Extra-Contractual Damages:
Excess of Judgment (Stowers), Bad Faith, and Prompt Payment

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In addition to policy benefits, a policyholder may be entitled to extra-contractual damages in the proper circumstances. These may include excess-of-limits judgments under the *Stowers* doctrine; common law or statutory bad faith damages; and enhanced pre-judgment interest.

I. Liability for judgment in excess of policy limits - *Stowers*

A third-party claimant's judgment against the policyholder exceeding the contractual policy limits may be recoverable against the insurer, if the insurer unreasonably failed to settle within policy limits despite an appropriate demand.

In consideration of the insurer's exclusive right to defend and control third-party litigation on behalf of the policyholder, Texas courts and legislature have imposed a concomitant duty on the insurer to act reasonably and to protect the policyholder's interests in coverage during the handling of such claims. Under the so-called *Stowers* doctrine, one of those duties is that the insurer must act with "that degree of care and diligence which an ordinarily prudent person would exercise in the management of his own business" in responding to settlement demands within policy limits. *Stowers Furniture Co. v. American Indem. Co.*, 15 S.W.2d 544, 547-48 (Tex. Comm'n App.1929, holding approved).

Ordinarily, upon a judgment against the insured, an insurer is liable for no more than the amount specified in the policy limit of their contract, the insurance policy. Violation of the *Stowers* duty, however, has the effect of shifting the risk of any judgment in excess of the policy limit onto the primary insurer in circumstances where the insurer was presented with a reasonable opportunity to prevent the excess judgment but failed to settle within the applicable policy limits. *American Physicians Ins. Exch. v. Garcia*, 876 S.W.2d 842, 849 (Tex. 1994).

Imposition of the *Stowers* duty is intended to protect the policyholder from an insurer abusing its control of defense and settlement and gambling at the policyholder's risk and expense. Otherwise, by failing to settle a claim that can and should be settled within the primary policy limits, the insurer could give priority to protecting its own limits by foregoing reasonable settlement opportunities, thus leaving the policyholder at risk and responsible for an uninsured loss beyond those primary limits.

A. Elements of *Stowers* demand

As developed by Texas courts in more recent years, the *Stowers* duty is not simply a free-floating and straight-forward negligence standard. Rather, it has become a highly technical doctrine enshrouded with restrictive elements preventing its application except where a number of requirements are met. The insurer's duty is activated only when the claimant's demand meets certain prerequisites:

* the claim against the insured is within the scope of coverage;
* the demand is within the policy limits;
* the terms of the demand are such that an ordinarily prudent insurer would accept it, considering the likelihood and degree of the insured's potential exposure to an excess judgment; and
* the proposed settlement fully, completely, and unconditionally releases the insured from liability of all claims, including liens.

An insurer is not required under *Stowers* to affirmatively initiate any settlement offer nor to engage in any give-and-take settlement negotiations; the Stowers duty arises solely in relation to an actual settlement demand proposed by the third-party claimant. *Id*.

But neither does a *Stowers* obligation depend upon the policyholder demanding that the offer be accepted; it is sufficient that the plaintiff makes a demand that meets the *Stowers* elements. *See Continental Cas. Co. v. St. Paul Fire & Marine Ins. Co.*, 2007 WL 2403656, *3, 6 (N.D.Tex. Aug 23, 2007) (No. Civ. A 304CV1866-D), relying upon *Highway Ins. Underwriters v. Lufkin-Beaumont Motor Coaches,* 215 S.W.2d 904, 929 (Tex.Civ.App.1948, writ ref'd n.r.e) ("It was not a defense to Insurer that Insured did not demand acceptance of [the settlement offers]. Insurer must perform the duty imposed upon it without being activated by Insured.")

Nor is it necessary that the insurer actually have a duty to defend; it is sufficient for *Stowers* that the insurer has taken actual control of settlement. *See Rocor Int'l, Inc. v. Nat'l Union Fire Ins. Co.*, 77 S.W.3d 253, 263-64 (Tex. 2002) (excess insurer assumed exclusive control over settlement negotiations).

It is imperative, then, that the underlying plaintiff's trial lawyer include all elements necessary for a *Stowers* claim if a real threat of excess exposure is to be imposed on an insurer to encourage current settlement. Because these technical requirements are keenly applied by Texas courts, out-of-state precedents are virtually irrelevant. *See e.g. In re Enron Corporation*, 2006 WL 1663383, * 8-9 (S.D.Tex.2006) (rejecting consideration of non-Texas cases as irrelevant on issue governed by applicable *Stowers* principles concerning insurer's right to exhaust limits in partial settlements).

The policyholder is placed in a delicate position when the *Stowers* demand is faulty, balancing the duty to cooperate with the insurer in the defense of the case over against the inclination to advise the underlying plaintiff on the deficiencies in the demand so as to retain leverage for settlement against the insurer within policy limits. There is very little jurisprudence to guide the policyholder on the boundaries of its "cooperation" obligation to the insurer in this context. *See* Rick Virnig, The Duty to Cooperate, 6 J. TEX. INS. L. 11 (Fall, 2005); *see also Mid-Continent Cas. Co. v. Petroleum Solutions, Inc.*, 2016 WL 5539895, *14-20 (S.D.Tex., Sept. 29, 2016).

II. Bad Faith

Texas law providing for a bad faith cause of action differs between common-law concepts and statutory provisions, and between the relief available for insurer's handling of third-party liabilities claims or first-party claims. The standard for proving a claim of bad faith is relatively high, and the policyholder should be conscientious in asserting this extra-contractual remedy only in appropriate circumstances.

A. Third-Party Liability Insurance

Texas law recognizes only a single tort duty with respect to an insurer's practices concerning third-party claims handling, that being the duty stated in *Stowers*. *Maryland Ins. Co. v. Head Industr. Coatings & Servs., Inc.*, 938 S.W.2d 27, 28 (Tex. 1996). The Court maintained that "an insured is fully protected against his insurer's refusal to defend or mishandling of a third-party claim by his contractual and Stowers rights" and that "[i]mposing an additional duty on insurers in handling third-party claims is unnecessary and therefore inappropriate." *Id*. at 28-29.

Therefore, a *Stowers* claim is quintessentially a negligence claim, and does not provide a common law action or remedy for bad faith. *Id*.; *Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 776 (Tex. 2007).

The Texas legislature has provided a statutory action for the unfair insurance practice of "[n]ot attempting in good faith to effectuate prompt, fair, and equitable settlements of claims submitted in which liability has become reasonably clear." TEX. INS. CODE, Art. 21.21-2, § 2(b)(4), recodified as TEX. INS. CODE, §541.060 (a)(2).

However, the Texas Supreme Court has determined that this standard also is the functional equivalent of the *Stowers* duty and involves meeting the essential prerequisites noted above, together with an additional requirement that "the insured's liability has become reasonably clear." *Rocor Int'l, Inc. v. Nat. Union Fire Ins. Co. of Pittsburgh, Pa.*, 77 S.W.3d 253, 262 (Tex. 2002). As under *Stowers*, the statutory standard requires that the insurer respond properly to an actual settlement demand, but does not obligate the insurer to initiate, solicit, or engage in give-and-take settlement negotiations. *Id.* at 261-62.

Since *Rocor*, courts readily recite that the statutory duty of §541.060(a)(2) equates to the *Stowers* standard, without further inquiry. *See Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 776 (Tex. 2007); *see also Pride Transportation v. Continental Cas. Co.*, 804 F. Supp.2d 520, 532 (N.D. Tex. 2011), *aff'd*, 511 F. App'x 347, 353-54 (5th Cir. 2013); *Martin v. State Farm Mutual Automobile Insurance Company*, No. 05-14-01473-CV, 2016 WL 1104878 (Tex. App.--Dallas Mar. 22, 2016, pet. denied) *citing Coats v. Ruiz*, 198 S.W.3d 863, 880 (Tex.App.-Dallas 2006, no pet.) (the "supreme court [has] held that an insurer owes its insured no common law duty of good faith and fair dealing to investigate and defend claims made by a third party against the insured.")

B. First-Party Insurance

A claim for breach of the policy is a "contract cause of action," while a bad-faith claim "is a cause of action that sounds in tort." *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663, 666 (Tex. 1995) (noting that a bad-faith claim is "distinct" from a suit for breach of the policy); *see also Viles v. Sec. Nat'l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990) ("[A] breach of the duty of good faith and fair dealing will give rise to a cause of action in tort that is separate from any cause of action for breach of the underlying insurance contract.").

1. Common-law bad faith

A common-law tort action for bad faith actions of an insurer is recognized in Texas. An insurer breaches its duty of good faith and fair dealing when "the insurer had no reasonable basis for denying or delaying payment of [a] claim, and [the insurer] knew or should have known that fact." *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex.1994) (superseded in part by statute, as recognized by *U-Haul Intern., Inc. v. Waldrip*, 380 S.W.3d 118, Tex. 2012); *see also Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210, 213 (Tex.1988). Evidence showing only a bona fide coverage dispute does not demonstrate that there was no reasonable basis for denying a claim, and therefore does not demonstrate bad faith. *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42, 44 (Tex.1998).

This standard for common-law bad faith was revised and expressed more clearly by reference to and adoption of the statutory bad faith standard: an insurer is liable for bad faith if the insurer knew or should have known that it was "reasonably clear" that the claim was covered. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 55-56 (Tex. 1997). Thus, the issue for establishing bad faith focuses not on whether the claim was valid, but on the reasonableness of the insurer's conduct in rejecting the claim. *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 601 (Tex.1993)

Whether the insurer had a "reasonable" basis is an objective standard, focusing on whether a reasonable insurer under the circumstances would have acted in a similar manner. *AIG Aviation, Inc. v. Holt Helicopters, Inc.*, 198 S.W.3d 276, 285 (Tex. App.- - San Antonio 2006, pet. denied) *citing Aranda v. Ins. Co. of North America*, 748 S.W.2d 210, 213 (Tex.1988). But an insurer cannot shield itself from bad faith liability by investigating a claim in a manner calculated to construct a pretextual basis for denying a claim. *See State Farm Lloyds v. Nicolau*, 951 S.W.2d 444, 448 (Tex.1997) (insurer's reliance on biased engineer's report was pretext for denying claim). The Court has clarified that the concept of a "pretextual"basis for denial or delay, is simply "another way of saying that there must be some evidence that there was no reasonable basis for denying the claim or that liability was reasonably clear." *Provident American Ins. Co. v. Castaneda*, 988 S.W.2d at 198 (Tex. 1998).

This enhanced common-law duty derives from a "special relationship" that is in contrast to the usual rule typically limiting an arms-length contract action to breach alone. The duty of an insurer to "deal fairly and in good faith with their insureds" is grounded in the recognition that

insurance policies are unique because of the inherently unequal bargaining power between the contracting parties where the insurer generally "has exclusive control over the evaluation, processing[,] and denial of claims," and it can easily use that control to take advantage of its insured. *Arnold v. Nat'l Cty. Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

2. Statutory Bad Faith

In addition to common-law bad faith, the Texas Insurance Code grants insureds a private action against insurers that engage in certain discriminatory, unfair, deceptive, or bad-faith practices. The statute permits insureds to recover “actual damages ... caused by” those practices, together with court costs and attorney's fees, plus up to treble damages if the insurer “knowingly” commits the prohibited act. §§541.151, .152,; *see also Tex. Mut. Ins. Co. v. Ruttiger*, 381 S.W.3d 430, 441 (Tex. 2012).

The Insurance Code establishes a "laundry list" of actions that comprise legislatively prohibited "Unfair Settlement Practices" as defined in §541.060:

(a) It is an unfair method of competition or an unfair or deceptive act or practice in the business of insurance to engage in the following unfair settlement practices with respect to a claim by an insured or beneficiary:

(1) misrepresenting to a claimant a material fact or policy provision relating to coverage at issue;

(2) failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of:

(A) a claim with respect to which the insurer's liability has become reasonably clear; or

(B) 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;

(3) failing to promptly provide to a policyholder a reasonable explanation of the basis in the policy, in relation to the facts or applicable law, for the insurer's denial of a claim or offer of a compromise settlement of a claim;

(4) failing within a reasonable time to:

(A) affirm or deny coverage of a claim to a policyholder; or

(B) submit a reservation of rights to a policyholder;

(5) 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;

(6) 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;

(7) refusing to pay a claim without conducting a reasonable investigation with respect to the claim;

(8) 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; or

(9) 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.

Even where the insurer violates the statute by acting in bad faith, however, liability ordinarily is limited to compensatory damages incurred by the policyholder as a result of the insurer's bad faith, together with court costs and attorneys fees. *See* §541.152. Upon a determination by the trier of fact that the insurer "knowingly" committed the act complained of, the trier of fact may award an amount not to exceed three times the amount of actual damages. *Id.*

3. Damages

A claim for bad-faith conduct that breaches the common-law duty "can potentially result in three types of damages: (1) benefit of the bargain damages for an accompanying breach of contract claim, (2) compensatory damages for the tort of bad faith, and (3) punitive damages for intentional, malicious, fraudulent, or grossly negligent conduct." *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex. 1994). "Actual damages" under the Insurance Code "are those damages recoverable at common law," *State Farm Life Ins. Co. v. Beaston*, 907 S.W.2d 430, 435 (Tex. 1995) (*citing Brown v. Am. Transfer & Storage Co.*, 601 S.W.2d 931, 939 (Tex. 1980).

a. Actual Damages - *USAA Texas Lloyds v Menchaca*

Within the last year, the Texas Supreme Court sought to clarify rules for determining actual damages in an insurance bad faith action; however, rehearing of that opinion was accepted in December 2017, and so it is not currently clear whether or to what extent the Court's guidance will change or remain intact. *USAA Texas Lloyds Co. v. Menchaca*, No. 14-0721, 2017 WL 1311752 (Tex. Apr. 7, 2017), *rehearing granted* December 17, 2017.

Menchaca directly addressed a perceived conflict created by its prior opinions, noted earlier by the Fifth Circuit in seeking guidance by certification in *In re Deepwater Horizon*, 807 F.3d 689, 697-98 (5th Cir. 2015). But that case settled before the Court could opine, so the certification was dismissed.

As identified by *Deepwater*, in *Vail v. Texas Farm Bureau Mutual Insurance Co.*, 754 S.W.2d 129 (Tex. 1988) the Court held that an insured who is wrongfully denied policy benefits *need not* show any injury independent from the denied policy benefits. [emphasis in *Deepwater's* citation] On the other hand, *Provident American Insurance Co. v. Castañeda*, 988 S.W.2d 189, 198-99 (Tex.1998) seemed to establish the opposite rule from *Vail*, that to maintain a Chapter 541 claim the policyholder is required to assert and provide evidence of some injury other than and independent from policy benefits and attorney's fees. Prior Fifth Circuit panels (and many Texas appellate courts) followed *Castaneda* rather than *Vail* and so imposed the independent injury rule. *Great American Ins. Co. v. AFS/IBEX Fin. Srvcs. Inc.*, 612 F.3d 800, 808 & n. 1 (5th Cir.2010); relying on *Parkans Int'l LLC v. Zurich Ins. Co.*, 299 F.3d 514, 519 (5th Cir.2002).

When the issue again was presented in *Menchaca*, the Court closely examined the supposedly conflicting cases, and determined that in fact the opinions that seemingly required independent injury did so because there was no proof asserted, or established, that coverage and policy benefits were owed by the insurer in the first place. So in the absence of policy benefit damages, of course the insured was required to show some other damages in order to proceed with a bad faith claim. But recognizing that its prior holdings had been unfortunately unclear on these points, the Court used the opportunity to confirm the continuing viability of *Vail* and to provide more explicit guidance by identifying 5 means of proving up bad faith damages.

1) The General Rule

The general rule is that an insured cannot recover policy benefits for an insurer's statutory violation if the insured does not have a right to those benefits under the policy. This rule derives from the fact that the Insurance Code only allows an insured to recover actual damages "caused by" the insurer's statutory violation. Thus, in a case where the policyholder asserts only damages under a claim of bad faith denial of policy benefits, that claim cannot succeed unless the claim for insurance benefits is actually covered.

2) The Entitled-to-Benefits Rule

The second rule is that an insured who establishes a right to receive benefits under an insurance policy can recover those benefits as "actual damages" under the statute if the insurer's statutory violation causes the loss of the benefits. Thus, where the insured acts in bad faith by unreasonably withholding policy benefits that are covered and should be paid, those damages can support and are recoverable in a bad faith cause of action.

3) The Benefits–Lost Rule

A third rule recognizes that an insured can recover benefits as actual damages under the Insurance Code even if the insured has no right to those benefits under the policy, if the insurer's conduct caused the insured to lose that contractual right. Examples of this principle are claims alleging that an insurer misrepresented a policy's coverage, waived its right to deny coverage or is estopped from doing so, or committed a violation that caused the insured to lose a contractual right to benefits that it otherwise would have had.

Under these sorts of circumstances, the insured may recover damages sustained because of the insurer's actions, even though the policy does not cover the loss. Or, the benefits-lost rule may apply when the insurer's statutory violation actually caused the policy not to cover losses that it otherwise would have covered.

4) The Independent–Injury Rule

The fourth rule derives from the fact that an insurer's extra-contractual liability is "distinct" from its liability for benefits under the insurance policy. There are two aspects to this independent injury rule (1) if an insurer's statutory violation causes an injury independent of the insured's right to recover policy benefits, the insured may recover damages for that injury even if the policy does not entitle the insured to receive benefits, and; (2) an insurer's statutory violation does not permit the insured to recover any damages beyond policy benefits unless the violation causes an injury that is independent from the loss of the benefits.

When an insured seeks to recover damages that "are predicated on," "flow from," or "stem from" policy benefits, the general rule applies and precludes recovery unless the policy entitles the insured to those benefits. The Court recognized that a successful independent-injury claim would be rare, and acknowledged that none has yet been successfully asserted.

5) The No–Recovery Rule

The fifth and final rule is simply the natural corollary to the first four rules: An insured cannot recover any damages based on an insurer's statutory violation unless the insured establishes a right to receive benefits under the policy or an injury independent of a right to benefits.

Despite the Court's effort to clarify these rules for recovering bad faith damages in relation to policy benefits, subsequent courts have had difficulty interpreting these guidelines and have reached conflicting results. The major problem lies with the underlying procedural facts in *Menchaca*, where the jury answered "no" to the question whether the insured could recover damages based on breach of the policy, but "yes" to the question whether the insured had incurred damage caused by the insurer's statutory violation. Although the *Menchaca* opinion strives to grapple with the related concepts of breach, coverage, and entitlement to policy benefits owed, it did not impose a ruling to affirm or reverse on these facts. Instead, the case was remanded for further proceedings, on the basis that the lack of clarity in prior precedents had caused both parties prejudicial confusion in their respective litigation decisions.

In particular, several courts have held that bad faith damages are unavailable where there is no concomitant finding that the insurer breached the policy. This approach has been especially frequent to excuse behavior of an insurer that ultimately pays the amount of an appraisal award, on the basis that acquiescence to appraisal is both a policy requirement and a favored alternative to litigation, so that policy benefits are not "owed" until an apprisal award is generated. *See* Elizabeth Von Kreisler and Suzette E. Selden, Annual Survey of Texas Insurance Law, 21 J. J. CONSUMER & COM. L. 54, 59-63 (Winter 2018) (in-depth article examining the conflicting cases).

Presumably, these difficulties of subsequent courts to clearly apply the principles enunciated by the Court is responsible for the highly unusual grant of rehearing of an essentially unanimous Court ruling in its *Menchaca* opinion in (Boyd, J. wrote for the entire Court, with Johnson, J. not participating). On rehearing the Court hopefully will resolve the residual confusion about the relationship of contractual breach of the policy as a necessary predicate, or not, to an insured's entitlement to receive policy benefits as damages caused by the insurer's bad faith.

b. Punitive and Multiplied Damages

Punitive damages may be awarded for common-law bad faith, but only when an insurer was actually aware that its actions involved an extreme risk-that is, a high probability of serious harm, such as death, grievous physical injury, or financial ruin-to its insured and was nevertheless consciously indifferent to its insured's rights, safety, or welfare. *Moriel* at 18 ("Only when accompanied by malicious, intentional, fraudulent, or grossly negligent conduct does bad faith justify punitive damages.")

Augmented liability for statutory bad faith, beyond compensatory damages, cannot be based on mere negligence or hindsight but must be based upon evidence that the Insurer was actually aware that it was handling the claim in a way that was false, deceptive, or unfair. *See Minnesota Life Ins. Co. v. Vasquez*, 192 S.W.3d 774, 779-80 (Tex. 2006). Pursuant to §541.002, such actual awareness "may be inferred if objective manifestations indicate that a person acted with actual awareness."

Only when the trier of fact finds that Insurer committed its bad faith "knowingly" may the policyholder potentially obtain an award - - determined by the trier of fact - - of up to three times the amount of actual damages. §541.152(c). The term "knowingly" is defined to mean "actual awareness of the falsity, unfairness, or deceptiveness of the [bad faith] act or practice" for which damages are sought. TEX. INS. CODE, §541.002.

The statute also provides for the insurer to recover court costs and reasonable and necessary attorney's fees against the policyholder, if the court finds that the statutory bad faith action is groundless and brought in bad faith or brought for the purpose of harassment. §541.153

III. Enhanced Pre-Judgment Interest under Prompt Payment of Claims Act

Another critical tool providing leverage for a policyholder is the enhanced pre-judgment interest available against an insurer who fails to meet the detailed timetable of the Prompt Payment of Claims Act (PPCA) statute, TEX. INS. CODE §§542.051 - 542.061. By its own terms, the statute "shall be liberally construed to promote the prompt payment of insurance claims." §542.054.

The PPCA applies to "claims" defined as a first-party claim that (A) is made by an insured or policyholder under an insurance policy or contract or by a beneficiary named in the policy or contract; and (B) must be paid by the insurer directly to the insured or beneficiary. §542.051.

To recover statutory interest under Chapter 542, an insured must establish three elements: (i) a claim under an insurance policy, (ii) for which the insurer is liable, and (iii) the insurer failed to follow one or more sections of Chapter 542 with respect to the claim. *GuideOne Lloyds Ins. Co. v. First Baptist Church of Bedford,* 268 S.W.3d 822, 830–31 (Tex.App.-Fort Worth 2008, no pet.) (addressing the predecessor statute, article 21.55 of the Insurance Code, which was repealed and re-codified as Chapter 542).

The insurer can be liable for PPCA damages even when it has a reasonable basis to deny coverage. *See Higginbotham v. State Farm Mut. Auto. Ins. Co.*, 103 F.3d 456, 461 (5th Cir. 1997) ("[The insurer] took a risk when it chose to reject [policyholder's] claim. [The insurer] lost when it was found liable for breach of contract. Therefore, it must pay this 18 percent per annum interest and reasonable attorneys' fees.")

A. Timetables established by PPCA

The PPCA establishes a timetable of 15 days (30 days for surplus lines) for the insurer to acknowledge a claim, begin its investigation, and ask the policyholder for reasonably necessary documents and information. § 542.055.

Not later than 15 days from receipt of all items, statements, and forms required by the insurer to secure final proof of loss, the insurer must notify a claimant in writing of the

acceptance or rejection of the claim. § 542.056(a). The insurer may provide this notification in 30 days if it reasonably believes the loss was caused by arson. § 542.056(b). If the insurer is unable to accept or reject the claim within the specified period, the insurer must within that period notify the claimant of the reasons that the insurer needs additional time; the insurer then must accept or reject the claim no later than 45 days from that notification. § 542.056(d). If the insurer rejects the claim, it must state its reasons within the required notification period. § 542.056(c).

If the insurer notifies the claimant that it will pay the claim, payment must be made no later than 5 days thereafter. § 542.057(a). Or if the payment is conditioned upon an action by the claimant, then payment must be 5 days from the date the act is performed. § 542.057(b). The payment deadline by an eligible surplus lines insurer is extended to 20 days. § 542.057(c).

After receiving all items, statements, and forms reasonably requested and required under Section 542.055, the insurer is liable for damages and attorneys fees if the insurer delays payment for more than 60 days. § 542.058(a). But this Subsection (a) does not apply where a claim is found by arbitration or litigation to be invalid and should not be paid by the insurer. § 542.058(b).

Special provision is made for life insurers faced with adverse, bona fide claims to avoid damages under the Act by filing an interpleader and tendering the benefits into the registry of the court not later than the 90 days after receipt of the reasonably requested and required information and documents. § 542.058(c). *See Prudential Ins. Co. v. Durante*, 443 S.W.3d 499, 512 (Tex. App.—El Paso 2014, pet. denied); *see also State Farm Life Insurance Co. v. Martinez*, 216 S.W.3d 799 (Tex. 2007) (decided prior to enactment of like-minded enabling provision §542.058(c)).

In the event of a weather-related catastrophe or major natural disaster, as defined by the commissioner, the claim-handling deadlines imposed under this subchapter are extended for an additional 15 days. §542.059. Additional specific provisions governing property damage claims arising from "forces of nature" were recently enacted under Chapter 542A, Certain Consumer Actions Related to Claims for Property Damage, § 542A.001 - § 542A.007 (effective September 1, 2017), but is outside the scope of this article.

B. Damages available for insurer's violation of PPCA requirements

If an insurer that is liable for a claim under an insurance policy is not in compliance with the PPCA subchapter, the insurer is liable to pay, in addition to the amount of the claim, interest on the amount of the claim at the rate of 18 percent a year as damages, together with reasonable and necessary attorney's fees. §542.060(a). The provision further provides that nothing in that subsection prevents the award of prejudgment interest on the amount of the claim, as provided by law. Attorneys' fees may also be recovered as costs for pursuing a claim for late payment under the statute. §542.060(b).

A newly enacted provision establishes a reduced interest rate for a claim under Chapter 542A (property damage from forces of nature) of simple interest on the amount of the claim as damages each year at the rate determined on the date of judgment by adding five percent to the interest rate determined under Section 304.003, Finance Code. §542.060(c).

The wording of the PPCA is somewhat confusing as to the type of violation that results in augmented damages. On the one hand, §542.058(a) seems to imply that the damages provision is applicable only when the insurer delays payment longer than 60 days after receiving all reasonably requested and required documentation and information, provided that the claim is not determined by rulings in arbitration or litigation to be invalid or that it should not be paid.

On the other hand, the wording of the damages provision itself is clearly far broader and refers to any non-compliance "with this subchapter". §542.060(a) The wording "this subchapter" must refer to Subchapter B of Chapter 542 of the Insurance Code, which comprises the entirety of the PPCA. This wording indicates that the PPCA damage provision should apply not only to the insurer's duty to timely pay the claim, but also for its failure to timely respond to a policyholders loss notification, investigate the claim, or meet any other deadlines or obligations specified in sections §542.055- 542.059 of the "this subchapter".

This broad interpretation is bolstered by the inclusion of a specific restriction included in the newly enacted interest awarded under this subsection as damages that accrues beginning on the date the claim was required to be paid as to Chapter 542A claims, stating that: "Interest awarded under this subsection as damages accrues beginning on the date the claim was required to be paid." §542.060(c). No such restriction is found in the general provision as to all other claims under §542.060(a).

Under standard rules of interpretation, then, the fact that §542.060(a) and §542.060(c) otherwise so closely mirror one another means that the restriction of §542.060(c) should not be inserted into §542.060(a) where no such a limitation is actually included. Ergo, the reasonable construction of §542.060(a) is that it extends to any non-compliance with the requirements of the PPCA and is not limited to the insurer's failure to pay, only.

The Fifth Circuit has clearly held that violation of any deadline under the PPCA begins accrual of statutory interest; accrual was not limited to only when insurer did not pay claim within the requisite number of days after receiving sufficient information upon which it could adjust the claim. *Cox Operating, L.L.C. v. St. Paul Surplus Lines Ins. Co.*, 795 F.3d 496, 509 (5th Cir. 2015):

> [T]he Texas Prompt Payment of Claims Act (1) imposes on insurers a series of claims-handling deadlines, §§ 542.055–.058; and (2) enforces those deadlines by requiring insurers who fail to comply with them (and who ultimately are liable on the claim) to pay statutory interest . . . violation of any of the Act's deadlines . . . begins the accrual of statutory interest.

See also Weiser-Brown Operating Co. v. St. Paul Surplus Lines Ins. Co., 801 F.3d 512, 519 (5th Cir. 2015); *GuideOne Lloyds Insurance Company v. First Baptist Church of Bedford*, 268 S.W.3d 822 (Tex.App.-Fort Worth 2008, no pet. 2008); *and see U.S. Fire Ins. Co. v. Lynd Co.*, 399 S.W.3d 206, 220-222 (Tex. App.--San Antonio 2012, pet. denied) ("any violation of Chapter 542 by [the insurer] triggers the statutory interest penalty.")

C. Accrual and termination of PPCA damages

The PPCA itself does not expressly state when the 18 percent penalty stops accruing. The Texas Supreme Court indicated that the interest runs "to the date of judgment", which the Fifth Circuit duly followed without independent analysis. *Great Am. Ins. Co. v. AFS/IBEX Fin. Servs., Inc.*, 612 F.3d 800, 809 (5th Cir. 2010), following *Republic Underwriters Ins. Co. v. Mex–Tex, Inc.*, 150 S.W.3d 423, 427–28 (Tex. 2004).

Adherence to this approach was criticized by a more recent Fifth Circuit panel, which noted that *Tex-Mex* does not appear to have considered the issue of when the penalty's accrual period ends, but that its passing statement for running statutory penalty "to the date of judgment" seems to have been simply a reference to an uncontested aspect of the trial court's judgment. *Lyda Swinerton Builders, Inc. v. Okla. Surety Co.*, 877 F.3d 600, 619 n. 8 (5th Cir. 2017).

Swinerton posited that allowing the penalty to accrue until the date the claim (or judgment) is actually paid, rather than adhering to the date of judgment, accords more fully with the purpose and wording of the PPCA to promote the prompt *payment* of insurance claims. *Id*, citing § 542.054 [emphasis in opinion]. *Swinerton* cited and seems clearly persuaded to the view of noted policyholder counsel Mark Kincaid that: "There is no rational basis nor any basis in the language of the statute for stopping the penalty on the date of judgment, when the violation is a failure to pay." *See* Mark L. Kincaid et al., Annual Survey of Texas Insurance Law, 19 J. CONSUMER & COM. L. 91, 97–98 (2016). Nonetheless, bound by the ruling of a prior Fifth Circuit panel, *Swinerton* had no choice but to follow the "accrue until judgment" rule established by *Great American*.

Having determined it must follow that rule, however, *Swinerton* went further and held that where an appeal is taken and the original judgment is reversed on appeal, it becomes a nullity as to those claims on which the reversal is based. 877 F.3d at 620. Consequently, if on remand the claimant prevails on its previously unsuccessful statutory bad faith claim, it would be entitled to the 18 percent penalty under the PPCA applied to the amount of those damages through the date of the new judgment. *Id.*

Several courts have held that where a contractual appraisal provision in the policy is timely invoked, the period for appraisal tolls the deadline for payment under the PPCA until an appraisal amount is determined. *See e.g. Gusma Props., L.P. v. Travelers Lloyds Ins. Co.*, 514 S.W.3d 319, 329-31 (Tex. App.-Houston [14th Dist.] 2016, no pet.); *citing Breshears v. State Farm Lloyds*, 155 S.W.3d 340, 345 (Tex. App.–Corpus Christi 2004, pet. denied) (mem. op.) (rejecting the policyholders' argument that "because of the appraisal process, they were not

actually paid until after State Farm paid them the difference between the first payment and the appraisal award, which occurred long after the sixty-day statutory limit"); *accord In re Slavonic Mut. Fire Ins. Ass'n,* 308 S.W.3d 556, 563–64 (Tex. App.–Houston [14th Dist.] 2010, orig. proceeding) (listing cases that support the proposition that "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").

These cases seem to reach this conclusion based on the sense that the appraisal process is favored by courts and imposed by the policy, so the insurer does not breach its contractual duties by awaiting the conclusion of appraisal to determine the amount to be paid. But the factors needed for PPCA entitlement do not require beach of contract by the insurer, only (i) a claim under an insurance policy, (ii) for which the insurer is liable, and (iii) the insurer failed to follow one or more sections of Chapter 542 with respect to the claim. *GuideOne Lloyds Ins. Co.*, supra, 268 S.W.3d at 830–31.

Nor do any of these opinions adequately address why the policyholder should not be entitled to late payment interest where the insurer chooses to dispute the amount due under the policy and the appraisal award is less than the insurer's estimate. Under the widely accepted *Higginbotham* rule the insurer takes the risk of paying augmented PPCA damages when it chooses not to pay as required by the policy. 103 F.3d at 461 ("A wrongful rejection of a claim may be considered a delay in payment for purposes of the 60-day rule and statutory damages. More specifically, if an insurer fails to pay a claim, it runs the risk of incurring this 18 percent statutory fee and reasonable attorneys' fees.") While appraisal may well serve good purposes in general, why should the insurer benefit by avoiding PPCA consequences, when an appraisal award proves that the insurer undervalued the claim when it refused to pay the full amount sought by the policyholder?

Furthermore, even if delay for appraisal might conceivably excuse an insurer's violation of the timetable for paying a claim, appraisal does not have any obvious connection to the insurer's liability for failing to meet other requirements such as timely acknowledging the claim, requesting documentation, or providing a coverage decision. Where violations of the PPCA unrelated to timely payment are involved, there seems no good rationale for excusing those violations and tolling application of the PPCA simply because the insurer seeks appraisal of the amount owed.

D. PPCA applies to wrongful denial of duty to defend

In addition to amounts owed under a normal first-party policy, a "claim" under the PPCA includes defense fees owed to the policyholder under a third-party liability policy. *Lamar Homes, Inc. v. Mid-Continent Cas. Co.,* 242 S.W.3d 1, 16 ff. (Tex. 2007). Defense fees are considered "first party" claims because the amount is payable directly to the policyholder as claimant, and not indirectly on behalf of the policyholder's for its liability to a third-party claimant.

An insurer's liability under the PPCA is established when it wrongfully rejects its defense obligation. The policyholder is not necessarily required to submit defense invoices for payment

to an insurer that has rejected its duty to defend, in order to accrue PPCA interest damages. But the generally accepted rule seems to be that attorney's fees are not awarded, and prejudgment interest does not begin accruing, until the policyholder actually incurs the defense costs and provides evidence to the insurer of the dates and amounts of its defense costs. *See Trammell Crow Residential Co. v. Virginia Sur. Co., Inc.*, 643 F.Supp.2d 844 (N.D.Tex. 2008) (citing the principle enunciated in *Primrose Operating Co. v. National American Insurance Co.*, 382 F.3d 546, 565 (5th Cir. 2004) that standard prejudgment interest should be assessed against the insurer based on the dates that underlying plaintiff paid each bill for attorney's fees rather than the date the insurer first refused to defend.)

On the other hand, the PPCA does not apply to payments owed by an insurer to reimburse the policyholder for monies it paid to a third-party claimant in settlement of a claim, even when the insurer's wrongful denial of coverage required the policyholder to use its own funds for settlement, and even though reimbursement is therefore owed directly to the policyholder. *Evanston Ins. Co. v. ATOFINA Petrochemicals, Inc.*, 256 S.W.3d 660, 674-75 (Tex. 2008).