

**DAMAGES RECOVERABLE IN  
INSURANCE BAD FAITH  
LITIGATION**

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**I. INTRODUCTION**

In the general context of first-party insurance claim lawsuits, a variety of causes of action may be asserted, and the categories of damages recoverable depends somewhat upon the cause of action or theory under which liability is found. A plaintiff is entitled to maximize his or her recovery by submitting alternative theories and measures of damages for the same loss and then, after obtaining the verdict, electing the theory of recovery desired. *Kish v. Van Note*, 692 S.W.2d 463, 466-67 (Tex. 1985). Although there still exists the possibility of high damage awards over and above the actual policy proceeds, the availability of damages recoverable has been restricted and reduced in recent years. Both the Texas Supreme Court and the Texas Legislature have responded to the "tort reform" and "lawsuit abuse" movements by shaping this relatively new body of law in a number of ways.

For the purposes of this paper, the damages are categorized as follows:

I. Actual Damages, including policy proceeds, economic damages (both direct and incidental) and mental anguish;

II. Additional Damages, including treble damages as well as statutory penalties and punitive/exemplary damages;

III. Attorney's fees; and

IV. Interest and taxable costs of court.

**II. ACTUAL DAMAGES**

**A. Policy Proceeds**

Actual damages are those recoverable at common law and may include the policy proceeds, out-of pocket economic damage and even mental anguish. The basic dispute in almost all first-party insurance lawsuits is the insured's right to the policy proceeds. When an insured is able to demonstrate policy liability by a preponderance of the evidence, the policy proceeds are recoverable as actual damages. In

*Vail v. Texas Farm Bureau Mutual Insurance Co.*, 754 S.W.2d 129 (Tex. 1988), the Supreme Court held that policy benefits were recoverable as a matter of law even without a separate damage causation finding. However, subsequent cases have limited *Vail* and held that a causation finding my nonetheless be required. See *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663 (Tex. 1995); *Seneca Resources Corp. v. Marsh & McLellan, Inc.* 911 S.W.2d 144 (Tex. App.—Houston [1st Dist.] 1995, no writ). The insured has the burden of establishing the amount of the damage as well as liability under the insurance policy.

**B. Economic Damages**

Economic damages are the general and most basic measure of damages in any cause of action in which liability is proven. The exact type and nature of the damages is necessarily fact specific, and depends upon the pleadings and the proof at trial. Common-law "contract" damages are generally divided into two categories: direct and consequential. *Mead v. Johnson Group, Inc.*, 615 S.W.2d 685 (Tex. 1981). Any of the common-law measures of damages for breach of contract may be available to a plaintiff in a DTPA or Insurance Code action as well. COMM. ON PATTERN JURY CHARGES, STATE BAR OF TEX., TEXAS PATTERN JURY CHARGES PJC 110.9 (2d ed. 1997).

**1. "Direct" Damages**

"Direct" damages are defined as those which are so "usual an accompaniment of the kind of breach alleged that that the mere allegation of the breach gives sufficient notice, and are conclusively presumed to have been foreseen or contemplated by the party as a consequence of his breach of contract." PATTERN JURY CHARGES, supra, 110.3 comment; *Hess Die Mold, Inc v. American Plasti-Plate Corp*, 653 S.W.2d 927, 929 (Tex. App.—Tyler 1983, no writ). No question as to the foreseeability of direct damages is to be submitted as long as the damages are properly characterized by the court as direct rather than "consequential." *American Bank v. Thompson*, 660 S.W.2d 831, 834 (Tex. App.—Waco 1983, writ ref'd n.r.e.).

**2. "Consequential" Damages**

"Consequential" damages may be recovered if

they are the “natural, probable, and foreseeable consequence” of the breach. Mead, 615 S.W.2d at 687. The added element of foreseeability is what distinguishes consequential damages from direct damages. “Consequential” damages are also fact and evidence specific. Examples of recoverable consequential damages are lost profits and damaged credit reputation. To recover for an alleged damaged credit reputation, a plaintiff is required to prove 1) that a loan was actually denied, 2) that the inability to procure the loan resulted in injury to the plaintiff, and 3) the amount of plaintiff’s injury. *St. Paul Surplus Lines Ins. Co. v. Dal-Worth Tank Co., Inc.*, 974 S.W.2d 51, 53 (Tex. 1998). As for lost profits, a plaintiff must present more than merely speculative evidence in support of such a claim in order to be sufficient to even get a fact question for a jury. *Southwest Battery Corp. v. Owen*, 115 S.W.2d 1097, 1099 (Tex. 1938).

### **C. Actual Damages Under the Insurance Code, DTPA and Bad Faith**

The Texas Insurance Code does not define “actual” damages. However the same direct/consequential damages recoverable at common-law under a contract theory are also available in Insurance Code, Deceptive Trade Practices Act (“DTPA”), and bad faith cases. These damages include: past lost profit, future lost profit, loss of use, the reasonable value of lost time and even damage to credit reputation where the evidence supports it. PATTERN JURY CHARGES, supra, 110.9. Loss of use damages are generally calculated as the reasonable rental value of a substitute, and the consumer need not actually incur any out-of-pocket expenses. *Luna v. North Star Dodge Sales, Inc.*, 667 S.W.2d 115, 118 (Tex. 1984). The recovery of these damages under the Insurance Code as well as DTPA require only a “producing” cause, and not the standard “proximate” cause as with the other causes of action, the only meaningful distinction being that a claimant need not prove that the damages were foreseeable. *Hycel, Inc. v. Wittstruck*, 690 S.W.2d 914 (Tex. App.–Waco 1985, writ dism’d).

### **D. Mental Anguish Damages**

Mental anguish damages are never recoverable on a simple breach of contract case. *Stewart Title Guar. Co. v. Aiello*, 941 S.W.2d 68 (Tex.

1997). While mental anguish may still form the basis for an award under the DTPA/Insurance Code or “bad faith,” the 1995 amendments to the DTPA limit damage recovery to economic damages unless the plaintiff proves the defendant acted “knowingly.” TEX. BUS. & COM. CODE ANN. §17.46(b) (Vernon Supp. 2003). Therefore, mental anguish damages are now available only if the insurer is found to have acted knowingly in violation of the Insurance Code or DTPA, or in breach of the common law duty of good faith and fair dealing. *State Farm Life Ins. Co. v. Beaton*, 907 S.W.2d 430 (Tex. 1995). “Knowing” has been defined as actual awareness of the falsity, deception, or unfairness of the conduct in question. The Supreme Court said in Dal-Worth: “a person must think to himself at some point, ‘Yes I know this is false, deceptive, or unfair to him, but I’m going to do it anyway.’” 974 S.W.2d at 54. The same “knowing” standard is used for awarding treble damages (addressed herein below). The bottom line on mental anguish and treble damages is that the plaintiff must prove that an adjuster had the Dal-Worth “knowing” state of mind before even legally stating a case for the recovery of either mental anguish or treble damages.

In order to be entitled to recover mental anguish damages, a plaintiff must do more than demonstrate a knowing violation. There is an elevated proof requirement for mental anguish to rise to the level of “recoverable” mental anguish. In order to recover, a plaintiff must introduce direct evidence of the nature, duration and severity of the mental anguish, and the resulting substantial disruption in the plaintiff’s daily routine. In other words, some mental anguish does not allow any recovery. It is only when the mental anguish is “substantial” that it then becomes compensable. *Parkway Co. v. Woodruff*, 901 S.W.2d 434 (Tex. 1995); *Saenz v. Fid. & Guar. Ins. Underwriters*, 925 S.W.2d 607 (Tex. 1996).

## **III. ADDITIONAL DAMAGES**

### **A. Treble Damages**

Prior to the 1985 changes in the Texas Insurance Code, an insured was entitled to an automatic trebling of actual damages upon a “knowing” finding. Act of March 13, 1985, 69th Leg., R.S., ch.22, § 3, 1985 Tex. Gen. Laws 395, 395,

amended by Act of May 17, 1995, 74th Leg., R.S., ch.414, § 13, 1995 Tex. Gen. Laws 2988, 3000. The 1985 amendments reduced the treble damages to double. *Id.* Now, after the legislature's 1995 amendments to the Insurance Code, when a jury finds that the violation was committed knowingly (as stringently defined in *Dal-Worth*), the jury may award up to three times actual damages. TEX. INS. CODE ANN. art. 21.21, § 16(b) (Vernon Supp. 2003). The additional damages are awarded at the discretion of the trier of fact. The amendments apply to all cases accruing on or after September 1, 1995, as well as all causes of action that accrued before September 1, 1995, but where suit was filed on or after September 1, 1996. The recovery of treble damages is the same whether suit is brought directly under article 21.21 or through the DTPA. TEX. BUS. & COM. CODE ANN. § 17.50(a)(4) (Vernon Supp. 2003). In *Vail*, the supreme court held that this DTPA section incorporates article 21.21 in its entirety, including the treble damages provision in article 21.21, section 16. 754 S.W.2d 129.

When mental anguish damages are part of actual damage award, they may be trebled under the DTPA if the insurer is found to have acted intentionally. TEX. BUS. & COM. CODE ANN. § 17.50(b) (Vernon Supp. 2003). However, attorney's fees, costs and interest cannot be trebled. TEX. BUS. & COM. CODE ANN. § 17.50(e) (Vernon Supp. 2003). Also, after 1995 there is no longer an automatic trebling of the first \$1,000 recoverable under section 17.50(b)(1) of the DTPA.

#### **B. Statutory Penalties**

Under article 21.55 of the Texas Insurance Code, an insurer which is found in violation any portion of this section is also automatically liable to the insured for an additional 18% per annum on the covered amount awarded, plus reasonable and necessary attorney's fees. Article 21.55 deals generally with the claims settlement practices of an insurer. There is a laundry list of prohibited behaviors. Although this additional amount is not within the discretion of the jury, the 18% may not be trebled under the DTPA or article 21.21.

#### **C. Punitive/Exemplary Damages**

For causes of action accruing on or after

September 1, 1995, exemplary damages may not ordinarily exceed an amount equal to the greater of:

(1) (A) two times the amount of economic damages, plus

(B) an amount equal to any noneconomic damages found by the jury not to exceed \$750,000; or

(2) \$200,000.

TEX. CIV. PRAC. & REM. CODE ANN. § 41.008(b) (Vernon Supp. 2003).

"Economic damages" is defined by the statute as compensation for pecuniary loss and does not include exemplary damages or damages for physical pain, mental anguish, loss of consortium, disfigurement, physical impairment, or loss of companionship or society. TEX. CIV. PRAC. & REM. CODE ANN. § 41.001(4) (Vernon Supp. 2003). However, where a defendant is found liable for knowingly or intentionally committing certain felonies, no such limitations apply. TEX. CIV. PRAC. & REM. CODE ANN. § 41.008(c) (Vernon Supp. 2003).

In the context of first-party claims, punitive damages are recoverable to an insured who proves actual damages attributable to the "bad faith" of the insurer but the insured must prove fraud or malice on the part of the insurer as well. TEX. CIV. PRAC. & REM. CODE ANN. § 41.003 (Vernon Supp. 2003). "Malice" has been defined as acting with ill will, evil motive, gross indifference, or reckless disregard for the safety of others. *Missouri Pac. R.R. Co. v. Lemon*, 861 S.W.2d 501 (Tex. App.—Houston [14th Dist.] 1993, writ dismissed). Punitive damages are not available in addition to the treble damages, penalties and attorney's fees recoverable under the other theories available (i.e. breach of contract, DTPA and Insurance Code violations). A successful plaintiff must elect between the tort recovery and the other causes of action.

#### **D. "Bad Faith"**

An insurer commits the common law tort of bad faith when it fails to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim in which the insurer's liability has become reasonably clear. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48 (Tex. 1997); TEX. INS. CODE ANN. art. 21.21 (Vernon Supp. 2003).

The two ways in which such a claim may be stated are: (1) Denial or delay of payment of a claim that the insurer knew or should have known was reasonably clearly covered, and (2) failure to reasonably investigate a claim. Giles, 950 S.W.2d at 56 n.5.

Therefore an insurer cannot avoid liability simply by willfully refusing to reasonably investigate a claim that may not appear on its face to be reasonably clearly covered. Also, because bad faith is a common law tort, the causation standard is the more stringent one of "proximate" cause, which requires a showing of foreseeability. When there is a delay or denial of payment of an insurance claim, there may be personal injury damages, damage to credit, lost profits and other damages. PATTERN JURY CHARGES, supra, 110.14.

One of the factors which a jury may consider in assessing exemplary damages is the net worth of the defendant. PATTERN JURY CHARGES, supra, 110.30.

#### IV. ATTORNEY'S FEES

Reasonable and necessary attorney's fees are generally recoverable for a breach of contract (TEX. CIV. PRAC. & REM. CODE ANN. § 38.001 (Vernon Supp. 2003)), and for violations of either the DTPA section 17.50(d) or Insurance Code article 21.21, section 16(b)(1). Bad faith, as a common law tort, will not support an award of attorney's fees.

Chapter 38 of the Texas Civil Practice and Remedies Code does have a special provision stating that such chapter (the attorney's fees chapter) does not apply to contract claims arising out of a contract that are subject to the provisions of, among others, article 21.21 of the Insurance Code. TEX. CIV. PRAC. & REM. CODE ANN. § 38.006(4) (Vernon Supp. 2003). The effect of this language has given rise to a split in authority over whether attorney's fees are available to a litigant in a breach of insurance contract lawsuit at all, and particularly in the UM/UIM situation. In *Whitehead v. State Farm Mutual Automobile Insurance Co.*, 952 S.W.2d 79 (Tex. App.—Texarkana 1997), rev'd on other grounds, 988 S.W.2d 744 (Tex. 1999), the court of appeals concluded that attorney's fees are recoverable in UM/UIM cases where the

only cause of action tried arose under UM/UIM contract when the insured established she had a valid claim, she was represented by an attorney, and she sent a timely presentment letter. Similarly, in *Novasad v. Mid-Century Insurance Co.*, 881 S.W.2d 546 (Tex. App.—San Antonio 1994, no writ), the court concluded that attorney's fees are recoverable in UM/UIM cases where insurer does not consent to settlement with an uninsured/underinsured driver and liability of that driver is disputed. Conversely, in *Sprague v. State Farm Mutual Automobile Insurance Co.*, 880 S.W.2d 415 (Tex. App.—Houston [14th Dist.] 1993, writ denied), Houston's Fourteenth Court of Appeals stated that attorney's fees are not recoverable in UM/UIM cases where there is no indication that the parties ever reached an agreement as to the amount, if any, the insured is legally entitled to recover. The Austin Court of Appeals came to a similar conclusion in *Sikes v. Zuloaga*, 830 S.W.2d 752 (Tex. App.—Austin 1992, no writ), ruling that attorney's fees are not recoverable in UM/UIM cases where liability of the uninsured driver has not been determined prior to trial. Although unclear, there is certainly a strong argument that attorney's fees are not recoverable, especially when the liability or amount of benefits an insured is entitled to are disputed.

The recent case of *Arthur Anderson & Co. v. Perry Equipment Corp.*, 945 S.W.2d 812 (Tex. 1997) has made the recovery of contingent attorney's fees questionable in first-party insurance litigation. Although Anderson was a straight DTPA case and did not involve insurance, it has recently been confirmed by a lower court that the same rule applies to Insurance Code cases. *Dunn v. S. Farm Bureau Cas. Ins. Co.*, 991 S.W.2d 967 (Tex. App.—Tyler 1999, no writ). The rule of the case is that evidence of a contingent fee contract alone will not support an award of attorney's fees. Rather, a plaintiff must seek a specific amount and prove that the amount of attorney's fees claimed was reasonable and necessary. The court in Dunn listed a number of factors which the fact finder must consider in determining the reasonableness of the fees which follows the language of the State Bar fee rule. Id. The bottom line is that where a plaintiff has a relatively large claim amount, the lawyer can no longer just state a claim for a percentage of the recovery. Instead, he must justify a dollar claim

amount with time records and other evidence.

## V. INTEREST AND TAXABLE COSTS

Prejudgment interest accrues at the rate of 6% per annum on all damages which can be categorized as liquidated or ascertainable sums, and at the rate of 10% per annum on other "soft" damages such as mental anguish damages. *Gen. Life & Accident Ins. Co. v. Higginbotham*, 817 S.W.2d 830 (Tex. App.—Ft. Worth 1991, writ denied). Additionally, the prejudgment interest on actual damages and mental anguish is all subject to trebling. *Beaston v. State Farm Life Ins. Co.*, 861 S.W.2d 268 (Tex.App.—Austin 1993), rev'd on other grounds, 907 S.W.2d 430 (Tex. 1995). The date of accrual for purposes of calculating prejudgment interest is the earlier of 180 days after the defendant receives written notice of the claim or the date suit is filed. *Johnson & Higgins of Texas, Inc. v. Kenneco Energy, Inc.*, 962 S.W.2d 507 (Tex. 1998). Prejudgment interest is no longer compounded daily, but is calculated as simple interest. *Id.* at 533. Interest is only charged on the damages, not on attorney's fees recovered. Prejudgment interest is not recoverable on exemplary damages. TEX. CIV. PRAC. & REM. CODE ANN. § 41.007 (Vernon Supp. 2003).

Post-judgment interest accrues on the entirety of the judgment, including costs and attorney's fees, at the rate of 10% per annum until the judgment is paid in full.

Costs of court are taxable in favor of the prevailing party. Taxable costs include: filing fees, service charges, original deposition costs, charges for masters, interpreters and ad litem (although this would not apply to a typical settlement situation). Also, the trial court is permitted to assess "other" costs as well. TEX. CIV. PRAC. & REM. CODE ANN. § 31.007(b) (Vernon Supp. 2003).

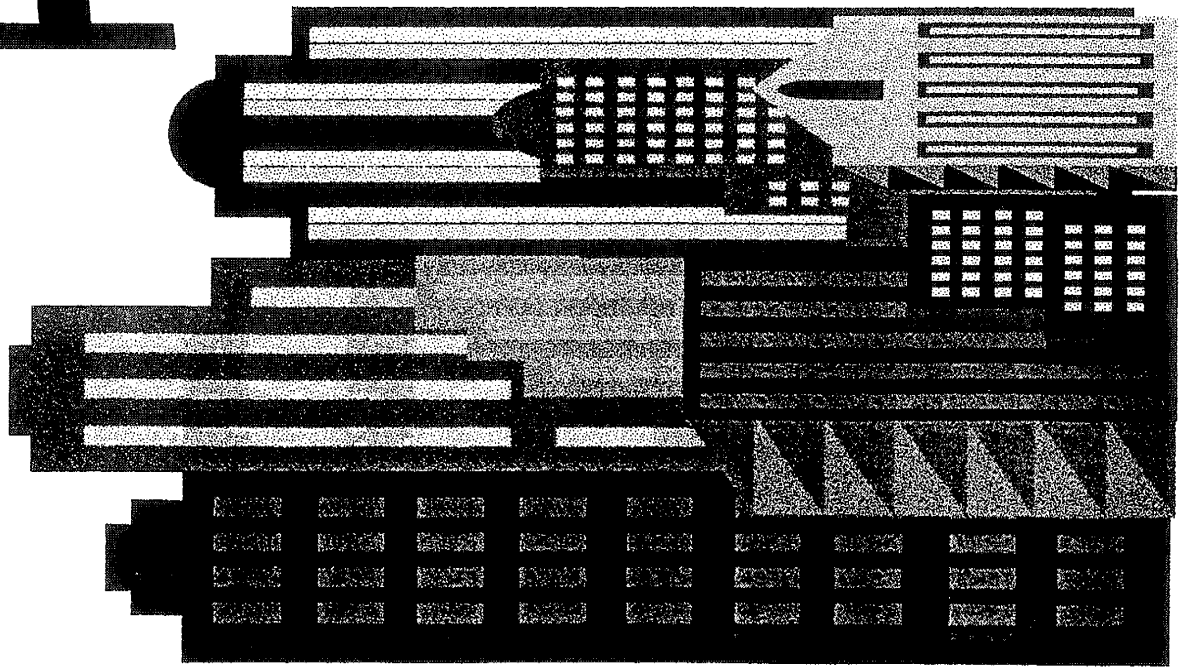
## VI. CONCLUSION

The tort of "bad faith" was created out of a perceived need to protect insureds based upon an unequal bargaining power in the claims settlement process. While technically there remains a viable cause of action for a truly malicious act or intentional and knowing statutory violation, it seems that lawmakers and judges have recognized the need to allow

insurers to deny doubtful or questionable claims without being unduly punished. The law still attempts to make a deserving insured whole and contains strong disincentives for any insurer who would cross the line into bad faith. Conscientious insurers who thoroughly investigate and promptly and decisively act with the proper frame of mind need not worry about damages.

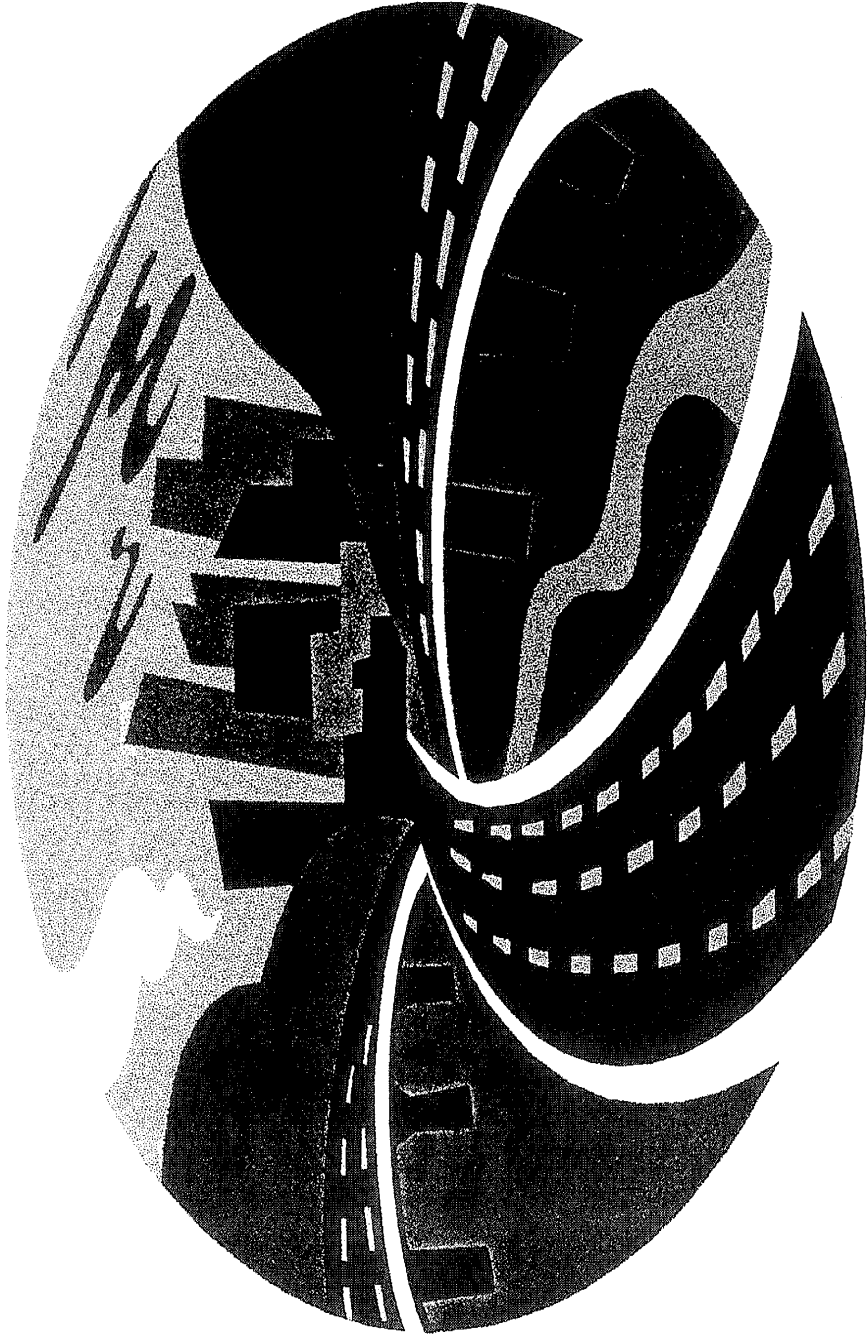
# HOW HIGH IS HIGH?

**Presented By:**  
**Beth Taylor**

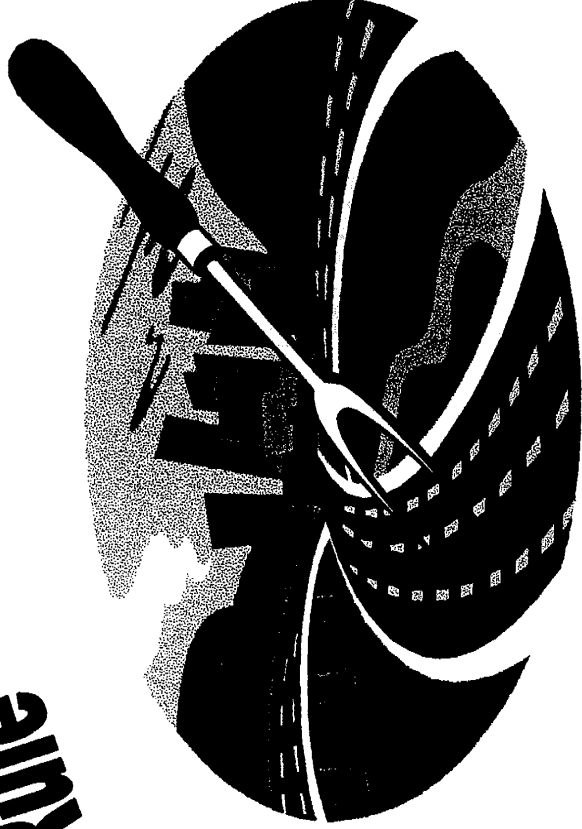


“When you come to a fork in the road...Take it”

Yogi Berra



# The Fork-in-the-Road Rule

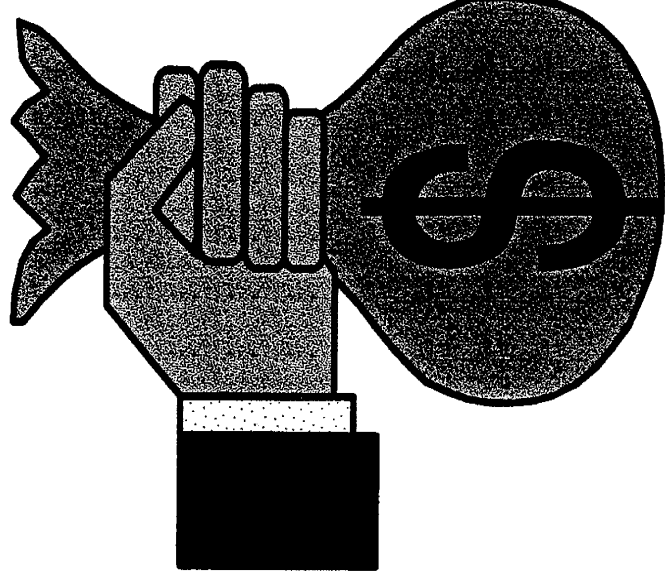


## Kish v. Van Note

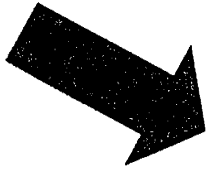
A Plaintiff is entitled to maximize recovery by submitting alternative theories for the same loss and then, after the verdict, electing the theory of recovery desired.

# Actual Damages

- Policy Proceeds
- Economic Damages
- Mental Anguish



# ECONOMIC DAMAGES



## DIRECT

Conclusively presumed  
to have been foreseen



## CONSEQUENTIAL

Natural, probable and  
foreseeable consequence  
of breach (lost profits,  
damaged credit)

# MENTAL ANGUISH

Breach of Contract

DTPA  
Ins. Code  
Bad Faith

Negligent  
Honest Mistake

Knowingly

Some Mental  
Anguish

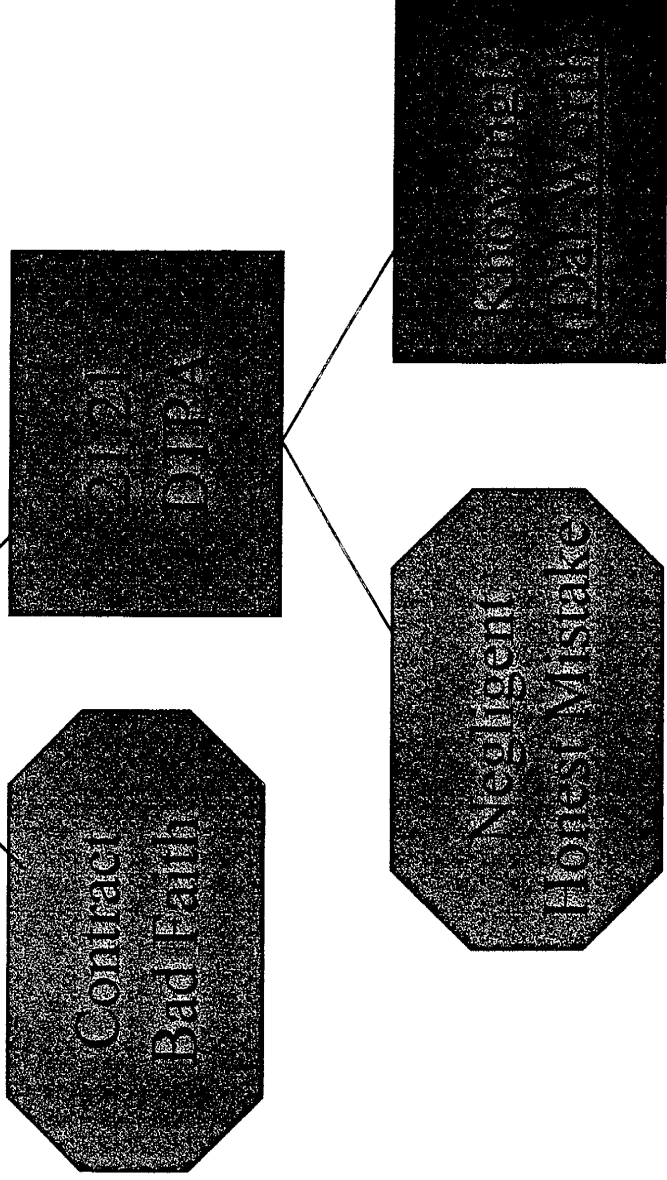
Substantial

# **“Knowingly” Under Dal-Worth**

- Actual Awareness of the falsity, deception or unfairness of the conduct in question.
- “Yes I know this is false, deceptive or unfair to him, but I am going to do it anyway.”



# TREBLE DAMAGES



Whatever Jury wants to award in addition:  
\$0 → treble actual damages\*

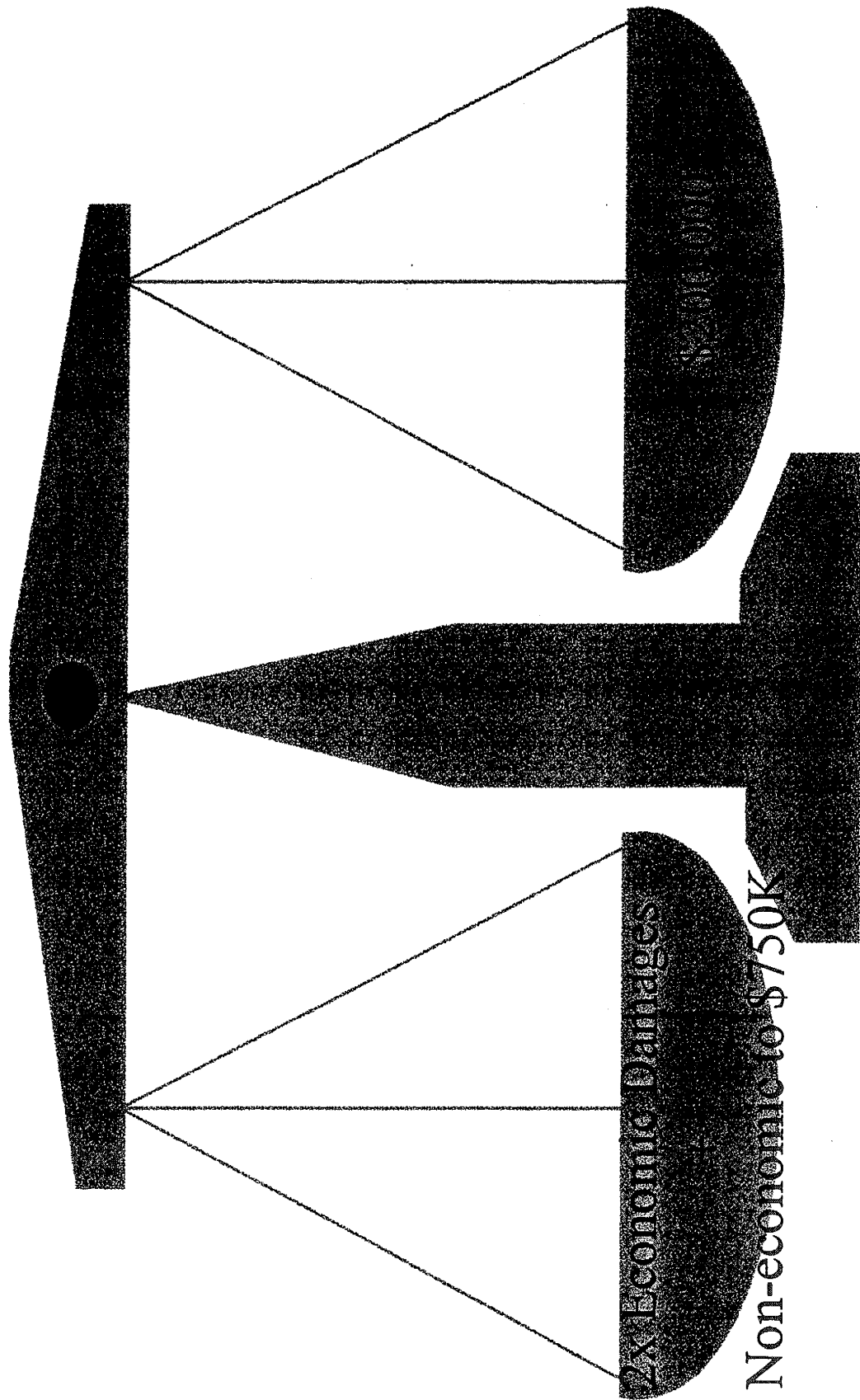
\*"Actual Damages" that may be trebled-includes Policy Proceeds, Economic (both direct and indirect) and Mental Anguish

# STATUTORY PENALTIES/CLAIM

## HANDLING

- 21.55 - Automatically liable for an additional 18% per year on covered amount awarded plus attorney's fees
- Wrongful Rejection = Delay according to the 5th Circuit (Higginbotham)

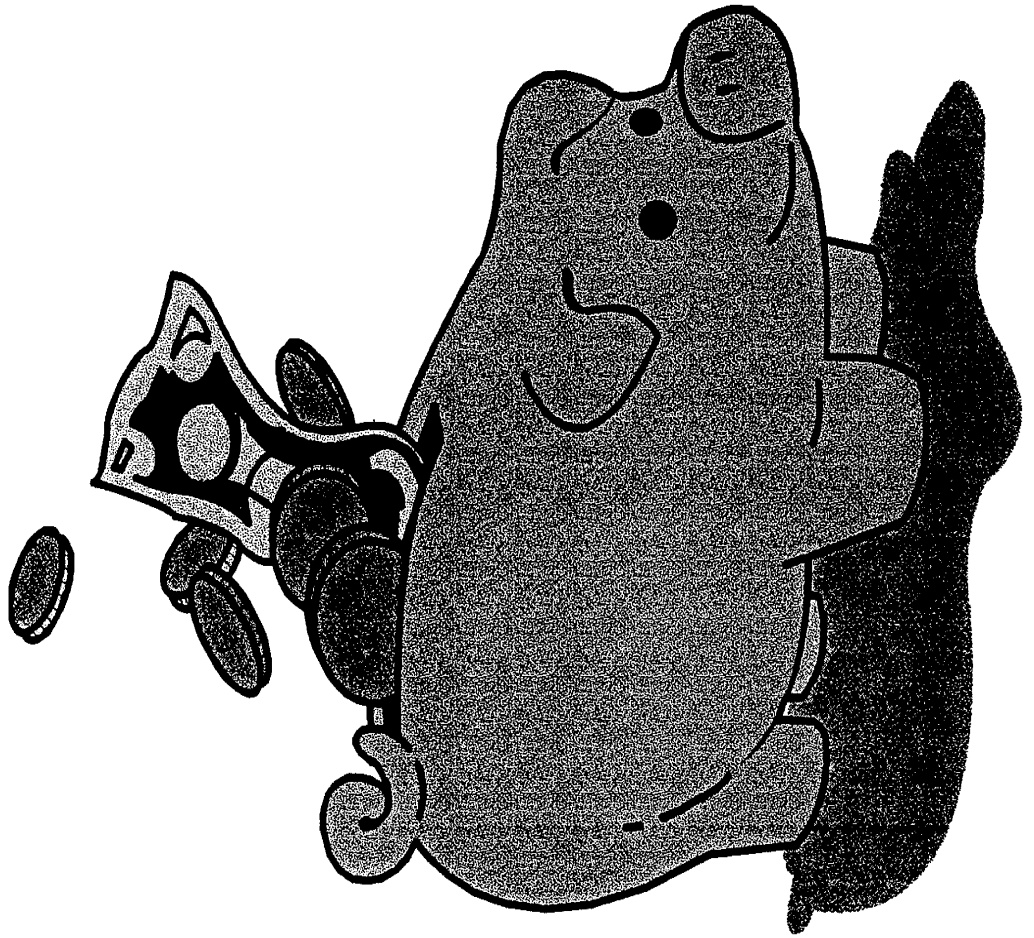
# PUNITIVE DAMAGES



# **MORIEL TEST FOR GROSS NEGLECT**

- Act or omission - objectively - extreme degree of risk
- Actor subjective awareness of risk of extraordinary harm

# ATTORNEY'S FEES

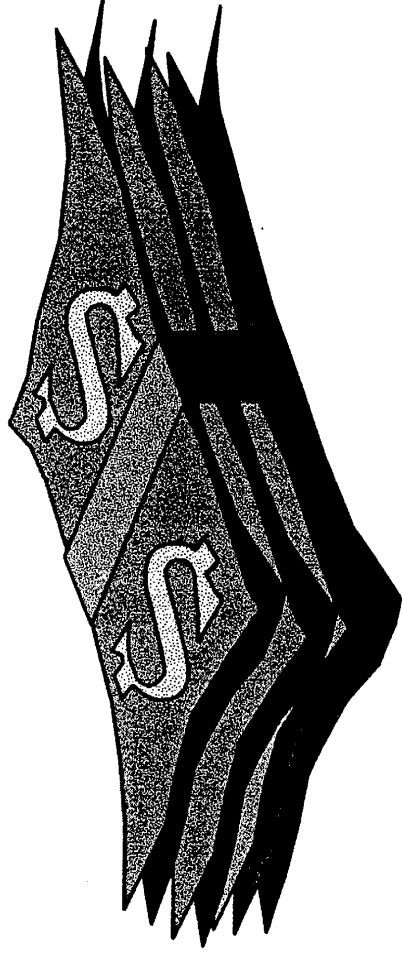


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**ARTHUR ANDERSON**

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Evidence of a contingency fee contract alone will not support an award of attorney's fees. Rather, a Plaintiff must present evidence in support of a specific amount of fees.



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	<b>Contract</b>	<b>Ins. Code 21.21</b>	<b>Ins. Code 21.55</b>	<b>DTPA</b>	<b>Bad Faith</b>
<b>Policy Proceeds/ Actual Damages</b>	✓	✓		✓	✓
<b>Mental Anguish</b>		✓		✓	✓
<b>Treble Damages</b>		✓		✓	
<b>18%</b>			✓		
<b>Punitive Damages</b>					✓
<b>Attorney Fees</b>	✓	✓	✓	✓	