract claim.¹⁷¹

2. *Bad Faith*

Chapter 541 of the Insurance Code "authorizes a private action against an insurer" when the insurer has committed "an unfair or deceptive act or practice in the business of insurance."¹⁷² Ortiz alleged State Farm "wrongfully den[ied] his claim, fail[ed] to settle the claim in good faith, and fail[ed] to conduct a reasonable investigation," in violation of the statute, and that State Farm violated its common law duty of good faith and fair dealing.¹⁷³ Ortiz argued "the discrepancy between State Farm's estimate and the [final] appraisal award constituted evidence that State Farm intentionally undervalued the claim," and that he was "entitled to recover the 'fees and expenses'" he incurred to pursue his benefits under the policy as a result of "State Farm's unreasonable investigation of his claim."¹⁷⁴

The supreme court ruled that Ortiz's attorney's fees and costs did not constitute "actual damages," and that the "law is clear that attorney's fees and costs incurred in the prosecution or defense of a claim, although 'compensatory in that they help make a claimant whole,' are not damages."¹⁷⁵ The supreme court reiterated that the legislature made clear in Chapter 541 that a claimant must "prevail on the underlying claim *and* recover damages in order to recover attorney's fees."¹⁷⁶ As such, the supreme court held that "[b]ecause Ortiz [sought] no actual damages other than the policy benefits . . . he [could] not maintain a bad faith claim under either common law or [C]hapter 541."¹⁷⁷

169. *Id.* at 132–33 (citing *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404, 412 (Tex. 2011)).

170. *Id.* at 133.

171. *Id.* (referencing *Breshears v. State Farm Lloyds*, 155 S.W.3d 340, 343 (Tex. App.—Corpus Christi–Edinburg 2004, pet. denied) (mem. op.)).

172. *Id.* (citing TEX. INS. CODE ANN. § 541.151).

173. *Id.* (citing TEX. INS. CODE ANN. §§ 541.060(a)(2)–(4), 541.060(a)(7)).

174. *Id.* at 133–134.

175. *Id.* at 135.

176. *Id.* (citing TEX. INS. CODE ANN. § 541.152(a)(1)).

177. *Id.*

3. Texas Prompt Payment of Claims Act

The supreme court next addressed “whether State Farm’s payment of the appraisal award foreclose[d] Ortiz’s recovery under” the TPPCA.¹⁷⁸ Citing its decision in *Barbara Techs.*, the supreme court noted that the TPPCA “imposes procedural requirements and deadlines on insurance companies to promote the prompt payment of insurance claims.”¹⁷⁹ Although the lower courts had concluded the payment of the appraisal award foreclosed recovery under the TPPCA, the supreme court reversed and remanded the TPPCA claims in light of its contemporaneous decision in *Barbara Techs.*, which held that “payment of an appraisal award does not as a matter of law bar an insured’s claims under the [TPPCA].”¹⁸⁰ The supreme court therefore held that, like the insured in *Barbara Techs.*, Ortiz was entitled to proceed on his TPPCA claim despite State Farm having paid the appraisal award.¹⁸¹

While *Barbara Techs.* and *Ortiz* clarify that, under Texas law, an insurer which pays an appraisal award will not be subject to liability for breach of contract or for extra-contractual liability in the absence of evidence of actual damages other than the policy benefits, the supreme court for the first time held that an insurer that pays an appraisal award is not exempt from the requirements of the TPPCA.¹⁸² Thus, an insurer can be subject to Chapter 542 penalties if it is found liable for the claim and to have delayed payment beyond the statutory deadlines.¹⁸³ These decisions, however, raise significant questions. Noticeably absent in the supreme court’s lengthy analyses (and that of the dissent in *Barbara Techs.*) is a discussion of how damages are to be calculated on remand. If the amount of the appraisal award is not the “actual damages,” as the supreme court concluded, will the parties be required to present evidence of the actual amount of the loss? Will the amount of the loss be capped at the amount of the appraisal award? Additional litigation over these issues seems inconsistent with the purpose of the appraisal provisions. The supreme court seemed to suggest that the issue is one that perhaps should be addressed by the legislature, which it opined was well-aware of appraisals but did not address them in the statute.¹⁸⁴ Pursuant to these decisions, the appraisal process—one which was meant to provide a final resolution for disputed claims—no longer provides such finality.

178. *Id.*

179. *Id.* (citing TEX. INS. CODE ANN. § 542.054).

180. *Id.*

181. *Id.* at 135–36.

182. *See id.*

183. *See id.*

184. *See Barbara Techs. Corp. v. State Farm Lloyds*, 589 S.W.3d 806, 815–16 (Tex. 2019).

C. THE SOUTHERN DISTRICT HOLDS THE *MAINALI*
“REASONABLENESS” STANDARD SURVIVES *BARBARA TECHS.*

In a pre-*Barbara Techs.* ruling, the U.S. District Court for the Southern District of Texas in *Hyewon Shin v. Allstate Texas Lloyds* granted summary judgment for Allstate on plaintiff’s TPPCA claim, holding that “under Texas law, ‘full and timely payment of an appraisal award under the policy precludes an award of penalties under the Insurance Code’s prompt payment provisions *as a matter of law.*’”¹⁸⁵ On motion for reconsideration after *Barbara Techs.*, the district court held that *Barbara Techs.* “overruled the prior line of cases on the effect of appraisal awards, at least as far as those opinions held that full and timely payment of an appraisal award precludes TPPCA damages.”¹⁸⁶

The *Shin* court asked the parties to brief the question of whether the *Mainali* “reasonableness” exception, set out by the U.S. Court of Appeals for the Fifth Circuit in *Mainali Corp. v. Covington Specialty Insurance Co.*, survives *Barbara Techs.*¹⁸⁷ In *Mainali*, the Fifth Circuit held that there could be no violation of the TPPCA if an insurer’s pre-appraisal payment was “reasonable.”¹⁸⁸ While *Shin* argued that *Barbara Techs.* overruled *Mainali*, the district court disagreed.¹⁸⁹ The *Shin* court pointed out that *Barbara Techs.* cited “*Mainali* with approval in support of the claim that ‘when an insurer complies with the TPPCA in responding to the claim, requesting necessary information, investigating, evaluating, and reaching a decision on the claim, use of the contract’s appraisal process does not vitiate the insurer’s earlier determination on the claim.’”¹⁹⁰

The district court thus read *Barbara Techs.* “in conjunction with *Mainali* as standing for the proposition that, in order for an insurer to avoid a [TPPCA] claim . . . the insurer must have made a reasonable preappraisal payment within the statutorily-provided period.”¹⁹¹ Because Allstate made its preappraisal payment within the required time period, the court was left to decide whether the pre-appraisal payment was reasonable.¹⁹² Here, “the appraiser reached an award of \$25,944.94, which was 5.6 times greater than the initial preappraisal payment of \$4,616.63.”¹⁹³ The court found the preappraisal amount reasonable because: (1) Allstate had complied with the procedural requirements set forth in the TPPCA; and (2) “the difference between Allstate’s preappraisal and the appraisal payments [was] no larger than the difference in other cases in which courts have made a similar reasonableness find-

185. See *Hyewon Shin v. Allstate Tex. Lloyds*, No. 4:18-CV-01784, 2019 WL 4170259, at *1 (S.D. Tex. Sept. 3, 2019) (citing *Nat’l Sec. Fire & Cas. Co. v. Hurst*, 523 S.W.3d 840, 847 (Tex. App.—Houston [14th Dist.] 2017, pet. denied)).

186. *Id.*

187. *Id.*

188. *Mainali Corp. v. Covington Specialty Ins. Co.*, 872 F.3d 255, 259 (5th Cir. 2017).

189. *Shin*, 2019 WL 4170259, at *1 (citing *Barbara Techs.*, 589 S.W.3d at 823).

190. *Id.* (citing *Barbara Techs.*, 589 S.W.3d at 823).

191. *Id.* at *2.

192. *Id.*

193. *Id.*

ing.”¹⁹⁴ The court affirmed summary judgment in favor of Allstate.¹⁹⁵

D. WAIVER OF APPRAISAL RIGHTS

Texas courts favor “enforcing appraisal clauses ‘because denying the appraisal would vitiate the insurer’s right to defend its breach of contract claim.’”¹⁹⁶ A party can, however, waive its rights to appraisal when (1) an impasse has been reached; (2) “there was unreasonable delay between the ‘point of impasse’ and the insured’s demand for appraisal; and (3) the insurer shows it has been prejudiced by such delay.”¹⁹⁷

In *Miranda v. Texas Lloyds Allstate*, the U.S. District Court for the Southern District of Texas addressed whether the insured had waived her right to appraisal by unreasonably delaying invoking the appraisal provisions thereby prejudicing the insurer.¹⁹⁸ In a storm damage case, Miranda requested appraisal more than three years after the date of loss and two years after filing her original lawsuit.¹⁹⁹ The district court rejected Allstate’s argument that the insured unreasonably delayed invoking appraisal, noting that “[c]ourts measure delay from the point of impasse by examining the parties’ conduct and surrounding circumstances. Such measure goes beyond ‘the amount of time involved in seeking appraisal.’”²⁰⁰

Miranda filed her claim with Allstate on March 30, 2017, and after Allstate “improperly denied/underpaid her claim,” filed suit on August 30, 2017.²⁰¹ Miranda subsequently non-suited her claims and refiled her lawsuit against Allstate on April 3, 2019, alleging violations of the Texas Insurance Code and breach of contract.²⁰² The parties participated in an unsuccessful mediation on September 5, 2019, and on September 9, 2019, the insured invoked appraisal.²⁰³

Focusing on the point of “impasse,” the district court noted that “[p]arties reach an impasse when there is ‘a mutual understanding that neither will negotiate further’ and the parties are aware of the futility of further negotiations.”²⁰⁴ The court found no indication that an impasse

194. *Id.* (referencing *Hinojos v. State Farms Lloyd*, 569 S.W.3d 304, 307 (Tex. App.—El Paso 2019, pet. filed)).

195. *Id.*; see also *Lambert v. State Farm Lloyds*, No. 02-17-00374-CV, 2019 WL 5792812, at *3–4 (Tex. App.—Fort Worth, Nov. 7, 2019 pet. filed) (holding that (1) insured could not recover extra-contractual damages after an appraisal award because the insured did not allege actual damages different from what had already been paid under the policy; and (2) because “the Lamberts’ TPPCA claims were ‘in the same procedural posture’” as those in *Barbara Techs.*, remand was proper for a determination of the liability issue).

196. *Miranda v. Tex. Lloyds Allstate*, No. 7:19-CV-146, 2019 WL 6208563, at *4 (S.D. Tex. Nov. 21, 2019) (citing *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404, 412 (Tex. 2011)).

197. *Id.*

198. *Id.* at *6

199. *Id.*

200. *Id.*

201. *Id.* at *1.

202. *Id.* at *1–2.

203. *Id.* at *2.

204. *Id.* at *5.

had occurred before the September 5, 2019 mediation, pointing out that “Allstate’s participation in the . . . mediation further evidences the possibility, rather than futility, of further negotiations.”²⁰⁵ Because the insured invoked her right to appraisal four days after the mediation—the date of impasse—there was no unreasonable delay.²⁰⁶

Agreeing with Miranda that “Allstate cannot establish prejudice by unreasonable delay where unreasonable delay did not occur,” the court nonetheless went on to note that “even if unreasonable delay had occurred, Defendant Allstate fail[ed] to otherwise prove prejudice.”²⁰⁷ The district court noted that the Texas Supreme Court has stated “it is difficult to see how prejudice could ever be shown when the policy . . . gives both sides the same opportunity to demand appraisal.”²⁰⁸ The district court pointed out that, at any time during the claims process and the litigation, during which Allstate was aware of the parties’ disagreement as to the value of the claim, “Allstate equally had an opportunity to invoke its right to appraisal.”²⁰⁹ The fact that Allstate continued on in the litigation and expended time and effort without invoking its own right to appraisal was insufficient to establish prejudice.²¹⁰

VI. IMPROPER JOINDER

A. COURT REJECTS IMPROPER JOINDER CLAIM BECAUSE SOME TEXAS COURTS HOLD THAT INDIVIDUALS CAN BE LIABLE UNDER CHAPTER 541.060(A)(2)(A)

In *Trejo v. Allstate Fire & Casualty Insurance Co.*, the U.S. District Court for the Western District of Texas in San Antonio addressed whether an insured’s addition of the claims adjuster as a defendant constituted improper joinder for purposes of diversity jurisdiction.²¹¹ After being involved in an accident, Velma Trejo filed a claim for UIM benefits with Allstate which was denied.²¹² Trejo filed suit against Allstate and the adjuster, Tonja Hess, asserting contractual and extra-contractual causes of action, including that “Hess failed to attempt in good faith to effectuate a prompt, fair, and equitable settlement of” the claim when liability was “reasonably clear.”²¹³ Allstate removed the lawsuit to federal court,

205. *Id.* at *6.

206. *Id.* at *7.

207. *Id.*

208. *Id.* (quoting *In re Universal Underwriters of Tex. Ins. Co.*, 345 S.W.3d 404, 412 (Tex. 2011)); *see also* *Ortiz v. State Farm Lloyds*, 589 S.W.3d 127, 131 (Tex. 2019) (rejecting Ortiz’s argument that State Farm waived its appraisal right by invoking it after suit was filed, the supreme court focused on point of impasse; the court noted that it has previously “recognized the inherent difficulty of demonstrating prejudice when a policy allows both parties the same opportunity to demand appraisal, opining that appraisal ‘could short-circuit potential litigation and should be pursued before resorting to the courts.’”).

209. *Miranda*, 2019 WL 6208563, at *7.

210. *Id.*

211. *Trejo v. Allstate Fire & Cas. Ins. Co.*, No. SA-19-CV-00180-FB-ESC, 2019 WL 4545614, at *2–3 (W.D. Tex. Sept. 19, 2019).

212. *Id.* at *1.

213. *Id.* at *1, *5 (quoting TEX. INS. CODE ANN. § 541.060(a)(2)(A)).

where Trejo argued lack of diversity because both Hess and Trejo are Texas residents.²¹⁴ Allstate argued improper joinder because Trejo's complaint failed to state a viable cause of action against Hess.²¹⁵

The district court noted that “[b]oth the Fifth Circuit and the Texas Supreme Court have held that an insurance adjuster may be individually liable for violating Chapter 541,” but that “there is some uncertainty regarding which specific provisions of Chapter 541 expose an independent adjuster to liability.”²¹⁶ The district court recognized that Texas courts are split regarding whether Chapter 541.060(a)(2)(A)²¹⁷ applies only to insurers, and not to adjusters.²¹⁸ Because some courts have held that adjusters can be liable under this section, the district court found that there was “arguably a reasonable basis for predicting that state law might impose liability,” and remand was proper.²¹⁹

B. COURTS ADDRESS INSURER'S ELECTION TO ACCEPT AGENT'S LIABILITY UNDER SECTION 542A.006 AND IMPACT ON DIVERSITY JURISDICTION: IT'S ALL ABOUT THE TIMING

On September 1, 2017, new provisions of the Texas Insurance Code took effect, including Section 542A.006 which provides that “an insurer that is a party to [a Chapter 542A] action may elect to accept whatever liability an agent might have to the claimant for the agent's acts or omissions related to the claim by providing written notice to the claimant.”²²⁰ Once the election is made, “the court shall dismiss the action against the agent with prejudice.”²²¹ When the election is made pre-suit, “no cause of action exists against the agent.”²²² An insurer “may not revoke, and a court may not nullify, an insurer's election.”²²³ As the U.S. District Court for the Western District of Texas noted, the amendment spawned a “novel question”: “if an out-of-state insurer is sued by a Texas insured, and the insurer elects to accept liability for a non-diverse agent (thus requiring the agent's dismissal per Section 542A.006), may a federal court disregard the non-diverse agent's citizenship?”²²⁴ According to the district court, “[t]he answer seems to be ‘maybe’ and ‘it depends.’”²²⁵

214. *Id.* at *2.

215. *Id.*

216. *Id.* at *5.

217. TEX. INS. CODE ANN. § 541.060(a)(2)(A) (prohibiting an insurer from “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.”).

218. *Trejo*, 2019 WL 4545614, at *6.

219. *Id.*

220. TEX. INS. CODE ANN. § 542A.006(a).

221. *Id.* § 542A.006(b)–(c).

222. *Id.* § 542A.006(b).

223. *Id.* § 542A.006(f).

224. *See Bexar Diversified MF-1, LLC v. Gen. Star Indem. Co.*, No. SA-19-CV-00773-XR, 2019 WL 6131455, at *3 (W.D. Tex. Nov. 18, 2019); *see also Stephens v. SAFECO Ins. Co. of Ind.*, No. 4:18-cv-00595, 2019 WL 109395, at *1 (E.D. Tex. Jan. 4, 2019) (noting that the amendment spawned a “novel question regarding removal based on diversity of citizenship”).

225. *Bexar*, 2019 WL 6131455, at *3.

All courts to address the issue agree “that when an insurer makes its election *before* an insured files suit, no cause of action exists against the agent, and if the insured later names the agent as a non-diverse defendant the court may disregard that agent’s citizenship for purposes of diversity jurisdiction.”²²⁶

There is a split of authority, however, over the issue of improper joinder “when an insurer elects to accept liability at any time *after* the insured files suit.”²²⁷ In *Bexar Diversified MF-1, LLC v. General Star Indemnity Co.*,²²⁸ the insurer made its election in its Notice of Removal.²²⁹ The district court noted that it and two other Texas courts had “previously found a non-diverse defendant to be improperly joined following an insurer’s post-suit election.”²³⁰ These courts reasoned that because “there is no reasonable basis to predict that the plaintiff might be able to recover against the agent” in state court, a finding of improper joinder was proper.²³¹

The *Bexar* court pointed out that “other federal district courts in Texas have disagreed,” focusing on whether the joinder was proper at the time the suit was filed.²³² The *Bexar* court however, held that the focus should be on whether, *at the time of removal*, the “election establishes the impossibility of recovery against the non-diverse defendant in state court”; if the answer is “no,” the joinder was improper.²³³ Because the insurer’s election at the time of removal required dismissal of the claims against the agent, the agent’s citizenship was disregarded for purposes of diversity jurisdiction.²³⁴

In *Kotzur v. Metropolitan Lloyds Insurance Co. of Texas*, the U.S. District Court for the Western District of Texas distinguished *Bexar* from the case before it on the basis that the insurer in *Kotzur* waited until thirty days after removal to file its election.²³⁵ The district court held that a post-removal election, while it “may have the effect of dismissing the non-diverse defendants in state court,” does not support a finding of improper joinder “because the ‘jurisdictional facts that support removal must be judged *at the time of the removal.*’”²³⁶ Because, at the time of removal, the district court could not say there was no reasonable basis to predict that plaintiffs might be able to recover against the agents on the

226. *See id.*

227. *Id.*

228. *Id.* at *1.

229. *Id.*

230. *Id.* at *3.

231. *Id.*

232. *Id.* (citing *Flores v. Allstate Vehicle & Prop. Ins. Co. Co.*, No. SA-18-CV-742-XR, 2018 WL 5695553, at *5 (W.D. Tex. Oct. 31, 2018) (denying remand)).

233. *Id.* at *4.

234. *Id.* at *5.

235. *Kotzur v. Metro. Lloyds Ins. Co.*, No. SA-19-CV-01165-XR, 2019 WL 6168207, at *4 (W.D. Tex. Nov. 19, 2019).

236. *Id.* at *4 n.3. (citing *Gebbia v. Wal-Mart Stores, Inc.*, 233 F.3d 880, 883 (5th Cir. 2000)).

insureds' claims, the district court held that remand was proper.²³⁷

237. *Id.* at *5.

