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IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

CECILIA SOTO,	§	
	§	
Plaintiff	§	
	§	
VS.	§	**CIVIL ACTION NO. A-06-CA-819-AA**
	§	
LIBERTY MUTUAL FIRE INSURANCE COMPANY,	§	
	§	
	§	
Defendant	§	

PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION (AND AMENDED MOTION) FOR PARTIAL SUMMARY JUDGMENT

I. Introduction

Liberty Mutual argues that an insurance company cannot be liable for bad faith or violations of the insurance code until it breaches the insurance contract. This argument has been specifically rejected by the Fifth Circuit and is in direct conflict with the history of bad faith/Insurance Code law. For these reasons, Liberty's Motion (and Amended Motion) for Partial Summary Judgment should be denied.

II. Facts and Claims

There is no dispute that Dr. Soto's claims are covered. Liberty has stipulated that while its policy was in effect, Dr. Soto was involved in a wreck with an uninsured driver. *See Defendant's Amended Motion for Partial Summary Judgment,* Docket Doc. 48, p. 3. Further, Liberty has agreed that the uninsured driver was solely at fault for the wreck. *Id.* While Liberty disputes the amount of the claim, there is no dispute that the claim is covered and that Liberty owes some amount to Dr. Soto. Dr. Soto contends that Liberty has breached its common law

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and statutory duties in its investigation of her claim and in its delay in attempting to settle her claim.

III.
Argument and Authorities

A. The Fifth Circuit's *Hamburger* decision specifically rejects Liberty's claim

In 2004, the Fifth Circuit specifically rejected Liberty's argument that a UIM carrier cannot be guilty of bad faith until there is a court determination of the amount that the insured is legally entitled to receive. *Hamburger v. State Farm Mutual Automobile Ins. Co.,* 361 F.3d 875, 880-881 (5th Cir. 2004). In that case, the court recognized that before an insurer has a contractual duty to pay a UIM claim, "the insured must establish the uninsured motorist's fault and the extent of the resulting damages before becoming entitled to recover [UIM benefits]."[1] *Id.* (brackets in original). Therefore, State Farm, like Liberty here, moved for summary judgment on the plaintiff's bad faith claims on the grounds that no bad faith liability could attach for State Farm's failure to settle the claim prior to the jury's determination of the plaintiff's damages caused by the accident. *Id.*

The Fifth Circuit specifically rejected State Farm's argument. *Id. at 881.* In rejecting the argument, the court noted that Texas law has clearly established that once there is a judgment, an insured does not have a bad faith claim against an insurer for failing to attempt a fair settlement of a UIM claim because at that time, there are no longer duties of good faith and the relationship becomes one of judgment debtor and creditor. *Id.* Thus, if State Farm (and Liberty here) are right, an insured could never successfully assert a bad faith claim on a UIM claim: pre-judgment,

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[1] While the Fifth Circuit's opinion predates the Texas Supreme Court's *Brainard* decision, the Fifth Circuit properly recognizes that the Texas courts of appeals had already reached the same decision as the *Brainard* court.

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liability wouldn't be possible under the State Farm/Liberty argument, and postjudgment, such an action is barred under existing Supreme Court law. *Id.*

For all the reasons that State Farm was not entitled to summary judgment on its argument that it cannot be liable for bad faith before a court determination of damages, Liberty is not entitled to summary judgment on its claims.

B. The *Hamburger* decision is consistent with existing bad faith insurance law

1. Basics of bad faith claims

In 1987, the Supreme Court was faced with a case very similar to the one at hand. The plaintiff, Glen Arnold, was injured when the motorcycle he was driving was struck by an uninsured vehicle. Even though it was undisputed that the uninsured motorist caused the collision (like the case at hand), the insurance company refused to negotiate a settlement. The plaintiff eventually sued, and in the resulting case, the Supreme Court recognized, for the first time, an insurance company's duty of good faith and fair dealing:

> Arnold raises the issue of whether there is a duty on the part of insurers to deal fairly and in good faith with their insureds. We hold that such a duty of good faith and fair dealing exists. *Arnold v. National County Mut. Ins. Co.,* 725 S.W.2d 165, 167 (Tex. 1987).

This duty of good faith and fair dealing included at least three independent responsibilities. In addition to a duty (1) to not breach a contract by failing to pay a claim without a reasonable basis, an insurer also has a duty, (2) to properly investigate a claim and, (3) to not delay settling the claim without a reasonable basis. *Id.*

Similarly, Texas Insurance Code section 541.060 provides that an insurer has a duty 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." TEX. INS. CODE § 541.060.

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2. Bad faith claims are distinct from contract claims and don't arise out of the contract

In the ten years following *Arnold*, the Texas Supreme Court struggled with how to review fact findings that insurance companies had breached this duty. Through those struggles, the Court has consistently held that the bad faith claims are distinct and separate from any cause of action for breach of the underlying insurance contract. *Chitsey v. National Lloyd's Ins. Co.*, 738 S.W.2d 641, 644 n. 1 (Tex. 1987); *Viles v. Security Nat'l Ins. Co.*, 788 S.W.2d 566, 567 (Tex. 1990)("That duty [of good faith and fair dealing] emanated not from the terms of the insurance contract, but from an obligation imposed in law.") ; *Lyons v. Millers Casualty Ins. Co.*, 866 S.W.2d 597, 601 (Tex. 1993); *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 18 (Tex. 1994); *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338, 340-341 (Tex. 1994); *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663, 666 (Tex. 1995).

Similarly, the duties to effectuate a settlement arise not from the contract, but from the Insurance Code. TEX. INS. CODE § 541.060.

3. Because the claims are distinct, a breach of contract is not a requirement for a bad faith or Insurance Code claim

In keeping the distinction between contract and bad faith claims, the Supreme Court has made clear that a breach of contract is not a prerequisite to a claim for bad faith. For example, the Court has stated that "While the failure to file a proof of loss, if not waived by the insurer, bars a breach of contract claim, it is not controlling as to the question of breach of the duty of good faith and fair dealing." *Viles*, 788 S.W.2d at 567; See also *Lyons*, 866 S.W.2d at 601 ("But the issue of bad faith focuses not on whether the claim was valid, but on the reasonableness of the insurer's conduct."); *Moriel*, 879 S.W.2d at 18, n.8 ("Claims for insurance contract coverage are distinct from those in tort for bad faith; resolution of one does not determine the other").

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4. Duties to timely try and settle and to timely investigate exist regardless of eventual compliance with the contract

Additionally, the Court has consistently held that there are several duties required of insurance companies by the duty of good faith and fair dealing and the insurance code. The first, and most obvious, duty is the duty to not deny claims without a reasonable basis. *Arnold,* 725 S.W.2d at 167. If this was the only duty, then Liberty might be correct in arguing that it cannot breach its duty as a matter of law because there is no contractual obligation to pay until the underlying claim is adjudicated.

But the Insurance Code and common law duties of good faith and fair dealing also include duties to not delay in settlement of a claim when liability is reasonably clear and duties to timely investigate an insured's claims. *Arnold,* 725 S.W.2d at 167; *Viles,* 788 S.W.2d at 567; *Stoker,* 903 S.W.2d at 341 (Tex. 1995) ("Nor should we be understood as retreating from the established principles regarding the duty of an insurer to timely investigate its insureds' claims."); *Universe Life Ins. Co. v. Giles,* 950 S.W.2d 48, 56, n.5 (Tex. 1997) ("We reaffirm that an insurance company may also breach its duty of good faith and fair dealing by failing to reasonably investigate a claim."). Setting forth the differences between claims that rely on the duty to pay (where a breach may be required) and the duties to not delay and to investigate (that can arise even without a breach of the contract), the Court said:

> Some acts of bad faith, such as a failure to properly investigate a claim or an unjustifiable delay in processing a claim, do not necessarily relate to the insurer's breach of its contractual duties to pay covered claims, and may give rise to different damages. *Twin City Fire Ins. Co.,* 904 S.W.2d at 666, n. 3.

These duties to investigate, to not delay and to attempt to effectuate a settlement would become meaningless if a breach of contract is a prerequisite to recovery. An insurer

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could never be liable for breaching these duties, no matter how long they delayed or how much they harassed the insured, as long as the insurer eventually paid the claim. Clearly, that is not the intent of the Court or the legislature. On the contrary, the Supreme Court adopted these duties because of concerns that insurers could take advantage of their insureds' misfortune in bargaining for settlement or resolution of the claims and that insurers would delay payments "with no more penalty than interest on the amount owed." *Arnold,* 725 S.W.2d at 167.

C. The critical question is whether the claim is covered; not whether the contract was breached

In *Republic Ins. Co. v. Stoker,* the Supreme Court was faced with the question of whether a plaintiff could "create coverage" through the insurance company's breach of the duty of good faith and fair dealing where no coverage existed. *Stoker,* like this case, was a UIM case. The plaintiff was involved in a multi-vehicle wreck after an unidentified truck dropped a load of furniture. The insurance company denied coverage on the grounds that the plaintiff was at fault in the wreck. However, during the litigation, the insurer moved for, and received, summary judgment on the grounds that the claim was not covered because there was no physical contact between the plaintiff's vehicle and the uninsured vehicle. The plaintiff continued with the suit and argued that the insurer was still liable for policy benefits, despite no coverage, because the insurer breached the duty of good faith and fair dealing and the Insurance Code while handling the claim. In rejecting this argument, the Court noted, "As a general rule there can be no claim for bad faith when an insurer has promptly denied a claim that is in fact not <u>covered</u>." *Stoker,* 903 S.W.2d at 341 (emphasis added).[2] To make

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[2] As Liberty noted, Stoker even held out the possibility that an insurer could commit acts so egregious that the insurer is liable for damages even when there is no coverage. *Stoker,* 903 S.W.2d at

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sure that its decision was not extrapolated to require a breach of contract before bad faith was found, the Court then added, "Nor should we be understood as retreating from the established principles regarding the duty of an insurer to timely investigate its insureds' claims." *Id.*

Following *Stoker,* the Court handed down the *Giles* opinion, which is particularly noteworthy because it adopted the Insurance Code's "reasonably clear" standard as the standard for bad faith claims. *Giles,* 950 S.W.2d at 55.[3] In reaching this holding, the Court stated, "The 'reasonably clear' standard recasts the liability standard in positive terms, rather than the current negative formulation. Under this standard, an insurer will be liable if the insurer knew or should have known that it was reasonably clear that the claim was covered." *Id.* (emphasis added). Earlier in the opinion the Court summarized its holding with the same statement, "A majority of the Court –eight Justices-- agrees that an insurer violates its duty of good faith and fair dealing by denying or delaying payment of a claim if the insurer knew or should have known that it was reasonably clear that the claim was covered." *Giles,* 950 S.W.2d at 49 (emphasis added).

In this case, it is admitted that the claim is covered and that Liberty will owe Dr. Soto for the claim. Because the claim is covered, Liberty has duties, which it has breached, to reasonably investigate and to not delay in effectuating the settlement once liability became reasonably clear.

On page 7 of its amended motion, Liberty takes the *Stoker* opinion out of context to argue that a breach of contract is required. *See Defendant's Amended Motion For Partial*

341.

[3] This holding essentially merged the common law duty of good faith and fair dealing with the statutory obligations.

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Summary Judgment, Docket Doc. 48, p. 7. In its motion, Liberty cites *Stoker* and an additional case and two treatises that are cited in *Stoker* as requiring a breach of contract before a finding of bad faith. However, as quoted above, the *Stoker* opinion only required that a claim be covered, not that the contract be breached. Moreover, the additional cites are part of a string cite showing that other jurisdictions require coverage or breach as a prerequisite of bad faith. Some of the cases cited in the string cite require merely a covered claim, and some required a breach of the contract. Had the Court wanted to require a breach of contract, it could have done so; it did not. Moreover, the Ostrager & Newman treatise, one of the Stoker treatises that Liberty chose to cite, only requires coverage: "The determination of whether an insurer acted in bad faith generally requires as a predicate a determination that coverage exists for the loss in question." *Stoker*, 903 S.W.2d at 341(citing and quoting OSTRAGER & NEWMAN, INSURANCE COVERAGE DISPUTES § 12.01 at 503(7th ed. 1994).

D. Liberty's reliance on *Moriel* is misplaced

On page 6 of its motion, Liberty cites *Moriel* for the proposition that a "bad faith threshold can be reached only after the contractual duty to pay is triggered." *See Defendant's Amended Motion for Partial Summary Judgment,* Docket Doc. 48, p.6. While there is a sentence in *Moriel* that can be interpreted to support that assertion, the sentence is likely the result of inattentive writing and not a holding. Not only would it have been the first pronouncement of such a holding by the Supreme Court, it is specifically contradicted in the opinion itself when the Court wrote, "Claims for insurance contract coverage are distinct from those in tort for bad faith; resolution of one does not determine the other." *Moriel,* 879 S.W.2d at 20, n. 8. If it was an intentional holding, it is merely dicta. The issue in *Moriel* is

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what conduct is necessary to give rise to exemplary damages in a bad faith case. Any statement that an insurer must first breach a contract before bad faith can arise is mere dicta.

To further support its claim, Liberty takes a block quote from *Moriel*, takes it out of context, and leaves out portions of the quote, to support a claim that:

> in other words, to violate the bad faith standard under either the common law of Insurance Code, the carrier must not only have delayed payment or failed to pay in breach of the contract, that breach must be accompanied by conduct so egregious that the conduct itself is tortious. When the conduct is more egregious still and done intentionally or with malice, punitive damages are recoverable. Each tier is a predicate for the next. *See Defendant's Amended Motion for Summary Judgment,*

Contrary to defendant's assertion, the quoted section is merely discussing the different damages available for the different claims in an insurance case. The full quote states:

> Our law recognizes a three-tier framework for measuring damages in an insurance coverage dispute, and each level is associated with distinctly different policies, substantive definitions, and measures of proof. A bad faith case 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. It is important to preserve distinct legal boundaries between the three bases of recovery to prevent arbitrariness and confusion at the critical thresholds. *Moriel,* 879 S.W.2d at 18-19.

This quote is clearly discussing what damages are available, not whether a breach of contract claim is a prerequisite for a bad faith claim. The *Moriel* court made it clear in other places that such a breach is not required. *Moriel,* 879 S.W.2d at 20, n. 8.

Finally, there's no support for Liberty's assertion that bad faith claims must be conduct so egregious to be considered a tort. Every Supreme Court pronouncement has established that the tort occurs when the insurer fails to pay a claim that is due, delays in

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effectuating a settlement when liability is reasonably clear, or fails to properly investigate a claim. The extra requirement that the conduct must be egregious is merely a standard for punitive damages.

IV.
Liberty Breached Its Common Law and Statutory Duties

Liberty breached its duties to investigate and to attempt to effectuate settlement once liability became reasonably clear. *See the affidavit of James Harris, attached.*

Wherefore, premises considered, Plaintiff prays that Defendant's Amended Motion for Partial Summary Judgment be denied and for general relief.

Respectfully Submitted,

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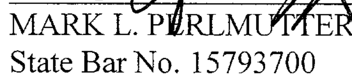
By: 
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CERTIFICATE OF SERVICE

I hereby certify by my signature above that a true and correct copy of the above and foregoing document has been forwarded to all parties pursuant to Federal Rule of Civil Procedures on the 15th day of June, 2007, addressed as follows:

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