ARE YOU IN GOOD HANDS? WHETHER BAD FAITH ACTIONS FOR WRONGFUL DENIALS OF UNINSURED AND UNDERINSURED MOTORIST CLAIMS STILL EXIST IN TEXAS

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I. INTRODUCTION

Consider the following scenario: Suzy is a middle-aged adult and has been paying for uninsured motorist and underinsured motorist ("UM/UIM") insurance coverage for several decades. One night as Suzy is leaving work, she pulls up to the red light. The light turns green and she pulls ahead. Another motorist runs the red light and collides with Suzy, totaling her car and injuring Suzy. Suzy calls the police, and the negligent motorist admits to the officer that he ran the red light and also acknowledges that he does not have insurance. The officer writes a police report, identifying the uninsured motorist as "at fault."

After recovering from initial medical injuries, Suzy files a claim with her insurance company for the uninsured motorist ("UM") coverage. Suzy, like millions of Texas drivers, relies on her UM coverage to protect her against uninsured motorists. This coverage appears to be a wise investment. After all, it is estimated that one in five vehicles is uninsured,[1] and Texas drivers pay an estimated $1 billion a year to protect themselves from these uninsured drivers.[2] However, as Suzy will see, the value of her UM/UIM coverage, as well as the $1 billion Texans spend on UM/UIM coverage, is now nebulous at best.

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[1] TexasSure Vehicle Insurance Information – Frequently Asked General Information Questions, Texas Department of Insurance, http://www.texassure.com/faqGI.html (last visited Nov. 24, 2013)

[2] Terrence Stutz, *Number of Uninsured Drivers on Texas Roads Drops Sharply*, Dal. Morning News, July 2, 2012, *available at* http://www.dallasnews.com/news/state/headlines/20120702-number-of-uninsured-drivers-on-texas-roads-drops-sharply.ece.

When the insurance company receives Suzy's claim, it is aware of something that Suzy is not. Suzy's insurance company knows the Texas Supreme Court in *Brainard v. Trinity Universal Insurance Company* recently held that it is under *no* contractual obligation to pay Suzy's UM claim until Suzy obtains a judgment in court establishing the liability of the UM motorist.[3] Neither a police report, a settlement with the UM motorist, nor even an admission of liability from the UM motorist is sufficient to trigger the insurance company's contractual obligation to pay Suzy's claim.[4] Because Suzy's insurance company knows about the *Brainard* holding, Suzy's insurance company denies Suzy's UM claim without reviewing any aspect of it.

Suzy is outraged and believes her insurance company acted in bad faith by denying her UM claim; she believes her insurer's obligation to pay is "reasonably clear" given the police report and admission of liability from the hit-and-run motorist. While Texas law recognizes a cause of action for an insurance company's "bad faith" refusal to settle a claim when its obligation to pay is "reasonably clear,"[5] the recent *Brainard* opinion draws into question whether Suzy's insurance company may be sued for bad faith.[6]

Courts have reached different conclusions on whether bad faith claims may still be brought against insurance companies for wrongful denials of UM/UIM claims.[7] In *Brainard* the Texas Supreme Court emphasized the unique status of UM/UIM insurance.[8] But how unique is UM/UIM insurance from any other insurance? Is it unique enough to be exempt from any bad-faith actions?

[3] 216 S.W.3d 809, 818 (Tex. 2006) (emphasis added).

[4] *See id.*

[5] For a statutory cause of action, *see* TEX. INS. CODE ANN. § 541.060(a)(1)(A) (West 2009) (imposing liability for an insurer's failure "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). For a common-law cause of action for an insurer's breach of this good faith, *see* Viles v. Sec. Nat'l Ins. Co., 788 S.W.2d 566, 567 (Tex. 1990).

[6] 216 S.W.3d at 818.

[7] *Compare* Weir v. Twin City Fire Ins. Co., 622 F. Supp. 2d 483, 486 (S.D. Tex. 2009), *with* Accardo v. Am. First Lloyds Ins. Co., No. CIV.A. H-11-0008, 2012 WL 1576022, at *5 (S.D. Tex. May 3, 2012).

[8] 216 S.W.3d at 818.

To answer these questions, this article will delve into what exactly UM/UIM insurance actually is.[9] This article will address how UM/UIM insurance developed nationally, as well as within Texas.[10] Further, the development of bad-faith claims, specifically in the context of UM/UIM insurance claims, will be covered.[11] This paper will outline the history of the law for bad-faith claims for UM/UIM insurance claims in Texas, particularly Fifth Circuit cases interpreting Texas law, and will summarize the current state of the law on this issue.[12] Finally, this article will cover the practical implications of the current uncertainty over bad-faith litigation in Texas, as well as opine on what the correct interpretation of the law is at this time.[13]

II. DEVELOPMENT OF UM/UIM INSURANCE

A. General History

In order to understand how courts have analyzed UM/UIM cases, it is helpful to cover its origins. When automobiles were first invented, they were a scarce commodity, so there was not much public concern about uninsured drivers and the damage they could inflict.[14] However, as the number of vehicles increased, uninsured motorists became a considerable problem.[15] The legislatures of most jurisdictions responded by drafting laws addressing the problem.[16]

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[9] *See infra* Part III.

[10] *See infra* Part II.

[11] *See infra* Part IV.

[12] *See infra* Parts IV–V.

[13] *See infra* Part VI.

[14] COUCH ON INS. 3D § 122:1.

[15] *See id.*; While there were some laws to protect motorists from vehicular accidents as cars became more prevalent:

> [I]t became clear to state authorities that the [such laws] had not completely solved the problems of numerous victims of financially irresponsible motorists. This was the case in three main areas: (1) where there was no policy in existence, (2) where coverage was not available under an existing policy by reason of exclusions or policy breaches, and (3) where the tortfeasor was an unidentifiable hit and run motorist.

IRVIN E. SCHERMER & WILLIAM J. SCHERMER, 2 Auto. Liability Ins. 4th § 19:1.

[16] *See* Mary G. Leary, 81 Am. Jur. *Trials* § 74 (2001) (stating that by 1978, forty-seven states had enacted some form of uninsured motorist legislation).

While the statutes in various jurisdictions differ,[17] what the statutes all have in common is a design to protect persons covered by insurance for claims against an uninsured tortfeasor and persons not otherwise covered by insurance for claims against an uninsured tortfeasor.[18] The stated purposes in most jurisdictions are both social and economic and reflect the public policy that the public should be protected for loss, damages, and injuries sustained as a result of the torts of financially irresponsible motorists.[19] This response has generally been three-pronged: (1) requirements that all or specified owners and/or drivers obtain liability insurance, drastically reducing the number of uninsured motorists;[20] (2) the introduction of a new kind of insurance, "uninsured motorist" insurance, under which the victim's own insurer paid the victim the amounts that the victim would have been able to collect from the person at fault in the accident if that person had been insured; and (3) state "indemnification" funds to compensate victims in accidents caused by persons who still do not carry liability insurance when the victim is not covered under an uninsured motorist insurance policy.[21]

As experience with uninsured motorist insurance developed, it became obvious that the original concept was limited and gave unsatisfactory results in a number of situations.[22] The existence of any insurance, for example, even though the insurance was less than the required minimum limits, extinguished the victim's uninsured motorist coverage.[23] The courts uniformly refused to hold that an "underinsured" motorist was also an uninsured motorist, even though an insured would have been much better off had the tortfeasor been totally uninsured.[24] Therefore, underinsured motorist coverage also developed.[25]

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[17] COUCH, *supra* note 14.

[18] *Id.*

[19] *Id.*

[20] As to these requirements, *see* Couch on Ins. 3d § 109:3. *See also* Nelson v. Progressive Cas. Ins. Co., 162 P.3d 1228, 1231 (Alaska 2007); Tapp v. Perciful, 120 P.3d 480, 483 (Okla. 2005); Kay v. State Farm Mut. Auto. Ins. Co., 562 S.E.2d 676, 678 (S.C. Ct. App. 2002); Eaquinta v. Allstate Ins. Co., 125 P.3d 901, 903 (Utah 2005); Salamon v. Progressive Classic Ins. Co., 841 A.2d 858, 864–65 (Md. 2004).

[21] COUCH, *supra* note 14.

[22] IRVIN E. SCHERMER & WILLIAM J. SCHERMER, 3 Auto. Liability Ins. 4th § 38:1.

[23] *Id.*

[24] *See, e.g.*, State Farm Mut. Auto. Ins. Co. v. Hallowell, 426 A.2d 822, 825 (Del. 1980), *superseded by statute*, 63 Del. Laws Ch. 243, § 1 (1982), *as recognized in*, Friends of H. Fletcher Brown Mansion v. City of Wilmington, 34 A.3d 1055, 1060 n.21 (Del. 2011), *and* Home Ins. Co.

B. UM/UIM Insurance in Texas

In Texas, UM/UIM insurance was created to protect responsible drivers from irresponsible drivers, who either do not buy insurance at all, or do not have sufficient insurance to cover damages they have caused.[26] Insurance Code Article 5.06-1 was originally enacted in 1967 to provide uninsured motorist protection, and it was amended in 1977 to add underinsured motorist coverage.[27] The original purpose of the statute was to protect conscientious motorists from "financial loss caused by negligent financially irresponsible motorists."[28]

The Texas Insurance Code mandates that every automobile policy sold in Texas contain at least minimal UM/UIM coverage.[29] Uninsured coverage typically provides coverage for accidents involving: (i) motorists who have no insurance; (ii) hit-and-run accidents; and (iii) motorists who have insurance, but their carrier denies coverage or has become insolvent.[30] Underinsured coverage provides insurance for accidents involving a negligent motorist who is covered under an automobile liability policy, but the limits are too low to fully compensate for actual damages incurred.[31] According to the statute, an "underinsured motor vehicle" means an insured motor vehicle on which there is valid and collectible liability insurance with limits of liability for the owner or operator which were: (i) originally lower than, or (ii) have been reduced by payment of claims arising from the same accident to an amount less than the limit of liability stated in the underinsured coverage of the injured insured's policy.[32] The purpose of UM/UIM coverage is to place the injured party in the same position as if the uninsured/underinsured motorist had been properly insured.[33]

v. Maldonado, 515 A.2d 690, 696 n.9 (Del. 1986), *and* State Farm Mut. Auto. Ins. Co. v. Arms, 477 A.2d 1060, 1064 (Del. 1984); State Farm Mut. Auto. Ins. Co. v. Eden, 666 P.2d 1069, 1072 (Ariz. 1983).

[25] SCHERMER, *supra* note 22.

[26] James L. Cornell & John H. Thomisee Jr., *Uninsured/Underinsured Motorist Coverage*, 62 Tex. B.J. 342, 343 (1999).

[27] *Id.*

[28] Act of Oct. 1, 1967, 65th Leg., 1st C.S., ch. 202, § 3, 1967 Tex. Gen. Laws 448, 449.

[29] TEX. INS. CODE ANN. § 1952.101 (West 2009).

[30] Cornell, *supra* note 26, at 343.

[31] *Id.*

[32] TEX. INS. CODE ANN. § 1952.103 (West 2009).

[33] Sikes v. Zuloaga, 830 S.W.2d 752, 753 (Tex. App.—Austin 1992, no writ).

III. ESTABLISHING A CLAIM FOR PAYMENT UNDER A UM/UIM POLICY

To understand when an insured is lawfully entitled to havea UM/UIM claim paid, an insured must understand some unique legal principles of UM/UIM insurance contracts. Uninsured motorist coverage is not liability insurance;[34] rather, it resembles limited accident insurance or an indemnity contract[35] and provides direct compensation to the insured, who is injured by an at-fault, uninsured, or underinsured motorist.[36]

A claim for UM/UIM coverage is typically paid when an insured is "legally entitled to recover" from the owner or operator of the uninsured or underinsured vehicle.[37] Under most circumstances, the "legally entitled to recover" requirement will apply when the tortfeasor is known but is uninsured or underinsured.[38] If the tortfeasor is unknown, the insured will only be able to establish the legal right to recover from that unknown person for purposes of UM/UIM coverage if the particular jurisdiction provides for bringing "John Doe" actions.[39] "Legally entitled to recover" refers to issues of fault,[40] which is determined by the application of legal principles,[41] and normally, "legally entitled to recover" requires the

[34] Mau v. N.D. Ins. Reserve Fund, 637 N.W.2d 45, 54 (Wis. 2001).

[35] Wagner v. Nationwide Mut. Fire Ins. Co., 653 S.E.2d 526, 527–28 (Ga. Ct. App. 2007); State Farm Mut. Auto. Ins. Co. v. D'Angelo, 875 N.E.2d 789, 799 (Ind. Ct. App. 2007); Broadway Clinic v. Liberty Mut. Ins. Co., 139 P.3d 873, 877 (Okla. 2006); Jankowiak v. Allstate Prop. & Cas. Ins. Co., 201 S.W.3d 200, 212 (Tex. App.—Houston [14th Dist.] 2006); *Mau*, 637 N.W.2d at 54.

[36] Terranova v. State Farm Mut. Auto. Ins. Co., 800 P.2d 58, 61 (Colo. 1990); Greenfield v. Cincinnati Ins. Co., 737 N.W.2d 112, 118 (Iowa 2007); Dyer v. Providian Auto & Home Ins. Co., 242 S.W.3d 654, 656 (Ky. Ct. App. 2007) (quoting Preferred Risk Mut. Ins. Co. v. Oliver, 551 S.W.2d 574, 577 (Ky. 1977)); Johnson v. Gov't Emps. Ins. Co., 980 So.2d 870, 873–74 (La. Ct. App. 2008) (quoting Duncan v. U.S.A.A. Ins. Co., 950 So.2d 544, 547 (La. 2006)); Erie Ins. Exch. v. Heffernan, 925 A.2d 636, 644 (Md. 2007).

[37] *See* Molleur v. Dairyland Ins. Co., 942 A.2d 1197, 1202 (Me. 2008); Spencer v. State Farm Mut. Ins. Co., 891 So.2d 827, 830 (Miss. 2005); Hanson v. Emp'rs Mut. Cas. Co., 336 F. Supp. 2d 1070, 1076 (D. Mont. 2004); Elgar v. Nat'l Cont'l/Progressive Ins. Co., 849 A.2d 324, 328 (R.I. 2004).

[38] COUCH ON INS. 3D § 123:14.

[39] *Id.* In Texas UM insurance covers hit-and-run accidents. Cornell, *supra* note 26, at 345.

[40] Walker v. Commercial Union Ins. Co., 879 S.W.2d 596, 598 (Mo. Ct. App. 1994); Kalhar v. Transamerica Ins. Co., 877 P.2d 656, 659 (Or. Ct. App. 1994); Vega v. Farmers Ins. Co. of Or., 895 P.2d 337, 342 (Or. Ct. App. 1995), *aff'd*, 918 P.2d 95 (1996); COUCH, *supra* note 38.

[41] *See* Williams v. State Farm Mut. Auto. Ins. Co., 641 A.2d 783, 787 (Conn. 1994); U.S. Fidelity and Guar. Co. v. Hutchinson, 710 A.2d 1343, 1347 (Conn. 1998); United Nat. Ins. Co. v. DePrizio, 705 N.E.2d 455, 458 (Ind. 1999); Hoffman v. Yellow Cab Co. of Louisville, 57 S.W.3d

claimant and the tortfeasor to be of the proper class of persons in accordance with the terms of the statute (i.e., the claimant must be an insured under the policy, and the tortfeasor must fall within the definition of an uninsured or underinsured motorist).[42] Also, the claimant must show the injuries arose out of the operation of a motor vehicle as defined in the statute.[43] The "legally entitled to recover" provisions of the policy must also meticulously detail any additional exceptions or requirements which the mandatory UM or UIM statutes may specify, or else the insurer may be deemed to have voluntarily provided greater benefits than was required by the statute.[44] If there is any ambiguity in whether an insured is "legally entitled to recover," courts have interpreted the operative language of underinsured motorist (UIM) statute to be resolved in favor of injured insureds.[45]

IV. DEVELOPMENT OF BAD FAITH CLAIMS AGAINST INSURANCE COMPANIES FOR FAILURE TO PAY ON A UM/UIM POLICY

A. Overview

Until recently, insurers, whose unreasonable refusal to pay a valid claim forced the insured to unnecessarily litigate the claim, were not generally

257, 259 (Ky. 2001); Antley v. Nobel Ins. Co., 567 S.E.2d 872, 875 (S.C. Ct. App. 2002), *overruled on other grounds by* Sweetser v. S. C. Dept. of Ins. Reserve Fund, 703 S.E.2d 509 (S.C. 2010); COUCH, *supra* note 38.

[42] *See Williams*, 641 A.2d at 787; *Hutchinson*, 710 A.2d at 1347; *DePrizio*, 705 N.E.2d at 458; *Hoffman*, 57 S.W.3d at 259; *Antley*, 567 S.E.2d at 875; COUCH, *supra* note 38. As to classifications, generally, *see* COUCH ON INS. 3D § 123:4.

[43] State Farm Mut. Auto. Ins. Co. v. Wilson, 782 P.2d 727, 728 (Ariz. 1989); COUCH, *supra* note 38. *See also* Progressive Cas. Ins. Co. v. Ferguson, 134 F. Supp. 2d 1159, 1164 (D. Haw. 2001); Berg v. Liberty Mut. Ins. Co., 319 F. Supp. 2d 933, 934 (N.D. Iowa 2004); Carrier v. Reliance Ins. Co., 759 So.2d 37, 39 (La. 2000); Lundy v. Aetna Cas. & Sur. Co., 458 A.2d 106, 108 (N.J. 1983) (further stating that automobile liability policy must provide not only coverage for liability related to the insured vehicle, but also coverage to the insured person for injuries caused by an uninsured automobile).

[44] *See, e.g.*, Pollard v. Williams, 623 So.2d 588, 589 (Fla. Dist. Ct. App. 1993); Molleur v. Dairyland Ins. Co., 942 A.2d 1197, 1201 (Me. 2008) (any ambiguity in "legally entitled to recover," the operative language of underinsured motorist (UIM) statute, is to be resolved in favor of injured insureds); Fox v. Country Mut. Ins. Co., 964 P.2d 997, 1001 (Or. 1998); COUCH, *supra* note 38. As to the permissibility of broadening the statutory requirements, *see* COUCH ON INS. 3D § 122:32.

[45] *Molleur*, 942 A.2d at 1201.

subjected to tort liability for damages.[46] However, tort concepts have emerged within the past few decades under which insurers may be called to account for overly sharp claims practices which compel the insured to resort to litigation to recover insurance benefits that should have been made available without dispute.[47]

A majority of states have adopted the concept that an insurer owes a duty of good faith and fair dealing to its insured.[48] Thus far, Alabama,[49] Alaska,[50] Arkansas,[51] Arizona,[52] California,[53] Indiana,[54] Iowa,[55] Louisiana,[56] Mississippi,[57] New Mexico,[58] Ohio,[59] Rhode Island,[60] South Dakota,[61] Tennessee,[62] Texas,[63] Utah,[64] and Washington[65] courts have held that an

[46] IRVIN E. SCHERMER & WILLIAM J. SCHERMER, 3 AUTO. LIABILITY INS. 4th § 36:1. An exception was sometimes made where an unjustified refusal to pay was accompanied by or amounted to an independent tort. *See* Stetz v. Am. Cas. Co. of Reading, Pa., 368 So.2d 912, 913 (Fla. Dist. Ct. App. 1979); Wallace v. Prudential Ins. Co. of Am., 299 N.E.2d 344, 349 (Ill. App. Ct. 1973). An example of an independent tort is the alteration of the terms of an oral agreement for coverage when reduced to writing by the insurer. *See* Exp. Ins. Co. v. Herrera, 426 S.W.2d 895, 900 (Tex. Civ. App.—Corpus Christi 1968, writ ref'd n.r.e.).

[47] SCHERMER, *supra* note 46..

[48] Bob G. Freemon, Jr., *Reasonable and Foreseeable Damages for Breach of an Insurance Contract*, 21 TORT & INS. L.J. 108, 108 (1985).

[49] Pitts v. Boody, 688 So.2d 832, 835 (Ala. Civ. App. 1996).

[50] United Servs. Auto. Ass'n v. Werley, 526 P.2d 28, 33 (Alaska 1974) (insurer's file discoverable).

[51] Shepherd v. State Auto Prop. & Cas. Ins. Co., 850 S.W.2d 324, 329–30 (Ark. 1993) (Applying state statute subjecting insurer to 12% penalty for bad faith failure to pay for an insured loss within the time specified in the policy).

[52] Deese v. State Farm Mut. Auto. Ins. Co., 838 P.2d 1265, 1268 (Ariz. 1992).

[53] Neal v. Farmers Ins. Exch., 582 P.2d 980, 985 (Cal. 1978).

[54] Erie Ins. Co. v. Smith ex rel. Hickman, 622 N.E.2d 515, 518 (Ind. 1993).

[55] Reuter v. State Farm Mut. Auto. Ins. Co., Inc., 469 N.W.2d 250, 253 (Iowa 1991).

[56] Palombo v. Broussard, 370 So.2d 216, 219 (La. Ct. App. 1979).

[57] Emp'rs Mut. Cas. Co. v. Tompkins, 490 So.2d 897, 906 (Miss. 1986) (allowing punitive damages where bad faith refusal to pay a UM claim constituted an independent tort).

[58] Hendren v. Allstate Ins. Co., 672 P.2d 1137, 1141 (N.M. Ct. App. 1983).

[59] Pizzino v. Lightning Rod Mut. Ins. Co., 638 N.E.2d 146, 151 (Ohio Ct. App. 1994).

[60] Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980).

[61] *See* Isaac v. State Farm Mut. Auto. Ins. Co., 522 N.W.2d 752, 758 (S.D. 1994); Stoner v. State Farm Mut. Auto. Ins. Co., 780 F.2d 1414, 1418 (8th Cir. 1986) (applying South Dakota law).

[62] MFA Mut. Ins. Co. v. Flint, 574 S.W.2d 718, 721 (Tenn. 1978) (release set aside; bad faith found in failing to inform settling insured of the extent of coverage available).

[63] Arnold v. Nat'l Cnty. Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987).

uninsured motorist carrier owes a duty of good faith to an insured in the handling and settlement of uninsured motorist claims, and that a breach of this duty permits the recovery of extra-contractual damages or other types of relief. It is important to understand the remedies recoverable from a breach of that duty, and the type of damages sustained by an insured for a breach of the duty of good faith and fair dealing in tort are distinct from those recoverable for breach of contract.[66] For a breach of good faith and fair dealing, a court may award compensatory,[67] consequential,[68] and punitive[69] damages.[70]

[64] Beck v. Farmers Ins. Exch., 701 P.2d 795, 799 (Utah 1985) (holding that duty of good faith sounded in contract, but not tort), *overruling* Lyon v. Hartford Acc. & Indem. Co., 480 P.2d 739 (Utah 1971).

[65] Escalante v. Sentry Ins., 743 P.2d 832, 838 (Wash. Ct. App. 1987), *disapproved of by* Ellwein v. Hartford Acc. & Indem. Co., 15 P.3d 640, 647 (Wash. 2001) (stating that the extent of the duty of good faith in UM/UIM cases is no greater than those for first party insurance coverage), *and* In re of Azula, 104 Wash. App. 1038 (2001).

[66] Douglas R. Richmond, *An Overview of Insurance Bad Faith Law and Litigation*, 25 SETON HALL L. REV. 74, 79 (1994). Richmond states:

> Were an insurer's duty of good faith purely contractual, an insured's recovery generally would be limited to those damages necessary to restore him to the position he would have occupied had the promise been performed, i.e., the "benefit of the bargain." Such limited damages would do nothing to deter predatory or unscrupulous insurers, inasmuch as their liability would always be tied to policy limits.

Id. (citing Bibeault v. Hanover Ins. Co., 417 A.2d 313, 318 (R.I. 1980) and explaining the need for a tort remedy to replace unsatisfactory contract remedies). *See also* Lyons v. Millers Cas. Ins. Co. of Tex., 866 S.W.2d 597, 600–01 (Tex. 1993) (stating "[T]he issue in bad faith focuses not on whether the claim was valid, but on the reasonableness of the insurer's conduct in rejecting the claim"); Richmond, *supra* at 109 (stating that "the unreasonableness of the insurer's conduct is the essence of this tort") (citing Alsobrook v. Nat'l Travelers Life Ins. Co., 852 P.2d 768, 770 (Okla. Civ. App. 1992)); Jay D. Reeve, Note, *Judicial Tort Reform: Bad Faith Cannot Be Predicated Upon the Denial of A Claim for an Invalid Reason If A Valid Reason Is Later Shown: Republic Insurance Co. v. Stoker*, 903 S.W. 2d 338 (Tex. 1995), 27 TEX. TECH L. REV. 351, 378 (1996).

[67] For decisions permitting the recovery of compensatory damages, *see, e.g.*, Hoffman v. Allstate Ins. Co., 407 N.E.2d 156, 159 (Ill. App. Ct. 1980); Olson v. Rugloski, 277 N.W.2d 385, 388 (Minn. 1979); Mann v. Glens Falls Ins. Co., 418 F. Supp. 237, 248–49 (D. Nev. 1974), *rev'd on other grounds*, 541 F.2d 819 (9th Cir. 1976).

[68] Phillips v. Aetna Life Ins. Co., 473 F. Supp. 984, 990 (D. Vt. 1979). Contractual liability has been held to include reasonably foreseeable consequential damages such as pain and suffering and harm to health. *E.g.*, Wilkins v. Grays Harbor Cmty. Hosp., 427 P.2d 716, 721–22 (Wash. 1967); *cf.* Standard Fire Ins. Co. v. Fraiman, 588 S.W.2d 681, 683–84 (Tex. Civ. App.—Houston [14th Dist.] 1979, writ ref'd n.r.e.) (preventing recovery of consequential damages for breach of

B. Texas Case Law Development of Bad Faith Claims Against Insurance Companies for Failure to Pay UM/UIM Policies

Texas, like other jurisdictions, has recognized a duty to pay on UM/UIM claims when liability is "reasonably clear."[71] However, the Texas Supreme Court has significantly limited the scope of an insurer's duty to act in good faith and fair dealing, and with recent dicta in *Brainard*, it is uncertain whether an insured can even still bring a claim against an insurance company for acting in bad faith by not paying on a UM/UIM policy.[72]

1) *Arnold v. National County Mutual Fire Insurance Co.*

The Texas Supreme Court first recognized a common-law tort duty of good faith and fair dealing for UM/UIM claims in *Arnold v. National County Mutual Fire Insurance Co*.[73] In *Arnold*, the plaintiff was injured by an uninsured motorist while riding his motorcycle and subsequently filed a UM claim with his insurer.[74] An independent insurance adjusting firm advised the insurer to pay the policy limit for this claim.[75] The insurer chose to deny the claim even though it never conducted an investigation of the claim because it believed that a jury would have biases against motorcyclists and that the insured was speeding and intoxicated at the time of the accident.[76] The plaintiff brought statutory causes of action through the Texas Deceptive Trade Practices Act ("DTPA") and the then-existing Texas insurance code, as well as on the theory of a common-law breach of duty of good faith and fair dealing.[77] The trial court granted summary

fire insurance contract absent bad faith or statute, but allowing consequential damages for breach of a procedural appraisal provision).

[69] Recovery for punitive damages has been permitted in Texas, as well as other jurisdictions. *See* Exp. Ins. Co. v. Herrera, 426 S.W.2d 895, 900 (Tex. Civ. App.—Corpus Christi 1968, writ ref'd n.r.e.). For other jurisdictions, *see, e.g.*, *Phillips*, 473 F. Supp. at 990; *Bibeault*, 417 A.2d at 319.

[70] *See, e.g.*, Sweet v. Grange Mut. Cas. Co., 364 N.E.2d 38, 42 (Ohio Ct. App. 1975) (collision coverage).

[71] Arnold v. Nat'l Cnty. Mut. Fire Ins. Co., 725 S.W.2d 165, 167–68 (Tex. 1987).

[72] Brainard v. Trinity Universal Ins. Co., 216 S.W.3d 809, 818 (Tex. 2006)

[73] 725 S.W.2d at 167.

[74] *Id.* at 166.

[75] *Id.*

[76] *Id.*

[77] *Id.* at 167.

judgment in favor of the insurer on all claims.[78] This decision was affirmed by the court of appeals.[79]

While the Texas Supreme Court agreed that the then-existing insurance code barred the plaintiff's statutory claims, the Court, for the first time, recognized a duty of good faith and fair dealing for insurers in dealing with first-party insurance claims.[80] The *Arnold* court also announced in dicta that the same principles allowing recovery of exemplary and mental damages in other tort actions would govern the recovery of those damages in first-party cases over an insurer's bad faith.[81] The Court established that a plaintiff would sufficiently plead this cause of action where he established: (1) there must be no reasonable basis for the denial of a claim or delay in payment; or (2) the insurer must fail to determine whether there is any reasonable basis for the denial or delay.[82] The Court specifically emphasized that this duty was founded in tort, not an implied covenant for contracts.[83]

2) *Mid-Century Insurance Co. of Texas v. Boyte*

The Texas Supreme Court clarified the scope of an insurer's good faith duty in *Mid-Century Insurance Co. of Texas v. Boyte*.[84] In *Mid-Century*, an insured brought a bad-faith action against his insurance company when the insurance company refused to pay UM/UIM benefits after a judgment had established liability of the UM/UIM motorist and the amount of damages owed to the insured.[85] The insurance company would not tender the full policy limits until the results from the court of appeals had been announced.[86] In a separate lawsuit, a jury awarded damages to the insured for the insurance company's bad faith in failing to tender the policy limits after the judgment had been rendered in the UM/UIM case.[87] The Texas

[78] *Id.* at 166.

[79] *Id.*

[80] *Id.* at 167 (citing Donald M. Zupanec, *Cause of Action in Tort for Bad Faith Refusal of Insurer to Pay Claim of Insured* § 2, in Vol. 1 Shepard's Causes of Action 205 (1983)).

[81] *Id.* at 168.

[82] *Id.* at 167.

[83] *Id.*

[84] 80 S.W.3d 546, 547 (Tex. 2002).

[85] *Id.*

[86] *Id.*

[87] *Id.*

court of appeals affirmed the decision of the trial court and the jury's award of damages.[88]

The Texas Supreme Court reversed the trial court and court of appeals and announced that a bad faith claim could not be brought against an insurance company for its failure to pay policy limits after a judgment established its obligation to do so.[89] The Texas Supreme Court explained that a prior decision in Texas made clear that once a judgment had been established, "the only legal relationship between the parties [an insurance company and an insured] following entry of judgment [is] that of judgment creditor and judgment debtor."[90] Thus, the *Mid-Century* holding made clear that bad-faith claims may never be brought against an insurance company for its failure to pay a UM/UIM claim after a judgment has established the liability of the UM/UIM motorist and the damages of the insured.[91]

3) *Hamburger v. State Farm Mutual Automobile Insurance Co.*

Although *Mid-Century*, limited the scope of an insurer's duty to act in good faith, the Fifth Circuit recognized that bad faith claims for failure to pay still existed in Texas.[92] In *Hamburger v. State Farm Mutual Automobile Insurance Co.*, the Fifth Circuit encountered a bad faith action against an insurance company for its failure to pay UIM benefits *before* a judgment had established that the insured was legally entitled to recover from the UIM motorist.[93] The insurance company argued liability could not be reasonably clear (such that the insurance company acted in bad faith in denying the UIM claim) until a judgment established the damages and liability of the UIM motorist.[94]

The Fifth Circuit acknowledged that generally in Texas, establishment of an insured's legal entitlement to UM or UIM coverage requires "a settlement with the tortfeasor or a judicial determination following trial on the issue of the tortfeasor's liability."[95] Therefore, the Fifth Circuit reasoned

[88] *Id.*

[89] *Id.* at 548–49.

[90] *Id.* at 549 (citing Stewart Title Guar. Co. v. Aiello, 941 S.W.2d 68, 69 (Tex. 1997)).

[91] *Id.*

[92] Hamburger v. State Farm Mut. Auto. Ins. Co., 361 F.3d 875, 880–81 (5th Cir. 2004).

[93] *Id.* at 879 (emphasis added).

[94] *Id.* at 880.

[95] *Id.* (citing Wellisch v. United Servs. Auto. Ass'n, 75 S.W.3d 53, 57 (Tex. App.—San Antonio 2002, pet. denied) (citing Henson v. S. Farm Bureau Cas. Ins. Co., 17 S.W.3d 652, 653

the insured, in this particular case, was not "legally entitled to recover" from its insurance company until the jury established the extent of Hamburger's damages caused by the tortfeasor, the other driver.[96]

In responding to the appellant's bad faith claim against its insurance company, the Fifth Circuit acknowledged, "There are no Texas cases which have squarely held that liability can never be reasonably clear before there is a court determination of proximately caused damages."[97] On the other hand, the Fifth Circuit recognized that in *Mid-Century Ins. Co. of Tex. v. Boyte*, the Texas Supreme Court held an insured does not have a bad faith cause of action against an insurer for the insurer's failure to attempt a fair settlement of a UIM claim *after* there is a judgment against the insurer, at which time there are no longer duties of good faith and the relationship becomes one of judgment debtor and creditor.[98]

The Fifth Circuit explained if the position argued by the insurance company in this case were adopted, an insured could "never successfully assert a bad faith claim against his insurer for failing to attempt a fair settlement of a UIM claim: pre-judgment, liability would not be reasonably clear under *Universe Life Ins. Co. v. Giles*,[99] and post-judgment, such an action would be barred under [*Mid-Century*]."[100] The Fifth Circuit reasoned, "[a]bsent a more clear indication from Texas courts that liability cannot be reasonably clear under *Giles* until the insured is found in a legal proceeding to be entitled to recover, we will not adopt this interpretation of Texas law."[101] Thus, the Fifth Circuit concluded that an insurance company could act in bad faith in denying a claim for UM/UIM coverage even when a judgment had not established liability of the UIM motorist and damages of the insured.[102]

(Tex. 2000))); Franco v. Allstate Ins. Co., 505 S.W.2d 789, 792 (Tex. 1974); Mid–Century Ins. Co. of Tex. v. Barclay, 880 S.W.2d 807, 811 (Tex. App.—Austin 1994, writ denied); Sikes v. Zuloaga, 830 S.W.2d 752, 753 (Tex. App.—Austin 1992, no writ).

[96] *Hamburger*, 361 F.3d at 880.

[97] *Id.*

[98] *Id.* (citing Barclay, 880 S.W.2d at 811) (emphasis added).

[99] In *Universe Life Ins. Co. v. Giles*, the Texas Supreme Court enunciated the standard for breach of the common law duty of good faith and fair dealing in the context of insurance companies' denials of claims for coverage. 950 S.W.2d 48, 55 (Tex.1997).

[100] *Hamburger*, 361 F.3d at 880–81.

[101] *Id.* at 881.

[102] *See id.*

4) *Brainard v. Trinity Universal Insurance Co.*

Brainard may be the clear indication from the Texas Supreme Court that liability is not "reasonably clear" until the insured receives a judgment in her favor, and it casts doubt on whether an insured may bring a bad faith claim for failure to pay.[103] In this case, the Texas Supreme Court explained that an insurer is not *contractually* obligated to pay UM/UIM coverage until liability for the UM/UIM motorist was established through a judgment.[104] The Texas Supreme Court has interpreted "legally entitled to recover" to mean an insurer is under no contractual duty to pay benefits until the insured obtains a judgment establishing the liability and underinsured status of the other motorist.[105] The Texas Supreme Court specifically held that neither requesting UIM benefits nor filing suit against the insurer triggers a contractual duty to pay.[106] The Texas Supreme Court did qualify its holding by cautioning that the insured is not required to obtain a judgment against the tortfeasor; the insured may also litigate the case directly against its insurance company.[107]

The Court explained the rationale for its holding is that the "UIM contract is unique because, according to its terms, benefits are conditioned upon the insured's legal entitlement to receive damages from a third party."[108] The Court explains that, unlike many first-party insurance contracts, in which the policy alone dictates coverage, UIM insurance "utilizes tort law to determine coverage."[109] Consequently, the Court felt that it would be improper to find that an insurance company was under a contractual obligation to pay damages before liability and damages are determined by a judgment.[110]

V. DO BAD FAITH CLAIMS AGAINST INSURANCE COMPANIES FOR FAILURE TO PAY ON A UM/UIM POLICY STILL EXIST?

It is unclear whether bad faith claims for failure to pay survive *Brainard*. After all, if an insurance company is under *no* contractual duty to

[103] Brainard v. Trinity Universal Ins. Co., 216 S.W.3d 809, 818 (Tex. 2006).

[104] *Id.* (emphasis added).

[105] *Id.* (citing Henson v. S. Farm Bureau Cas. Ins. Co., 17 S.W.3d 652, 653–54 (Tex. 2000)).

[106] *Id.*

[107] *Id.*

[108] *Id.*

[109] *Id.*

[110] *Id.*

pay until liability is determined by a judgment, can it be said to be in bad faith for failing to do something it has no contractual obligation to do?

The majority of federal district courts have interpreted *Brainard* to be *the* Texas Supreme Court opinion that "squarely" addresses whether an insured may maintain a bad faith action against an insured before obtaining a judgment establishing the insured's entitlement to UM/UIM benefits.[111] However, there is a split within this majority on how to now handle bad faith actions for failure to pay a UM/UIM claim.[112] Some district courts believe bad faith actions have been wholly abrogated by *Brainard*.[113] Other district courts find the extra-contractual, bad faith actions must be abated until a judgment has been obtained against the UM/UIM motorist, and then, after the insured gets its judgment, the bad faith action may proceed against the insurance company.[114] However, both analyses agree that a bad faith action may no longer proceed against an insurance company before a judgment has been obtained establishing the liability of the UM/UIM motorist and damages of the insured.[115] Nevertheless, at least one federal district court still follows *Hamburger* and argues *Brainard* does not "squarely" address the continued existence of bad faith claims for failure to pay.[116]

A. Bad Faith Claims Do Not Exist

Some district courts believe bad-faith claims have been wholly abrogated by *Brainard*.[117] In *Weir v. Twin City Fire Insurance Co.*, an insured brought a bad faith claim against its insurance company for failure to pay a UIM claim before the insured had obtained a judgment establishing

[111] *See, e.g.*, Weir v. Twin City Fire Ins. Co., 622 F. Supp. 2d 483, 485–86 (S.D. Tex. 2009); Owen v. Emp'rs Mut. Cas. Co., CIV. A. No. 3:06-CV-1993-K, 2008 WL 833086, at *2 (N.D. Tex. Mar. 28, 2008); Schober v. State Farm Mut. Auto. Ins. Co., No. 3:06-CV-1921-M, 2007 WL 2089435, at *2 (N.D. Tex. July 18, 2007). For Texas cases, *see* In re Am. Nat. Cnty. Mut. Ins. Co., 384 S.W.3d 429, 436–38 (Tex. App.—Austin 2012, no pet.); In re United Fire Lloyds, 327 S.W.3d 250, 256 (Tex. App.—San Antonio 2010, no pet.) (emphasis added).

[112] *See, e.g.*, *Weir*, 622 F. Supp. 2d at 485–86; *Schober*, 2007 WL 2089435, at *5.

[113] *See, e.g.*, *Weir*, 622 F. Supp. 2d at 485–86.

[114] *Owen*, 2008 WL 833086, at *4; *see, e.g.*, *Schober*, 2007 WL 2089435, at *5.

[115] *See Weir*, 622 F. Supp. 2d at 485–86; *Schober*, 2007 WL 2089435, at *5.

[116] *See* Accardo v. Am. First Lloyds Ins. Co., CIV.A. No. H-11-0008, 2012 WL 1576022, at *5 (S.D. Tex. May 3, 2012).

[117] *See Weir*, 622 F. Supp. 2d at 486.

the liability of the UIM motorist and the insured's damages.[118] The district court held that the bad faith claims had been wholly abrogated by *Brainard* and declined to abate the claims until resolution of the underlying UM/UIM lawsuit, as other district courts had done.[119]

The *Weir* court explained cases where abatement occurred are not persuasive because those cases "ignore the unique status of the UIM insurance contract."[120] Quoting *Brainard*, the district court explains the UIM insurer is under no contractual duty to pay benefits until the insured obtains a judgment establishing the liability and underinsured status of the other motorist.[121] The *Weir* court concluded, "If there is no contractual duty to pay, [an insurance company] cannot be in 'bad faith,' under common law or statute, for not paying."[122] The district court did acknowledge that if the insurance conduct was so extreme as to create damages separate from the mere denial of coverage, a potential bad faith claim could exist in tort.[123] However, the district court explained the insured failed to plead any allegations of that type in his complaint.[124]

B. Bad Faith Claims Exist But Must Be Brought Post Judgment

Other district courts, while acknowledging the *Brainard* holding, do not believe bad faith claims for failure to pay have been wholly abrogated by that Texas Supreme Court opinion.[125] In *Owen*, an insured pursued contractual and extra-contractual bad faith claims against its insurance company.[126] While the district court concluded the insured's bad faith claims based on the contractual duty to pay must fail, the district court acknowledged, "[I]f the insurer's conduct is extreme in nature and causes injury in tort independent of the claim against the policy, the insurer's conduct may be deemed to be in bad faith."[127] The court concluded that

[118] *See id.* at 485.

[119] *See id.* at 487.

[120] *Id.* at 486.

[121] *Id.*

[122] *Id.*

[123] *Id.* at 487.

[124] *Id.*

[125] Owen v. Emp'rs Mut. Cas. Co., CIV. A. No. 3:06-CV-1993-K, 2008 WL 833086, at *4 (N.D. Tex. Mar. 28, 2008).

[126] *Id.* at *1.

[127] *Id.* at *3.

while the bad faith claim based on a contractual duty must fail, the insured may still be entitled to damages in tort for the insured's failure to pay when liability was "reasonably clear."[128] Thus, the district court abated the insured's bad faith claims until the underlying UM/UIM suit established the liability and damages of the UM/UIM motorist.[129]

C. Bad Faith Claims May Be Brought Before a Judgment

At least one court has rejected the position that bad faith claims have been wholly abrogated or should be abated until the underlying litigation is resolved.[130] A district court in the Southern District of Texas held that *Brainard* does not preclude bad faith claims against insurance companies for wrongful denials of coverage.[131] In *Accardo v. American First Lloyds Insurance Company*, the plaintiff asserted a bad faith claim against its insurance company for a bad faith denial of a claim for UM coverage.[132] The insurance company moved for summary judgment and argued it could not be subjected to a bad faith claim because its obligation to pay UM benefits would not be "reasonably clear" until the plaintiff had a judgment establishing the liability and damages for the uninsured motorist accident.[133]

The district court disagreed with the insurance company and explained that controlling legal precedent from *Hamburger* clearly demonstrated the plaintiff's claim was ripe.[134] The court further explained *Brainard* did not squarely address the issue of bad faith claims with respect to UM/UIM claims and thus did not provide clear enough guidance for the district court to deviate from *Hamburger*'s holding.[135] The court explains that *Brainard* "does not address or call into doubt *Hamburger's* holding."[136] *Accardo* then

[128] *Id.*

[129] *Id.* at *4.

[130] *See* Accardo v. Am. First Lloyds Ins. Co., CIV.A. No. H-11-0008, 2012 WL 1576022, at *5 (S.D. Tex. May 3, 2012).

[131] *Id.*

[132] *Id.* at *4.

[133] *Id.*

[134] *Id.* at *5 (explaining how *Brainard* does not address or call into doubt *Hamburger's* holding). The holding from *Hamburger*, referenced in the *Accardo* opinion, is that an insurance company could still be liable for wrongfully denying a UM/UIM insurance claim in bad faith, even without a judgment establishing the liability of the UM/UIM tortfeasor. *See* Hamburger v. State Farm Mut. Auto. Ins. Co., 361 F.3d 875, 881 (5th Cir. 2004).

[135] *Accardo*, 2012 WL 1576022, at *5.

[136] *Id.*

recognizes the continuing existence of bad faith claims for UM/UIM claims in Texas with the following language:

> 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.[137]

Thus, the *Accardo* court concluded that *Brainard* did not foreclose the possibility of an insurance company committing bad faith even when it was under no contractual obligation to pay a UM/UIM claim.[138] *Accardo* is the only court, post-*Brainard*, within the Fifth Circuit, as well as within Texas, to currently hold that bad faith claims may still be brought against an insurance company before a judgment has been obtained establishing the liability of the UM/UIM motorist and damages of the insured. However, given the gravity of wholly abrogating a cause of action, as well as the Texas Supreme Court's silence on this precise issue, *Accardo's* holding should not be discounted.

VI. THE CONSEQUENCES OF *BRAINARD*

Because *Brainard* did not directly speak to the state of the law of bad faith actions for UM/UIM insurance claims, insurance companies are put in a tough position. After the *Brainard* opinion was released, many insurance companies may feel comfortable denying all of their UM/UIM claims until a judgment has been obtained by the insured establishing the liability of the UM/UIM motorist and the insured's damages. However, if *Brainard* has not abrogated bad faith claims, those insurance companies could potentially be subjecting themselves to a slew of bad faith litigation for blanket denials of UM/UIM claims.

Further, people who have been paying for UM/UIM insurance premiums for decades may reconsider the value of their insurance upon discovering the immense flexibility that insurance companies now have in paying these claims. Insureds may feel much less secure in their investment, knowing that the insurance company may not have to pay a claim until after a trial, which may be several years after an injury by a UM/UIM motorist.

[137] *Id.*

[138] *Id.*

Even more discouraging is that insurance companies could potentially not even be subjected to a bad faith claim against them, despite the fact that bad faith actions help encourage insurance companies to pay those claims with merit.

VII. CONCLUSION

As this article concludes, one may be asking what will become of Suzy and her potentially unscrupulous insurance company. What is the real value of the $1 billion Texans spend a year on UM/UIM coverage? This author believes the correct answer, which is followed by the majority of the courts, is that the Texas Supreme Court has foreclosed these claims since liability is not "reasonably clear" until the liability of the UM tortfeasor is fully litigated. In *Brainard*, the Texas Supreme Court, in reaching its analysis about the scope of an insurer's contractual duty to pay UM/UIM claims, highlighted the unique nature of UM/UIM insurance law compared with all other forms of insurance claims given the fact that UM/UIM insurance is predicated on the liability of a third-party tortfeasor.[139] Because of this unique aspect of UM/UIM insurance, the *Brainard* court explained the necessity of a tort judgment, and nothing less, before any contractual duty could arise for an insurance company to pay a UM/UIM insurance claim.[140] Thus, given the complete lack of contractual duty owed to an insured to pay a claim prior to a judgment, the logical extension of the *Brainard* holding is that an insurer cannot be in bad faith for failing to do something it has no contractual obligation to do, especially when the insurers obligations are not "reasonably clear."

This result unfortunately leaves Suzy without any protection against an insurer's denial of her claim, no matter how unreasonable, until she obtains her judgment, which could require years of litigation and costly expenses. The only hope for fellow and future insureds in Suzy's position is that insurance companies will not be willing to gamble that bad-faith actions are wholly abrogated until the Texas Supreme Court has squarely addressed the issue. In light of all these developments in the bad faith doctrine, Suzy should be checking with her insurance company about whether she really is "in good hands."

[139] Brainard v. Trinity Universal Ins. Co., 216 S.W.3d 809, 818 (Tex. 2006).

[140] *Id.*