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Case Nos. 17-0640 & 17-1048
IN THE SUPREME COURT OF TEXAS

Barbara Technologies, Inc.,
Petitioner,
v.
State Farm Lloyds
Respondent
and
Oscar Ortiz,
Petitioner
v.
State Farm Lloyds,
Respondent

BRIEF OF AMICI CURIAE, TEXAS AUTOMOBILE DEALERS ASSOCIATION, INDEPENDENT BANKERS ASSOCIATION OF TEXAS, TEXAS HOSPITAL ASSOCIATION, TEXAS ORGANIZATION OF RURAL AND COMMUNITY HOSPITALS, TEXAS INDEPENDENT AUTOMOBILE DEALERS ASSOCIATION, TEXAS HOTEL & LODGING ASSOCIATION, TEXAS ASSOCIATION OF COMMUNITY SCHOOLS AND THE TEXAS LEAGUE OF COMMUNITY CHARTER SCHOOLS

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Independent Bankers Association of Texas
Texas Hospital Association
Texas Organization of Rural & Community Hospitals
Texas Independent Automobile Dealers Association
Texas Hotel & Lodging Association
Texas Association of Community Schools
Texas League of Community Charter Schools

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INTERESTS OF AMICI CURIAE

This brief is submitted jointly on behalf of several amici curiae, whose common interest is that they represent the members of a variety of different commercial and governmental trade groups that own or depend on real property in Texas, who pay substantial premiums for property insurance, and who rely upon clear legal duties being imposed on insurers to promptly investigate and pay covered losses in good faith. The purpose of this brief is to apprise the Court of some of the crucial policy and practical implications of encouraging insurers to create unnecessary delay in paying covered claims, by contracting around long-standing rules intended to create equal bargaining power between insurers and policyholders, and by allowing insurers to shift the duty and cost of investigating covered losses to the insured through the appraisal process.

Because the outcome of this case substantially affects the rights of all Texas property owners to timely obtain full insurance benefits for covered losses, these amici curiae join together in this brief urging the Court to adopt a rule that does not reward unnecessary delay in investigating and paying covered insurance claims, that does not reward underpaying or delaying payment of covered claims, and that protects the public policies embodies in the Texas Legislature's passage of Chapters 541 and 542 of the TEXAS INSURANCE CODE, as well as this Court's long recognition of the special relationship insurers have with policyholders that justifies a duty of good faith and fair dealing.

The undersigned counsel were not compensated for the preparation and filing of this brief.

Texas Automobile Dealers Association (TADA) is the statewide trade association representing approximately 1355 franchised automobile and truck dealerships in nearly 300 communities throughout the State of Texas. It represents the franchised dealers before the Texas Legislature, Congress, and regulatory agencies. As the voice of Texas' franchised automobile and truck dealers in public policy and regulatory matters, TADA advocates on behalf of its members for fair and ethical business practices to better serve consumers in Texas. By supporting laws that benefit the public, the state, and the automobile industry, TADA promotes a business climate that fosters a sound system of distributing and selling motor vehicles, growth, opportunity and financial stability. TADA members are committed to creating jobs, providing quality service, and giving back to their communities through time and resources. TADA estimates that its members account for over $90,000,000,000 in annual vehicle sales, employ more than 100,000 people, and add $4 billion in tax revenue in this State. For the Texas franchised motor vehicle and truck dealer in Texas, insurance is a major expense and the timely and proper investigation and payment by an insurance company for damage to a dealer's inventory or facilities is a major concern. The security of a dealer's investment in their inventory and real property depends on

their ability to rely on the prompt and good faith investigation and payment of insurance coverage benefits.

Independent Bankers Association of Texas (IBAT). Formed in 1974, the IBAT represents Texas community banks. The Austin-based group is the largest state community banking organization in the nation, with membership comprised of more than 2,000 banks and branches in 700 Texas communities. Providing safe and responsible financial services to all Texans, IBAT member bank assets range in size from $21 million to $31 billion with combined assets statewide of nearly $193 billion. IBAT member banks are committed to supporting and investing in their local communities.

IBAT's members are FDIC insured commercial banks, committed to providing consumer and commercial loans to the communities that they serve. Consistent with safe and sound banking practices, these members make loans that are secured by personal property as well as by real estate, both residential and commercial. Collateral secured loans are secondarily protected through the prudent placement of property and casualty insurance, as expected by state and federal regulators and as provided in applicable state law.

According to the most recent reports of condition filed with the FDIC, all real estate secured loans reported by Texas depository institutions totaled $170.561 billion, farm loans totaled $4.782 billion, commercial and industrial loans (typically secured by

collateral, inventory, and real property) totaled $71.723 billion, and automobile secured loans totaled $17.663 billion. As a general proposition, all of these loans would have collateral for which insurance would be required.

Texas Hospital Association ("THA") is a nonprofit trade association that represents 444 hospitals across the State. THA member hospitals have made and continue to make very substantial investment in property insurance premiums to protect against significant damage or loss of care facilities, including ambulatory surgery centers, hospitals and primary care clinics. As with other commercial property owners, owners and operators of hospitals and medical care facilities pay for and depend on the availability of insurance coverage in order to continue to deliver service to patients in the event of damage or loss to hospital property, such as losses caused by fire, hurricanes, tornadoes and other catastrophes.

Texas Independent Automobile Dealers Association (TIADA) has been and continues to be the only statewide organization for independent automobile dealers since 1944. TIADA represents the interests of small, medium and large independent and used vehicle dealers. TIADA is a member-owned, member-governed association that consists of more than 1400 of the best used car dealers in Texas that believe in creating a better image for the industry while protecting the rights of auto dealers as business owners. In addition to the protection afforded directly to TIADA members for their own inventory and buildings, TIADA members have another important

interest that is guarded by the Court's and the legislature's rules imposing additional remedies for bad faith insurance practices. TIADA members often self-finance vehicle purchases and place liens on the property to secure payment. Like any business that secures a debt through collateral in property (such as mortgage banks and credit unions) TIADA members are often dependent upon good faith investigation and payment of covered losses (under comprehensive auto policies) to protect their security for loans made against vehicles sold by TIADA members and may often find themselves in the position of policyholders trying to secure insurance coverage payments when a debtor defaults in payments on damaged or destroyed collateral.

Texas Hotel & Lodging Association (THLA) is a nonprofit trade association representing every aspect of the lodging and tourism industry. THLA membership ranges from the largest convention center hotel to the smallest bed & breakfast, full service and limited service operators, convention and visitor bureaus, chambers of commerce, and vendors who work within the hospitality industry. THLA is the largest hotel association in the nation, with over 3,500 members. THLA and its members have a significant interest in this case because its members generate their income around the use of real property and improvements, and pay significant amounts in premiums for commercial property insurance because they depend on insurers being legally obligated to promptly investigate and pay for covered losses.

Texas Organization of Rural & Community Hospitals (TORCH) is an organization of rural and community hospitals, corporations, and interested individuals working together to address the special needs and issues of rural and community hospitals, staff, and patients they serve. The organization's mission is to be the voice and principal advocate for rural and community hospitals in Texas, and to provide leadership in addressing the special needs and issues of these hospitals. The prompt and adequate payment of insurance claims is especially critical to the hospitals represented by TORCH, because many of these facilities provide the only reasonably accessible health care available to medically-underrepresented communities in Texas. Eliminating the remedies for bad faith underpayment or delay in payment of insurance claims could have disastrous consequences for community health and health-care costs, as well as jeopardize the financial viability and continued existence of such facilities.

Texas Association of Community Schools (TACS). TACS is an organization that has been active in Texas since 1951. For the first 25 years it was known as the Texas Association of Small Schools and was housed in the Texas Education Agency building, changing its name in 1976, TACS became independent from TEA. TACS represents school districts with 12,000 ADA and below. It represents various legislative and other important shared interests of its membership – the small, mid-sized and rural school districts in Texas. There are 986 school districts eligible for membership.

The Texas League of Community Charter Schools is a statewide member association of Texas open-enrollment charter schools and operators. The member schools consist of highly innovative and quality-focused small, mid-sized and community charter schools from around the state. Founded in 2014, the League seeks to protect the legal rights of Texas charter schools, and safeguard the educational freedom intended by Texas Statute for charter schools by preserving meaningful educational choices for parents.

ARGUMENT & AUTHORITES

I. Misconstruing Appraisal Economically Incentivizes Handling Claims in Bad Faith.

In *State Farm Lloyds v. Johnson*, 290 S.W.3d 886, 887 (Tex. 2009), the Court noted that appraisals had occurred for nearly a century with little need for this Court's input. However, over the last fifteen years there has been a sudden explosion of litigation regarding issues surrounding property insurance appraisals. This occurred because a line of cases emerged from appellate courts and federal courts effectively absolving insurers from any liability for breach of contract, attorneys' fees, statutory and common law bad faith, interest, or statutory penalties for violation of the Prompt Payment of Claims Act ("PPCA") if the insurer invokes the appraisal process. This is so even if the insurer loses in appraisal and it is determined that the insurer substantially underpaid the loss **and** even if there is evidence that the insurer knowingly did so in bad faith.

This line of cases has effectively broken Texas insurance law. Insurers have thus far successfully convinced lower courts that appraisal – an alternative dispute resolution device intended to resolve a particular type of factual disagreement between insurer and insured – is actually just a regular part of the claims adjusting process that divests the courts of any power to enforce the PPCA or the statutory duties of good faith and fair dealing for any conduct that occurs prior to an appraisal. In effect, this line of cases has insulated insurers from any liability for breach of contract, delay or bad faith if they later invoke the appraisal process and pay any adverse appraisal award.

This is why – a decade ago – there were so many cases in Texas courts involving the question of whether an insurer has waived the appraisal process, culminating in this Court's opinion in *In re Universal Underwriters of Tex. Ins. Co.,* 345 S.W.3d 404, 412 (Tex. 2011) (orig. proceeding). *If* a policyholder were compelled to appraisal, it would lose as a matter of law almost all of the remedies intended to economically incentivize insurers to promptly investigate and pay claims in good faith.

The inverse of that is also true – *if* an insurer is not responsible as a matter of law for breach of contract, bad faith or violation of the PPCA as a matter of law (or any of the legal remedies available under these causes of action), the insurer is economically incentivized to use appraisal to delay the payment of the claim and to even delay the appraisal itself. As appraisal is currently being misconstrued, there are a variety of ways

in which insurers are perversely rewarded for refusing to investigate claims or to promptly pay them in good faith.

A. Insurers can shift the duty and expense of investigating claims onto the insured.

One way in which misuse of appraisal undermines these established duties is that it incentivizes the insurer to shift the duty and expense of investigating and valuing the claim onto the insured. If an insurer does not completely investigate and pay for a covered loss, it can rely on the appraisal clause to avoid any responsibility in the civil justice system. The insured would have to perform its own investigation, at its own expense in order to get the coverage it was owed. Under the mistaken reasoning of the lower courts, the insurer would not pay anything more than it would have paid had it properly adjusted and agreed to pay the claim promptly.

Absent any potential liability for attorneys' fees (available under all three causes of action), PPCA delay penalties, or any potential liability for additional damages for knowing bad faith, the insurer has a direct and immediate financial incentive to shift the burden and expense to the insured to investigate its own claim by under-investigating or undervaluing the claim, and resolving any ensuing disputes through appraisal only after the insured has paid experts to perform its own investigation. Importantly, by doing so, the insurer would not pay any more than it would have otherwise paid had it fully and timely investigated and paid the claim.

B. Insurers economically benefit from underpaying claims then finding ways to delay invoking or resolving the appraisal process.

Misconstrued to absolve an insurer of contractual and bad faith liability after the fact, appraisal also provides an insurer an incentive to undervalue the loss. At best, an insured who has suffered a catastrophic loss and cannot afford any delay or expense in proving up its covered loss may have to accept substantially less than it is owed under its policy just to get any payment it can as part of a coerced settlement. At worst, the insured proves up the actual value of the loss at its own expense and the insurer simply invokes the appraisal clause and pays an appraisal award equal to what it would have had to pay had it properly evaluated the amount of the loss in the first place. In the meantime, the insurer has been able to retain all or part of the amount owed for the covered loss until such time as the appraisal process is complete, both placing pressure on the insured to accept less than it is owed and collecting interest on policy benefits that rightfully belong to the policyholder.

This has the added effect of encouraging insurers to pretend that the claims process is perpetual and never ending. By taking the position that they have never made any final claim determination, the insurer can claim there was no 'impasse,' and then delay attempts to invoke appraisal under *In re Universal Underwriters*. Of course, ordinarily that would be a clear violation of the PPCA and also likely could be evidence of bad faith claims handling – however, under the current state of Texas insurance law, an insurer could willingly admit that it refused to investigate a loss and deliberately low-

balled a loss valuation to improve its negotiating position with its policyholder, and it would *still* not be liable as a matter of law for breach of contract, violation of the PPCA or bad faith just so long as the insurer promptly pays the appraisal award once the policyholder goes through all of the cost and delay to get the appraisal completed. And this would have to be accomplished while the insurer is incentivized to delay even the appraisal process for as long as possible.

C. Insurers can use appraisal to coerce the insured into agreeing to less than the amount owed.

Thus, insurers are economically incentivized to shift the cost of claims investigation and economically incentivized to delay payment to keep the funds in the insurer's possession earning additional income or interest. There is yet a third perverse economic incentive created by the misuse of appraisal. An insurer can take advantage of the delay and the additional expense the insured will have to incur in order to get the insured to agree to accept a lesser amount than it is owed, or delay while a loss worsens or the policy deadlines expire for additional benefits such as Replacement Cost payments and Law & Ordinance coverage. This would be particularly true with the most vulnerable policyholders – those whose business has suffered a catastrophic loss to income-earning property and face the real prospect of bankruptcy as a result of delayed payments or lacking the ability to front the additional cost of a claims investigation when the property is no longer producing income. As discussed in Section II below, this is precisely why the duties of good faith and fair dealing were imposed on insurers

in the first place. Logically, the bigger the loss and more desperately in need the policyholder is to get some of the insurance benefits for which it already paid, the more the insurer is incentivized to not pay and use the policyholder's dire circumstances to negotiate a lower payment.

This is particularly problematic because many property insurance policies include language (typically in the form of a "Texas Changes" endorsement) that specifies that the insurer has no obligation to ever pay the loss unless the insured either agrees to accept whatever amount the insurer is offering, or the insured invokes and pays for the appraisal of its own covered loss. These endorsements are common in both residential and commercial property policies, and typically read as follows:

> We will pay for covered loss or damage within 5 business days after:
>
> > (a) We have reached agreement with you on the amount of the loss; or
> > (b) An appraisal award has been made.

See e.g. Republic Underwriters Ins. Co. v. Mex-Tex, Inc., 106 S.W.3d 174, 177 (Tex. App. – Amarillo 2003) *rev'd* 150 S.W.3d 423 (Tex. 2004).

Despite the common law and statutory duty to promptly pay for covered losses, this provision provides an incentive to insurers to under-investigate or under-pay covered losses in order to force the insured to either waive its right to full policy benefits by agreeing to the insurer's valuation of the loss, or else invoke the appraisal clause, thereby incurring additional expenses for experts and attorneys to prove its loss. It also

indefinitely extends the insurer's obligation to pay *any* policy benefits until after the appraisal is completed.

In any subsequent lawsuit, the insurer can simply take the position that it did not breach the contract by failing to pay the covered loss because it had no duty to do so if the insured disagreed with the loss valuation. Moreover, even if the insurer were to admit that it knowingly did this for its own economic benefit, it would not be liable for bad faith or violation of the PPCA as a matter of law the way Texas law is currently being misconstrued.

D. Insurers can use appraisal and delays to force their policyholders to retain counsel and even initiate suit to collect insurance benefits.

One of the specific statutory duties imposed on an insurer in the claims handling process is a duty not to compel the insured to initiate suit to recover amounts due under the policy. *See* TEX. INS. CODE §542.003(b)(5). The common law and Insurance Code ordinarily provide penalties for an insurer for failing to pay amounts it knows are owed – bad faith liability, liability for attorneys' fees, PPCA delay penalties, and interest. However, since the appraisal process is being treated by courts as merely an additional part of the claims adjusting process, an insurer has a financial incentive to underpay a claim and force the insured – who typically will not be sophisticated enough in the law or the mechanics of insurance claims adjusting – to try to force the insurer into an appraisal that it has an incentive to delay as much as possible.

This gives yet a further incentive to insurers to under-investigate and underpay covered losses – as it imposes additional costs on the policyholder that the policyholder will never be able to recover even if it prevails in appraisal. Appraisal, while not as complex as litigation in the courts, is still a relatively complex and potentially expensive alternative dispute resolution process that in many, if not most, instances will require the insured to retain counsel who understands the process, the applicable deadlines, and when and how to exercise the insured's rights. This is especially true of a catastrophic loss or a significant loss to a large commercial property, such as an apartment complex, hospital or school building. Thus, in addition to the delay and incurring the cost of experts to value a large commercial loss, a policyholder will likely also face having to hire an attorney to contend with the insurance carrier and its legal department.

This perverse incentive is compounded if the insurer can add to the delay and expense by ignoring a clear disagreement about the amount of the loss and force the insured to file suit to resolve the dispute, as some insurers are starting to now do through the use of *unilateral* appraisal clauses. *See e.g. In re GuideOne Nat'l Ins. Co.,* No. 07-15-00281-CV, 2015 WL 5766496 (Tex. App. – Amarillo Sept. 29, 2015, orig. proceeding) (mem. op.); *In re GuideOne Mut. Ins. Co.*, No. 10-16-00404-CV, 2017 WL 1749793, at *3 (Tex. App. – Waco May 3, 2017, orig. proceeding) (mem. op.).

In sum, as it is being misconstrued and applied by lower courts and federal courts applying Texas law, the appraisal process is undermining and negating critical public

and statutory policies that squarely place the duty on an insurer to promptly investigate and pay covered claims in good faith, and cuts off the civil and statutory remedies for breach of those duties.

As it stands, Texas insurance law is being applied in a way that is unfriendly to any business owners who are not in the insurance business. In order to give effect to the public policies underlying these duties, this Court should clarify that appraisal is not a part of the claims handling process that divests courts of jurisdiction the way it would with a UM/UIM policy, for instance. *See Brainard v. Trinity Universal Ins. Co.*, 216 S.W.3d 809 (Tex. 2006). Rather, the Court should reaffirm the role of appraisal consistent with how it has characterized appraisal for more than a century – as an ADR procedure that resolves the specific factual dispute about the amount of the loss, *"leaving the question of liability for such loss to be determined, if necessary, by the courts."* *Scottish Union & Nat'l Ins. Co. v. Clancy*, 83 Tex. 113, 18 S.W. 439, 441 (Tex. 1892)(emphasis added); *Johnson*, supra.

Appraisal does not divest the courts from determining a breach of contract action but merely resolves a factual dispute that goes "to the heart of the plaintiff's breach of contract claim." *In re Allstate County Mut. Ins. Co.*, 85 S.W.3d 193, 195 (Tex. 2002). Far from precluding a breach of contract claim, the effect of appraisal is that the parties agreed to it as "the method by which to determine whether a breach has occurred." *In re Universal Underwriters*, 345 S.W.3d at 412.

E. Excusing insurers from these duties will have wide-ranging effects.

As a final consideration, the Court should keep in mind that economically incentivizing an insurer to delay payment and underpay covered losses can echo throughout the Texas economy. For instance, if an apartment complex owner were to suffer a devastating flood or fire that rendered the units uninhabitable, the owner would face the loss of the income from the insured property, but also now be faced with paying experts and attorneys to obtain insurance benefits for which the owner already paid its premiums, without any remedy to encourage the insurer to pay sooner or any legal means to recoup those additional costs.

Indeed, if the owner of the damaged property owed mortgage payments, a substantial delay and additional costs when the property is catastrophically damaged could leave the policyholder with no choice but bankruptcy. That, in turn, could result in a secured lender (such as a mortgage bank, or the financier of a vehicle purchase) being left with a partially unsecured debt, because its collateral is damaged or destroyed with no incentive for the insurer to pay for it. While the lender might be able to prosecute a claim against the insurer (typically as an additional insured or a subrogated party), it would run into the same problems as the policyholder. It would have to pay the cost of the investigation, the cost of the delay, the cost of attorneys, and be unable to recoup any of that additional cost when it prevails against an insurer who has several

economic incentives to delay payment of a covered loss and even delay the appraisal itself.

In addition, it could have wide-ranging effects on others. An uninhabitable apartment building also results in delays for families trying to get back into their homes. A catastrophically damaged hospital in a rural community could leave residents with limited access to healthcare. A badly damaged public school could result in the disruption of students' education and the additional expense of temporary facilities that would likewise be unrecoverable since the school would still be legally obligated to continue its educational mission.

Those duties, and the economic incentives they embody, are in place for extremely important reasons and in acknowledgment of the inherent position of economic power given to insurers. It is a grave mistake to simply allow insurers to contract around them.

II. An Appraisal Award Sets the Amount of Actual Damages, If Any; Appraisal Award Is Neither A "Proof of Loss" Nor "Additional Information . . . Requested by the Insurer."

The duty to promptly investigate and pay covered claims in good faith, both as a matter of both public policy and statute, are squarely upon the insurer – as they should be. It is long settled in Texas that because of the "special relationship between an insured and an insurer" the law imposes upon the insurer a "duty to investigate thoroughly and in good faith." *Viles v. Sec. Nat'l Ins. Co.*, 788 S.W.2d 566, 568 (Tex.

1990). Likewise, Texas law provides that an insurer has a duty to deal fairly and in good faith with its insured in processing and paying claims. *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165, 167 (Tex. 1987).

"This duty of good faith and fair dealing arises out of the special trust relationship between the insured and the insurer." *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210, 212 (Tex. 1988), *overruled on other grounds Tex. Mut. Ins. Co. v. Ruttiger*, 381 S.W.3d 430, 433 (Tex. 2012). Because this duty arises out of a relationship recognized at common law, it gives rise to a common law action in tort that is separate and apart from any cause of action for breach of the underlying contract. *In re Liberty Mut. Ins. Co.*, No. 14-09-00086-CV, 2009 Tex.App.LEXIS 1234, *9 (Tex. App. – Houston [14th Dist.] 2009, orig. proceeding)(mem. op.)(*citing Viles*, 788 S.W.2d at 567).

The Court has long recognized the need for the duty of good faith and fair dealing owing to the inherently unequal bargaining power between an insurer who has already been paid the policy premiums, and the policyholder, who is otherwise at the mercy of the insurer and all the more so after a catastrophe. As the Court wrote in *Arnold*:

> In the insurance context a special relationship arises out of the parties' unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insureds' misfortunes in bargaining for settlement or resolution of claims. In addition, without such a cause of action insurers can arbitrarily deny coverage and delay payment of a claim with no more penalty than interest on the amount owed.

Arnold, 725 S.W.2d at 167; *see also USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479, 487 (Tex. 2018)("An insurance policy, however, is a unique type of contract because an 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.")(*quoting Arnold*). With appraisal being misconstrued as a means of contracting around all of the duties of an insurer to promptly pay covered losses in good faith, there is not even the penalty of interest on the amount owed.

These duties are not only imposed on an insurer through the common law as a matter of public policy, but are codified by the Texas Legislature. Chapters 541 and 542 of the Texas Insurance Code imposes numerous, specific duties on the insurer to promptly investigate and pay covered claims, including duties to:

- Conduct a reasonable investigation of the claim;
- Effectuate a prompt, fair and equitable settlement of a claim with respect to which the insurer's liability has become reasonably clear;
- Adopt and implement reasonable standards for the prompt investigation of claims;
- Attempt in good faith to effect a prompt, fair and equitable settlement of a claim; and,
- Abstain from compelling a policyholder to institute a suit to recover amounts due under the policy.

TEX. INS. CODE §§ 541.060 & 542.003(b). In addition, under the PPCA, the legislature has enacted clear timelines for the acknowledgment, investigation, adjusting and payment of claims, making clear its intent to place the duty upon the insurer to promptly investigate claims and pay covered losses – and outlining what the legislature considers

to be the events constituting the claims handling process as well as the timeline for those events. *See* TEX. INS. CODE §542.051, *et. seq.* The legislature has made the policy behind this statute clear, as well, indicating that it is to be "liberally construed to promote the prompt payment of insurance claims." TEX. INS. CODE §542.054.

By statute, the claims handling process essentially involves three stages: (1) acknowledging the claim and investigation (§542.055); (2) notice of acceptance or rejection of the claim (§542.056); and, (3) payment of the claim (§542.057). The PPCA sets deadlines to acknowledge, investigate notify the insured of its position, and to pay the claim, but critically does not provide any exceptions to these deadlines for late payments when the parties disagree about the amount of the loss after the claim has been adjusted.

A. An appraisal award is not a "proof of loss."

Thus, the insurer determines the amount of the loss as part of its investigation and adjustment of the claim, and its duties to pay the claim are triggered at the point that it completes that process and makes its coverage decision, notifying the insured of the insurer's acceptance or rejection of the claim and making any payments due as required by TEX. INS. CODE §542.056-57. Where the insurer has not requested any additional items or forms from the insured to adjust the loss, the deadline to notify the insured whether the claim will be paid is fifteen (15) days after the insurer received everything it needs to secure final proof of loss. TEX. INS. CODE §542.056(a). The

insurer then has five (5) more days to issue any payment or partial payment of the claim. TEX. INS. CODE §542.057.

At that point, the claim value has been determined by the insurer. If the policyholder disagrees about the amount of the loss, and the parties have agreed to appraisal as an alternative dispute resolution process to resolve such disagreements, this does not extend any of the deadlines for the insurer to adjust the claim. This is logically and necessarily so. If the insurer has not made a determination of the amount of the loss, there is nothing about which the parties could disagree and thus no dispute to resolve through appraisal. As this Court has held for more than a century, the only purpose of appraisal is to resolve a disagreement about the amount of the loss, leaving the question of liability for that amount for the courts. *Scottish Union*; *Johnson*, supra.

Appraisal, by its very nature, requires both parties to have made a decision about the amount of the loss so that a disagreement between them can trigger the appraisal clause. Contrary to the position taken by Central Mutual Insurance Company as an amicus in the *Barbara Technologies* case, the appraisal award itself cannot be the "final proof of loss" because that would mean the claims handling process remains open indefinitely despite the legislature's clear imposition of statutory deadlines on each stage of the process. Indeed, by Central Mutual's logic, a jury's verdict that an insurer grossly underpaid a claim in bad faith could also be construed as the "final proof of loss" that,

if paid before a judgment was entered on that verdict, would prevent a claimant from recovering for breach of contract, bad faith or violation of the PPCA after a jury trial.

Put simply, a proof of loss is simply a *form* item an insurer may request at its option before it makes an undisputed payment. The insurer may pay the claim at the value it has determined without requesting a proof of loss, but it is not necessary if the insurer makes it claim determination and pays the loss without one. Indeed, Texas law has long recognized that a completed proof of loss form is not necessary, even if technically required, so long as the insurer had sufficient opportunity to investigate the loss and adjust the claim. In *Connecticut General Life Ins. Co. v. Turner*, 123 S.W.2d 997 (Tex. Civ. App. – Beaumont 1938, writ dism'd), for instance, the court held that where the insurer had sufficient ability to conduct its own investigation of the loss and request any actual information it needed to adjust the claim, it was "in no way prejudiced by the plaintiff's failure to supply a 'proof of loss' in the technical form and manner required by the policy." *Id.* at 998. The court concluded:

> So far as disclosed by the record, it could have obtained, and doubtless did obtain from the Gulf Oil Corporation, and its medical agents, a full report of the case. If it desired additional information to that furnished by the plaintiff in the letter of his attorneys, it should have requested it. Its position here is a purely technical one without any equities to support it.

Id.

This is consistent with the structure and language of the PPCA and its outline of the claims handling process. Some of the claims adjusting deadlines may be extended,

specifically for instance, where the insurer notifies the policyholder that the insurer needs additional "items, statements or forms" to complete its loss adjustment. TEX. INS. CODE §542.055(a)(3). But no exception is made to the PPCA deadlines for appraisal, or for situations where the insured disagrees that the insurer has fully paid the covered loss once the insurer has finished adjusting the claim. *See* TEX. INS. CODE §542.051, *et. seq*. And where the insurer has completed its valuation of the claim and refused any further payment, a further proof of loss form is *de facto* not an item the insurer needs to complete its handling of the claim. At that point there is now the potential for a disagreement about the amount of the, no further undisputed payment will be made, and any "proof of loss" provided without the insurer's approval or request is, at most, just one means by which an insured could communicate its disagreement.

Nothing about the PPCA statute suggests the legislature left room for these deadlines to be contractually extended for indefinite periods of time by so broadly construing "final proof of loss" to encompass the resolution of a disagreement about the amount of the loss through ADR or litigation after the statutory deadlines have passed. Construing it at such would contravene the statute's expressly stated purpose that it be liberally construed to promote the prompt payment of claims. TEX. INS. CODE §542.054. Central Mutual's position is not consistent with the language or the purpose of the PPCA.

Central Mutual's position is also inconsistent with the general public policy of Texas that an insurer should not be allowed to avoid its coverage obligations based on technicalities that in no way prejudiced the insurer or affect the coverage that would be due. *See e.g. Puckett v. U.S. Fire Ins. Co.*, 678 S.W.2d 936, 938 (Tex. 1984) (holding clauses purporting to allow an insurance company "to avoid liability when the breach of contract [by the insured] in no way contributes to the loss is unconscionable and ought not be permitted."); *see also PAJ, Inc. v. Hanover Ins. Co.*, 243 S.W.3d 630, 631 (Tex. 2008)(" We hold . . . that an immaterial breach does not deprive the insurer of the benefit of the bargain and thus cannot relieve the insurer of the contractual coverage obligation.") (*citing Hernandez v. Gulf Group Lloyds*, 875 S.W.2d 691, 692 (Tex. 1996)(disregarding UM consent-to-settle clause where no prejudice was shown)).

An appraisal award is *not* a "proof of loss."

Likewise, appraisal is not "additional information" under TEX. INS. CODE §542.055(b) as State Farm argues, because the statute expressly limits that to *information requested by the insurer* and *during the investigation*: "An insurer may make additional requests for information if during the investigation . . .". *Id.* If the insurer has determined the amount of the loss such that there is now a disagreement, *ipso facto*, the insurer has not requested any additional information to investigate the claim.

B. An appraisal award in favor of the insured determines the "actual damages" in the form of withheld policy benefits under *Menchaca*.

If appraisal is not part of the claims adjusting process, then what is it? The answer to this question has been obvious from this Court's jurisprudence since *Scottish Union* in 1892. By its very nature, an appraisal operates as an alternative dispute resolution process for the purpose of resolving a specific disputed fact – a dispute about the amount of the loss. That factual dispute is, in turn, the predicate for determining whether the insurer met its obligation under the contract to pay the amount of the covered loss, as well as its statutory and common law obligations to investigate and promptly pay covered losses in good faith. This is clear from how this Court has long characterized appraisal. It has said that the purpose of appraisal is limited to resolving disagreements about the amount of the loss, *"leaving the question of liability for such loss to be determined, if necessary, by the courts." See e.g. Scottish Union*, 8 S.W. at 631(emphasis added); *Johnson*, 290 S.W.3d at 889 (emphasis added). The Court has also expressly characterized appraisal as going to "the heart" of a plaintiff's breach of contract claim and the means agreed by the parties to determine "*whether a breach has occurred*." *In re Universal Underwriters*, 345 S.W.3d at 412 (emphasis added)(*quoting In re Allstate*, supra).

In short, an appraisal serves in place of a jury's fact finding in resolving this one, disputed fact – the amount of the loss. Once that fact is resolved at the conclusion of the appraisal process, and the "amount of loss" is determined in this binding alternate

process, the legal effect of that amount is then addressed to the courts, just as it would if a jury had found that disputed fact instead.

In *USAA Tex. Lloyds Co. v. Menchaca*, 545 S.W.3d 479, 487 (Tex. 2018)., the Court reaffirmed what it long ago held in *Vail v. Texas Farm Bureau Mutual Insurance Co.*,754 S.W.2d 129, 136 (Tex. 1988) – that withheld or underpaid policy benefits can be "actual damages" for purposes of a bad faith claim. The Court went on to delineate several other scenarios where an insurer might still be liable to a policyholder in the absence of such damages (i.e. the actual "independent injury" rule) or where there was no technical breach of the contract. *Menchaca*, 545 S.W.3d at 495-500. But the first ground of recovery clarified by the Court was the "entitled to benefits" rule: "an insured who establishes a right to receive benefits under an insurance policy can recover those benefits as 'actual damages' under the statute [Chapter 541] if the insurer's statutory violation causes the loss of the benefits." *Menchaca* at 495.

The relationship between appraisal and breach of contract claims and bad faith claims is thus already obvious from this Court's existing jurisprudence. The appraisal resolves the factual matter of the amount of the loss and this amount is handled as is any factual dispute once it is determined – whether by admission, by a jury verdict, or (as with appraisal) by agreement. That amount can then be compared to the amount the insurer actually paid, if anything, to determine as a matter of law whether there was an underpayment of the loss. If not, there would be no breach of contract or the

PPPCA as a matter of law, and the insured would have to demonstrate some "independent injury" other than withheld policy benefits under *Menchaca* in order to recover.

Conversely, if appraisal demonstrates the loss was undervalued by the insurer (and assuming the loss is covered) the difference between the "undisputed payment" made when the claim was adjusted and the amount that should have been paid based on the appraisal award would fix the amount of "actual damages." If the claim is covered (either because the parties agree it is, or the court resolves a disagreement in favor of coverage), this would further mean the court could find the contract and PPCA were breached as a matter of law based on these actual damages, leaving potential fact questions regarding whether the insured should recover "additional damages" under Chapter 542 for knowing bad faith, and the amount of reasonable and necessary attorneys' fees.

The fact that the actual damages for a breach of contract or breach of the duty of good faith and fair dealing were already paid as a result of the insurer losing in appraisal does mean these are not actual damages for a breach of contract or breach of Chapter 541. That result is illogical. If a jury were to value the loss, the insurer could not avoid a judgment based on that same verdict by paying the actual damages before a judgment could be entered by the court. Following appraisal, there are *still* "actual damages" in the form of policy benefits under *Menchaca* – they are just determined

through an agreed alternative process rather than by a jury. The *resolution* of the amount of loss is carried back into the case for the court to determine its legal effect as would any other binding factual finding – i.e. it does not "divest" the courts of jurisdiction over the dispute and leaves liability for that amount "to be determined, if necessary, by the courts." *Scottish Union*, supra; *Johnson*, supra.

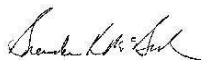
CONCLUSION

Amici Curiae, Texas Automobile Dealers Association, Texas Organization of Rural & Community Hospitals, Texas Independent Automobile Dealers Association, Texas Hotel & Lodging Association, Texas Association of Community Schools, and The Texas League of Community Charter Schools, respectfully request that in deciding this issue, the Court give careful consideration to the purposes underlying property insurance, and the importance of clearly placing the duty on the insurer to promptly investigate and pay covered claims in good faith. The Court should resolve this issue in a manner that honors the well-established public and statutory policy of assuring that those who pay for insurance to help them in times of crisis are not denied all or part of their benefits should the law give a financial incentive to insurers to delay the investigation and payment of claims.

To that end, this Court should clarify that the prompt payment of an appraisal award does not absolve the insurer of liability for breach of contract, bad faith or for liability under the Prompt Payment of Claims Act, and further clarify that appraisal is

not a part of the claims adjusting process, but an alternative dispute resolution mechanism limited solely to resolving disputes about the amount of the loss, leaving the question of liability for that loss, when necessary, for the courts.

Respectfully submitted,



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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the above and foregoing Amici Curiae brief has been forwarded to all counsel of record via electronic service through Texas.gov on this 21st day of February 2019.

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CERTIFICATE OF COMPLIANCE

I hereby certify that this brief is in compliance with the rules governing the length and font requirements for briefs prepared by electronic means. The brief was prepared using Microsoft Word 2010. According to the software used to prepare this brief, the total word count, including footnotes, but not including those sections excluded by rule, is 5,774. The "Garamond" font is used in this brief, with 14 pt. font for the body of the brief, and 12 pt. font for footnotes.

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