Case No. 14-0721

IN THE SUPREME COURT OF TEXAS

USAA TEXAS LLOYDS COMPANY,
Petitioner,

v.

GAIL MENCHACA,
Respondent

On Petition for Review from the Thirteenth Court of Appeals
Cause No. 13-13-00046-CV

BRIEF OF AMICI CURIAE, TEXAS AUTOMOBILE DEALERS ASSOCIATION, BRASS REAL ESTATE FUNDS, TEXAS INDEPENDENT AUTOMOBILE DEALERS ASSOCIATION, AND TEXAS ORGANIZATION OF RURAL & COMMUNITY HOSPITALS

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Brass Real Estate Funds
Texas Independent Automobile Dealers Association
Texas Organization of Rural & Community Hospitals

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TABLE OF CONTENTS

Page

TABLE OF AUTHORITIES

Page

Cases

Statutes

Legislative History

Law reviews

INTERESTS OF AMICI CURIAE

This brief is submitted jointly on behalf of several amici curiae, whose common interest is that they represent the interests of various owners of commercial property in Texas who pay substantial premiums for property insurance, and who depend upon clear legal duties being imposed on their insurers to promptly investigate and pay for covered losses in good faith. The purpose of this brief is to apprise the Court of some of the policy and practical implications of removing long-standing rules intended to encourage the prompt investigation and payment of covered losses in good faith, and the importance of those rules to securing and protecting the rights of Texas business owners and operators of commercial property.

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 join together in this brief urging the Court follow the plain language of, and protect the public policies embodied in, the Texas Legislature's passage of Chapter 541 of the TEXAS INSURANCE CODE, as well as this Court's well-established common law rules for bad faith in the investigation and payment of covered losses developed over the last several decades.

No fee has been charged by the undersigned counsel for the preparation and filing of this brief.

Texas Automobile Dealers Association ("TADA") is the statewide trade association representing approximately 1300 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 have a statewide total of $5.2 billion in new and used vehicle inventory and parts inventory and a statewide total of approximately $5 billion in facilities. 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 property depends on their ability to rely on the prompt and good faith investigation and payment of insurance coverage benefits in order to provide for their community, customers, and employees.

Brass Real Estate Funds ("Brass") and its subsidiary, Magi Realty, Inc, is the largest owner operator of commercial office properties in San Antonio, Texas and the surrounding area. Brass specializes in finding problematic office properties; implementing needed capital improvements, leasing the property to market and then selling the stabilized asset. Proper insurance coverage is a requirement by lenders and investors in order to secure the necessary debt and equity to acquire the project and to protect their investments. In situations where a covered peril impacts the property, it is vital for continued business operations that claims are investigated and paid timely and in good faith. Exacerbated delays in payment of claims, or short paying claims, places the property at risk of losing tenants, and negatively impacting monies invested by debt and equity participants alike.

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. If insurers are excused from their duty to investigate and fully pay covered claims in good faith, such a financial incentive would additionally hurt businesses that depend on insurance coverage to protect the collateral for loans on real and personal property.

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. As with other commercial property owners, owners and operators of rural and community hospitals 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 catastrophic losses. 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 a damaged hospital.

ISSUES ADDRESSED

Amici Curiae, TADA, Brass, TIADA and TORCH respectfully submit this brief to address the following issues:

(1) The Court is being asked by USAA, and its supporting amici from the insurance industry, to limit the scope of Chapter 541 so that it does not apply to an insurer's bad faith failure to pay insurance coverage benefits as actual damages. They ask the Court to re-define "actual damages" to exclude damages from the failure to pay coverage benefits to a policyholder, despite this Court's prior opinions to the contrary in *Vail* and *Davis*. The insurance industry is well aware that Chapter 541 is *not* so limited, because the industry sought to convince the legislature to change the statute in the last legislative session – a change the legislature refused to adopt. This Court should reject the insurance industry's invitation to legislate from the bench.

(2) The rules governing prompt payment of claims in good faith (both the statutory rules and the common law rules developed by this Court over the last several decades) are there for the protection of all policyholders – including commercial property owners and businesses – who depend on insurance coverage being paid promptly and in good faith after a catastrophic loss. The policy behind these rules is to account for the natural imbalance in bargaining power that exists when a business or person suffers a catastrophic loss to their property, and where the carrier then has a natural financial incentive to take advantage of the policyholder's precarious position to shift the costs of investigation or underpay or delay paying covered losses in bad faith. The Court should continue to interpret "actual damages" under Chapter 541 consistent with the well-established purposes and public policies behind statutory and common law bad faith to encourage prompt investigation and payment of covered losses in good faith.

ARGUMENT

A. The Court Should Not Do What the Legislature Refused to Do in the Last Legislative Session.

The insurance industry attempted to convince the legislature to amend Chapter 541 to embody the so-called "independent injury" rule during the last legislative session. The legislature rejected the change to the statute that USAA and its supporting amici are now asking the Court to make through the common law. The Court should decline USAA's invitation to legislate from the bench. If the insurance industry is dissatisfied with the incentives and liabilities imposed by the legislature, it obviously knows that is a matter to be addressed to the legislature and not to this Court.

In the 2015 Regular Session, the legislature considered and rejected SB1628, which would have re-defined "actual damages" to expressly limit the application of the bad faith statute to what the industry has pushed as the "independent injury" rule. The proposed law would have added a definition of "actual damages" as part of TEX. INS. CODE §541.151 as follows:

> Sec. 541.151. PRIVATE ACTION FOR ACTUAL DAMAGES AUTHORIZED.
>
> (a) A person who sustains actual damages may bring an action against another person for those damages caused by the other person engaging in an act or practice:
>
> (1) defined by Subchapter B to be an unfair method of competition or an unfair or deceptive act or practice in the business of insurance; or

(2) specifically enumerated in Section 17.46(b), Business & Commerce Code, as an unlawful deceptive trade practice if the person bringing the action shows that the person relied on the act or practice to the person's detriment.

(b) *For purposes of this subchapter, "actual damages" means an injury independent of the harm resulting from the insurer's denial of policy benefits. The policy benefits wrongfully withheld, as well as any attorney's fees or costs incurred to recover those policy benefits, do not constitute "actual damages" for purposes of this section.*

S. J. of Tex., 84th Leg., R.S., C.S.S.B. 1628, § 2, sec. 541.151 (2015) (Committee Substitute Senate Bill proposing amendment to Tex. Ins. Code § 541.151)[1] (emphasis added). A companion bill in the House, HB3646, which contained the same attempt to redefine "actual damages" to codify the so-called "independent injury" rule likewise never made it out of committee. S. J. of Tex., 84th Leg., R.S., H.B. 3646, § 4, sec. 541.151 (2015) (House Bill proposing amendment to Tex. Ins. Code § 541.151)[2].

The Senate Bill was passed by the full Senate but only after striking the proposed amendment that would have incorporated the "independent injury" rule that USAA is now asking this Court to graft into the statute. *See* S.J. of Tex., 84th Leg., R.S. 1184 (Apr. 29, 2015) (Floor Amendment 3 struck the proposed amendment, found at Section 2, subsection (b) of C.S.S.B. 1628); S.J. of Tex., 84th Leg., R.S. 1244 (Apr. 30, 2015) (Senate passed the bill after the amendment had been struck by Floor Amendment 3

[1] The text of the bill and its history can be accessed at the following URL: http://www.legis.state.tx.us/BillLookup/Text.aspx?LegSess=84R&Bill=SB1628

[2] http://www.legis.state.tx.us/BillLookup/Text.aspx?LegSess=84R&Bill=HB3646

the previous day). In *Allstate Ins. Co. v. Watson*, 876 S.W.2d 145, 149 (Tex. 1994), interpreting part of the predecessor to Chapter 541, the Court gave significant weight to the fact that the legislature had rejected an amendment to Section 21.21-2 that would have allowed third party claims for unfair claims practices. *Id.* ("we cannot ignore the legislature's refusal to create a statutory private cause of action for unfair claim settlement practices for third party claimants"); *see also Chastain v. Koonce*, 700 S.W.2d 579, 583 (Tex. 1985)("The legislative history of the 1979 amendments to the DTPA supports the conclusion that the legislature did not intend to require proof of intent, knowledge or conscious indifference to support recovery . . . The intent language was deleted prior to the legislature's passage of the DTPA amendments."); *Love v. Wilcox*, 119 Tex. 256, 275-276, 28 S.W.2d 515, 524 (Tex. 1930) (relying on the legislature's rejection of senate committee amendment to a statute to interpret and apply the statute).

USAA and its amici know that the proper venue for this issue is the legislature. Since this Court had already defined "actual damages" under Chapter 541 to include unpaid or underpaid policy benefits in *Vail v. Texas Farm Bureau Mutual Insurance Co.*, 754 S.W.2d 129 (Tex. 1988), the insurance industry knew that it had to change the statute in order for its "independent injury" argument to be legally valid. That attempt failed in the last legislature.

As this Court explained in *Vail,* the statutory bad faith cause of action (as well as the DTPA) are meant to act as a separate remedy when an insurer refuses wrongfully to pay what it owes on a valid claim:

> The fact that the Vails have a breach of contract action against Texas Farm does not preclude a cause of action under the DTPA and article 21.21 of the Insurance Code. Both the DTPA and the Insurance Code provide that the statutory remedies are cumulative of other remedies[3] . . . It would be incongruous to bar an insured – who has paid premiums and is entitled to protection under the policy – from recovering damages when the insurer wrongfully refuses to pay a valid claim.

Id., 754 S.W.2d at 136. In *Twin Cities Ins. Co. v. Davis*, 904 S.W.2d 663, 666 (Tex. 1995), the Court clarified in unequivocal terms what it meant in *Vail* by its rejection of the independent injury rule:

> The insurer responded that such benefit of the bargain damages were not "actual damages" subject to the enhanced remedy provisions of the DTPA and Insurance Code for unfair claims settlement practices. In rejecting this argument, this Court held "that *an insurer's unfair refusal to pay the insured's claim causes damages as a matter of law in at least the amount of the policy benefits wrongfully withheld*." . . . As it relates to the issue in this case, *Vail* was only concerned with the insurer's argument that policy benefits improperly withheld were not "actual damages in relation to a claim of unfair claims settlement practices." *In rejecting the insurer's argument, we held that policy benefits wrongfully withheld were indeed actual damages.*

Davis (citations omitted, emphases added, *quoting Vail*).

[3] The court cited TEX. BUS. & COMM. CODE ANN. § 17.43 (Vernon 1987) and TEX. INS. CODE ANN. art. 21.21, § 11 (Vernon 1981). Article 21.21 was re-codified in Chapter 541 of the current Insurance Code, which still provides that the remedy is not exclusive. TEX. INS. CODE §541.007.

Here, the Court cannot ignore the legislature's refusal to codify the "independent injury" rule when it was asked to do so in the last legislative session – especially given that the legislature's decision was long after this Court had already interpreted "actual damages" in the statute to include unpaid policy benefits in *Vail* and *Davis*. It is presumed that the legislature is aware of judicial opinions interpreting its statutes. *See e.g. Coastal Industrial Water Authority v. Trinity Portland Cement Div., etc.*, 563 S.W.2d 916, 918 (Tex. 1978)

It was because of this Court's correct reading of Chapter 541, and its express allowance of unpaid coverage benefits as "actual damages," that the insurance industry sought to amend the statute to avoid the result compelled by the statute's plain language and this Court's opinions in *Vail* and *Davis*. The "independent injury" rule as urged by USAA and its amici support is *not* to be found in the statute as it is worded – and the Court has already so held.

Having failed to convince the legislature, and knowing that the statute does not support the "independent injury" rule as they propose it be adopted by this Court, USAA and its amici now ask this Court to change the statute through an opinion – an invitation the Court should politely decline. That request would, in turn, also require the Court to expressly reverse its stated understanding of what constitutes "actual damages" under the Insurance Code expressed in *Vail* and *Davis*. If the insurance industry's requested change to the statute makes public policy sense, that is a matter to

be addressed to the legislature, where USAA and the insurance industry can try to convince the legislature that such a change is somehow good for Texas businesses.

This is not the right venue for such a change. However, even if the Court were to consider the meaning of "actual damages" as an appropriate exercise of the Court's power, for the reasons that follow, the "independent injury" rule is not consistent with the long-standing public policies and balancing of interests behind the statutory and common law rules governing bad faith insurance practices.

B. If The Court Addresses The "Independent Injury" Rule It Should Preserve the Statutory and Common Law Duties Imposed on Insurers to Promptly Investigate and Pay Covered Losses in Good Faith.

The duty to promptly investigate and pay covered claims in good faith, both as a matter of 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). 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. *Ramirez v. Transcontinental Ins. Co.*, 881 S.W.2d 818, 823 (Tex. App. – Houston [14th Dist.] 1994, writ denied) (*citing Viles*, 788 S.W.2d at 567)("we hold that a breach of the duty of good faith and fair dealing will give rise to a cause of action in tort that is separate from any cause of action for breach of the underlying insurance contract.")).

These duties are not only imposed on an insurer through the common law as a matter of public policy, but have been 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).

As the Court explained in *Viles*, the purpose behind the bad faith cause of action was specifically to create a punitive incentive and allow a broader remedy to that available under a breach of contract theory to offset the unequal bargaining power with which policyholders would ordinarily find themselves:

> This Court first recognized the tort more than ten years ago. *Arnold v. National County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987). We did so because "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. . . . An insurance company has exclusive control over the evaluation, processing and denial of claims." *Id.* at 167.
>
> Before we recognized the tort, contract law served as the exclusive theory on which policyholders could recover from an insurer for the bad faith handling of claims. Although a policyholder may have successfully proved that an insurer wrongfully denied benefits, damages were limited to the amount due under the policy, plus interest. The policyholder was prevented from recovering damages for emotional distress or economic loss caused by the deprivation of policy benefits. Punitive damages also were unavailable to deter insurers from wrongfully or even fraudulently denying claims. Therefore, insurers had nothing to lose by wrongfully denying claims or coercing unfair settlements.

Viles at 52 (*citing* James A. McGuire & Kristin Dodge McMahon, Issues for Excess Insurer Counsel in Bad Faith and Excess Liability Cases, 62 DEF. COUNS. J. 337, 337 (1995) (citations omitted).

The issue in this case is that insurers are seeking this Court's help to absolve themselves of their common law and statutory duties to promptly investigate and pay covered losses in good faith. The so-called "independent injury" undoes what the Court (and the legislature since) have sought to effectuate through common law and statutory bad faith causes of action. The Court should preserve these long-standing policies that protect the rights of vulnerable policyholders and balance the interests when a business

or commercial property owner is placed in an impossible bargaining position as a result of a catastrophic loss.

Eliminating liability for coverage benefits under the insurance code harms a business suffering a catastrophic loss in a number of important ways.

Insurers can shift the duty and expense of investigating claims onto the insured. The first way the "independent injury" rule would undermine 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 and does so knowingly and intentionally, it would not be subject to any punitive remedy or liability for mental anguish damages and would effectively be limited to paying the amount of actual policy benefits it should have paid in the first place. The insured would have to perform its own investigation, at its own expense, and wait through the litigation process incurring the additional expense of testifying experts, in order to get the coverage amounts the insurer should have long ago investigated and paid. Those costs, which generally are not recoverable in a breach of contract action, could cripple a business already hurting from a covered loss to its revenue-producing property. This inherent unequal position would encourage the very sort of unscrupulous conduct the bad faith tort and statute were meant to prevent, because insurers would be economically incentivized to shift their costs onto their insureds.

Insurers Are Incentivized to Deliberately Undervalue Covered Losses. Removing bad faith liability for underpaid or unpaid policy benefits also provides an insurer an incentive to deliberately undervalue a covered loss. At best, an insured who has suffered a catastrophic loss and cannot afford any delay or expense in proving the amount of its covered loss may have to accept substantially less than it is owed under its policy – the result predicted by the Court in *Viles* and *Arnold*. 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 litigation 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. So long as the insurer can pressure the policyholder into settling, all that the insurer risks is an occasional award of attorneys' fees and the penalty provided under the Prompt Payment of Claims Act. The legislature and this Court in creating the statutory and common law bad faith causes have already determined that these are not sufficient incentives to ensure good faith payment of covered losses.

Insurers can coerce the insured into agreeing to less than the amount owed. Without the risk of bad faith liability, 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. This undermines, and indeed negates, the insurer's contractual duties to investigate and pay covered losses, while the expense and risk compounds for the insured as the litigation continues. The insurer, which is

already substantially less risk-averse than a business owner with damaged property, does not face a risk large enough to discourage taking the chance that it can force a struggling business to settle for less than is owed.

This inherent unequal bargaining power is the reason for the statutory and common law rules imposing liability on insurance carriers who fail to investigate claims and pay in good faith those covered losses for which the insurer's liability is reasonably clear. Indeed, it was to preserve these policies that the Court rejected the independent injury rule in *Vail*: "It would be incongruous to bar an insured – who has paid premiums and is entitled to protection under the policy – from recovering damages when the insurer wrongfully refuses to pay a valid claim. Such a result would be in contravention of the remedial purposes of the DTPA and the Insurance Code." *Id.*, 754 S.W.2d at 136.

Since these policies are already embodied in Chapter 541 and this Court's prior jurisprudence, the Court should reject the "independent injury" rule urged in this case, and let the insurance industry take its argument to the legislature where this issue belongs.

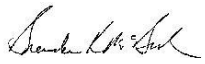
CONCLUSION

Amici Curiae, Texas Association of Automobile Dealers, Brass Real Estate Funds, Texas Independent Automobile Dealers Association, and Texas Organization of Rural & Community Hospitals, respectfully request that the Court give careful

consideration to the costs of, and purposes underlying, commercial property insurance, as well as 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 by insurers acting in bad faith or taking unscrupulous advantage of policyholders following a catastrophic loss.

To that end, this Court should continue to treat the statutory bad faith cause of action as a separate tort claim from breach of contract; reaffirm its understanding of "actual damages" as expressed in *Vail* and *Davis*; and continue to permit a statutory and common law bad faith claim against insurance carriers when they fail to investigate claims and pay policy benefits for covered losses in good faith.

Respectfully submitted,



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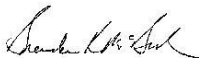
CERTIFICATE OF SERVICE

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 filing through Texas.gov on September 23, 2016.



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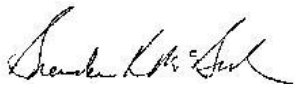
CERTIFICATE OF COMPLIANCE

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 2015. According to the software used to prepare this brief, the total word count, including footnotes, but not including those sections excluded by rule, is 4,428. 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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