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Is There A "Separate and Independent Injury" Rule Under Tex. Ins. Code Ch. 541?

David J. Schubert

Author contact information:
David J. Schubert
Schubert & Evans, P.C.
Dallas, TX

dschubert@schubertevans.com
214-744-4400

I.
ISSUE PRESENTED

Is there a "separate and independent injury" rule that requires the insured to sustain damages above and beyond the denied claim itself in order to subject the insurer for extra-contractual, treble damages under Texas law? As set forth below, the answer appears to be "yes" at least according to the way that several Texas Courts of Appeals and the 5th Circuit have broadly construed the Texas Supreme Court's 1998 decision in *Castaneda*. But if it is an "across the board" "yes," that answer is not *necessarily* mandated by the currently existing Texas Supreme Court case law unless, as it appears to possibly be the case, the Texas Supreme Court's 1988 decision in *Vail* has, in effect, been overruled sub silentio on this issue. Accordingly, this suggests that the definitive word on this issue is ripe for the Texas Supreme Court to address in some future case.

In 1988 in *Vail v. Texas Farm Bureau Mut. Ins. Co.,* 754 S.W.2d 129, 136 (Tex. 1988), a first-party claim "bad faith" case, the Texas Supreme Court held that under the former version of what is now Tex. Ins. Code Ch. 541 (i.e. Art. 21.21) "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." Thus, under *Vail,* if the insurer denies a claim and such denial is found to have been in bad faith or otherwise to have violated the statutory unfair denial prohibitions of Texas Ins. Code Chapter 541, then the policy benefits wrongfully denied can be potentially trebled. This particular holding in *Vail* has never been overruled or otherwise disapproved by the Texas Supreme Court since 1988.

In recent years, however, under the same statutory causes of action as now recodified in Chapter 541, several courts of appeals and the Fifth Circuit have read the *Castaneda* decision by the Texas Supreme Court as establishing a rule that "there can be no recovery for extra-contractual damages for mishandling claims unless the complained of actions or omissions causes injury independent of those that would have resulted from the wrongful denial of policy benefits." *Great Am. Ins. Co. v. AFS/IBEX Fin. Services*, 612 F.3d 800, 808 n.1 (citing *Parkans Int'l v. Zurich Ins. Co.*, 299 F.3d 514, 519 (5th Cir. 2002)). Thus, has become known as the "independent injury rule".

But if *Vail's* holding that denied policy benefits are damages as a matter of law and subject to trebling under Article 21.21 (now Ch. 541) has never been overruled, how have some more recent decisions by courts of appeals and the Fifth Circuit come to the conclusion that there is an "independent injury" rule such that wrongfully denied policy benefits are not extra-contractual damages under Chapter 541? Has *Vail* been effectively overruled by the passage of time and more recent Texas Supreme Court cases even though none of them have said so?

II.
VAIL

The Vails' home burned. They made claim on their homeowner's policy. The insurer denied the claim and the Vails sued. They sued for the policy benefits denied and brought extra-contractual claims under the DTPA and old Article 21.21 based on the insurer's alleged bad faith

denial of the claim. Specifically, the Vails alleged that the insurer had not attempted in good faith to effectuate a prompt, fair and equitable settlement of their claim on which liability had become clear as prohibited by old Article 21.21-2 as incorporated into Article 21.21 via a Department of Insurance Board Order so as to be privately actionable as an unfair claim settlement practice. (That same theory of recovery is now contained expressly in Section 541.060(a)(2).) The jury found that the insurer had violated the provision by denying the claim and the trial court entered judgment in the Vails' favor for three times the policy benefits. The court of appeals affirmed the actual damage finding (i.e. the policy benefits) but reversed the trebling of them. The Vails appealed to the Texas Supreme Court.

In addition to the issue of whether the old board orders could be used as a basis for a private cause of action under the DTPA and Article 21.21 (the court held that they could) and whether the version of the DTPA and Article 21.21 in place at the time required a "knowing" finding in order to trigger the trebling (the court held that it did not), the court also had to address the insurer's argument that the policy benefits, as sums due under the contract, could not be the basis of damages awarded under the statutory unfair claims practices provisions. *Vail*, 754 S.W.2d at 136. In rejecting the insurer's argument in that regard, the court's 6-3 majority held "We hold 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." *Id.* (emphasis added). The court added that the fact that the Vails also had a breach of contract claim for the same damages did not preclude claims under the DTPA or Article 21.21. *Id.* Accordingly, the Texas Supreme Court reversed the Court of Appeals' decision and reinstated the treble damage award which, as noted, was expressly based on policy benefits withheld.

III.
POST-*VAIL* CASES

A. *Beaston* (1995)

In *Beaston v. State Farm Life Insurance Co.*, 861 S.W.2d 268 (Tex. App.—Austin 1993), rev'd, 907 S.W.2d 430 (Tex. 1995), a life insurance case, the insurer denied payment of benefits on the basis that the policy had lapsed for nonpayment of premium a few days before the insured's death. The beneficiaries sued. The trial court granted an instructed verdict in favor of Plaintiffs as to coverage and benefits owed and the jury returned a verdict finding Article 21.21 violations and awarding mental anguish damages. But, since the trial court failed to instruct the jury that it had found coverage under the policy, the jury awarded $0 as to policy benefits damages. Since the version of Article 21.21 involved at that time did not require a "knowing" finding to trigger trebling, there was no express finding of "knowing" violations. However the trial court concluded that a "knowing" finding was required for the recovery of mental anguish and thus concluded that mental anguish was not recoverable. Thus, in light of the jury's finding of $0 in policy benefits damages on the Article 21.21 claims, the trial court rendered judgment only for the policy benefits (that it found to be owing because of the instructed verdict) plus interest and attorney fees.

On appeal, the court of appeals concluded that a "knowing" finding was not required for recovery of mental anguish damages. Thus, the court of appeals re-instated the mental anguish award. Beaston also argued, however, that under *Vail*, the jury's failure to find any policy

benefits damages was immaterial since the trial court had directed a verdict in her favor on benefits owed. Thus, she argued that the Art. 21.21 violations and the automatic trebling provisions of the version of Article 21.21 involved entitled her to recover trebling of the policy benefits. The court of appeals acknowledged that *Vail* supported Beaston's argument but held that it was constrained by the jury's awarding of mental anguish damages but refusal to award any policy benefits as damages for the 21.21 violations and Beaston's failure to object to the court's failure to instruct the jury that it had found coverage. *Beaston*, 861 S.W.2d at 278-79.

Thus, the Court of Appeals opinion in *Beaston* stands for the proposition that if the denied policy benefits are submitted to the jury as an element of damage but the jury expressly fails to award any policy benefits as damages, then the denied policy benefits will not be considered damages subject to being trebled under Chapter 541.

In the end, it did not matter because the Texas Supreme Court concluded that the denial of benefits was proper since the policy had been validly cancelled for non-payment and thus reversed the entire judgment against the insurer. *State Farm Ins. Co. v. Beaston*, 907 S.W.2d 430 (Tex. 1995). Thus, the Texas Supreme Court did not have to address whether *Vail* obviated the need for the jury to award policy benefits as damages where the court has previously found coverage as a matter of law.

B. *Davis* (1995) — The seeds of the "Independent Injury Rule" Are Planted, At Least for Workers Compensation and Punitive Damage Purposes

While *Beaston* was pending at the Texas Supreme Court, the Texas Supreme Court still had another occasion to address the issue of policy benefits as damages as a matter of law under *Vail*. *Twin City Fire Ins. Co. v. Davis*, 904 S.W.2d 663 (Tex. 1995) was a worker's compensation "bad faith" case. This appears to be the case where the initial seeds of the "independent injury rule" were sown, although as discussed below, it did not expressly address the issue.

In *Davis*, the workers comp claim involved was settled via an agreed judgment that included an "open medical" provision. Plaintiff and her doctor contended that she needed a $3500 hot tub "for life". The carrier denied the request. Davis sued. The jury found that the insurer had engaged in unfair and deceptive practices, breached the duty of good faith and fair dealing and breached the settlement agreement. The jury awarded $3500 as benefits "wrongfully withheld" but without specifying which of the three liability theories it was tied to. But the jury failed to award any mental anguish damages as Plaintiff requested. The jury also awarded punitive damages of $100,000. The trial court, however, refused to enter judgment for the punitives, agreeing with the insurer that punitive damages required some identifiable tort damages separate and independent from the contractual benefits owed. Thus, the trial court entered judgment solely for the $3500 in benefits/expenses, interest, statutory interest penalties, and attorney fees.

On Plaintiff's appeal to the court of appeals, the court of appeals agreed with the Plaintiff that, under *Vail*, the $3500 in policy benefits were tort damages under the breach of duty to good

faith and fair dealing findings as a matter of law to support the punitive damage award and, thus, reinstated the punitive award.

At the Texas Supreme Court, the insurer argued that a punitive damage award must be supported by separate and independent identifiable tort damages and that since the $3500 in benefits damages found by the jury were contract damages, and the jury had failed to award any separate tort damages by failing to award any mental anguish, they would not support any punitive damages. The Texas Supreme Court agreed with the insurer.

The court first noted that under prior Texas punitive damage case law, breach of contract claims will not support a punitive damage award unless there is some separate and independent tort with accompanying tort-based damages. *Davis*, 904 S.W.2d at 665. The court acknowledged that the breach of duty of good faith and fair dealing, as found by the jury, was a tort and was separate from breach of contract, *Davis*, 904 S.W.2d at 666, and that if separate damages are awarded for bad faith conduct above and beyond the contractual benefits, those would support a punitive damage award in a bad faith case. *Id.* The court then honed in on the precise dispute involved: Could the punitive damage award be supported, under *Vail* by the jury's award of only policy benefits as the actual damages for the tort bad faith when the jury did not specify which of the theories of recovery those damages were attributable to and the jury failed to award any clearly tort-based damages (i.e. mental anguish)? *Id.*

Plaintiff argued that under *Vail*, the policy benefits awarded were damages as a matter of law under the bad faith theory as well. *Id.* The Texas Supreme Court, held, however, that Plaintiff's reliance on *Vail* was misplaced since here the issue was what type of actual damages were necessary to support a punitive damage award, whereas *Vail* only addressed the policy benefits issue in terms of actual damages. *Id.* Instead, the court held that since this case involved a worker's compensation insurance policy, *Aranda* was the governing legal framework and in *Aranda* the Texas Supreme Court had held that because of the exclusivity of remedy provisions of the Texas Workers Compensation Act, the Plaintiff in a worker's compensation "bad faith" case must show that the carrier's breach was "*separate* from the compensation claim and produced an *independent* injury." *Id.* at 667 (quoting *Aranda*, 748 S.W.2d at 214). Accordingly, since the only damages found by the jury were the $3500 in policy benefits denied, the court held that the punitive damage award could not stand.

In a footnote (footnote 3), the Court held that *Vail's* statement that policy benefits wrongfully denied were damages as a matter of law was made in case, i.e. *Vail,* where the complaint was the insurer had wrongfully denied the insured's claim and should not be extrapolated blindly to other types of extra-contractual or bad faith complaints, such as failure to properly investigate or unjustified delay, since those types of complaints may give rise to different types of damages that do not necessarily relate to the denial of the claim. *Id.* at 666, n. 3.

In short, *Davis* was a worker's compensation bad faith case and, under *Aranda*, workers compensation bad faith claims require a separate and independent injury because of the exclusivity provisions of the Comp Act. The *Davis* court's discussion of and distinguishment of *Vail* does not suggest that it was retreating from *Vail* as applied to actual damages in other types

of first party insurance scenarios. Instead, *Davis* only dealt with the issue of whether denied policy benefits standing alone would support a punitive damage award in a worker's compensation case under *Aranda* and not the broader issue of whether denied policy benefits were actual damages in other types of bad faith scenarios.

C. *Seneca* (1995) — The "Independent Injury" Rule Takes Root, At Least in Misrepresentation Cases

In *Seneca Resources Corp. v. Marsh McClennan, Inc.* , 911 S.W. 2d 144 (Tex. App.—Houston [1rst] Dist. 1995, no pet.) the policyholder sued its broker for misrepresentations under the DTPA/Article 21.21 as to the scope of coverage of certain policies that it purchased to cover its off-shore oil platforms. Apparently based on evidence that tended to show that the insured was aware prior to binding the coverage that certain earlier representations made by the broker were not accurate, the jury found that the broker made misrepresentations but that the insured suffered no damages as a result of them. Thus, the trial court rendered judgment in favor of the broker.

On appeal, Seneca argued that under *Vail*, the policy benefits of the policies as misrepresented by the broker were damages as a matter of law and that it therefore did not need to obtain any jury findings on them. *Seneca*, 911 S.W.2d at 148. Rejecting that argument, and relying on footnote 3 in *Davis* (see above discussion), the court reaffirmed that the "damages as a matter of law" language in *Vail* applied where the claim was that the insurer wrongfully failed to pay the insured's claim under the policy but that nothing in *Vail* suggested that where the claim is one of misrepresentation of the policy the insured was relieved of its obligation to obtain jury findings that the misrepresentations were a producing cause of actual damages. Thus *Vail* was inapplicable. *Id.* at 149-50.

Thus, *Seneca* stands for the proposition, consistent with footnote 3 in *Davis*, that where the issue is some wrongful act by the insurer or agent other than denial of the claim, the *Vail* language does not apply and the insured has to obtain jury findings on separate damages caused by the misrepresentation or other act complained of. *Seneca*, like *Davis* at least suggests that *Vail* remains the law as to bad faith cases premised on a bad faith denial of the claim.

D. *Castaneda* (1998) — The "Separate and Independent Injury" Rule Sprouts, At Least if there is No "Bad Faith" Denial of the Claim

In *Provident American Ins. Co. v. Castaneda*, 988 S.W.2d 189 (Tex. 1998), the Plaintiffs sued their health insurer after it denied coverage for treatment based on its interpretation of certain pre-existing condition provisions of its policy. The jury found that the illness did not manifest before the policy incepted. However, the plaintiff did not seek any contractual relief but sought and obtained a jury verdict solely based on extra-contractual theories: that the insurer had violated the DTPA and Article 21.21 by denying the claim after liability became reasonably clear, misrepresenting the policy, and engaging in other unfair claims settlement practices (inadequate investigation), and that it had done so knowingly. The jury awarded damages for denied benefits and damage to credit but no mental anguish. Based on the

"knowingly" finding, the trial court entered a treble damage judgment against the insurer. The court of appeals affirmed except as to a 12% penalty.

A 6-3 majority of the Texas Supreme Court, however, held that, even assuming that the denial was improper as a matter of contract, there was a bone fide dispute as to the facts and proper interpretation of the policy language. Therefore, there was no evidence to support the jury's extra-contractual answer under Article 21.21 that the insurer denied the claim after its liability was reasonably clear. *Castaneda*, 988 S.W.2d at 197. Stated differently, the denial may have been in error, but it would not support Art. 21.21 liability.

As to the jury findings of inadequate investigation under Article 21.21, the court, relying on *Republic Ins. Co. v. Stoker*, 903 S.W.2d 338 (Tex. 1995), held that inadequate investigation or other types of claims mishandling, are not a basis in themselves for recovering policy benefits as bad faith damages. *Id.* at 198. In *Stoker*, the court stated in dicta that it was not excluding the possibility "that in denying the claim, the insurer may . . . cause injury independent of the policy claim." *Id.* (citing *Stoker*, 903 S.W.2d at 341). But, after reviewing the evidence, the majority in *Castaneda*, held that the damage to credit damages awarded by the jury were part and parcel of the damages flowing from the claim denial and that there was no evidence to support the jury's findings that flaws in the investigation, delays in communication, etc. caused any separate and independent harm distinct from the claim denial. *Id.* at 198-99.

At a minimum, therefore, *Castaneda* stands for the proposition that where the insurer's denial of the claim was reasonable, albeit in error, so as to not support extra-contractual liability, other investigation and claims handling mistakes or misrepresentations by the carrier will only support extra-contractual liability if they have caused some other separate and independent injury other than the denied claim. As noted below, however, while *Castaneda* did not address a situation where the insurer has, in fact, denied the claim without any reasonable basis or after liability is reasonably clear, and thus, does not technically hold that wrongfully denied policy benefits are never damages for purposes of extra-contractual liability and does not even mention, much less overrule, *Vail* on that point, it has been read more broadly by later courts.

E. *Parkans* (2002) — Purporting to Follow *Castaneda But* in Another Case Where There Was No "Bad Faith" Denial of Coverage

In *Parkans International v. Zurich Ins. Co.*, 299 F.3d 514 (5th Cir. 2002), the insured submitted a first-party loss under the crime coverage of its policy which Zurich denied. The trial court granted summary judgment for the insured on coverage. The extra-contractual claims then went to trial and the trial court instructed the jury that it had found the claim covered and thus Zurich had breached its policy. The jury found that Zurich "knowingly" engaged in unfair and deceptive practices in denying the claim as well as under various misrepresentation provisions of the statute. The jury awarded $1.34M on the contract claim and $1.29M on the statutory bad faith claims. The insured elected judgment on the contract damages. Zurich appealed.

On appeal, the 5th Circuit concluded that the claim was not a covered "forgery" under the terms of the policy and thus reversed. Of course, this necessarily meant that the denial of the claim could not have been in bad faith. The court then states that since the jury found no tort

injuries independent of the contract damages, there could also be no extra-contractual damages for claims mishandling, citing *Castaneda*. *Parkans*, 299 F.3d at 519.

Thus, although the court used somewhat broad language regarding the need for an independent injury, it did so in the context of a case where, as in *Castaneda*, the denial of the claim itself was not in bad faith.

F. *USAA v. Gordon* (2002)-Seeming to Interpret *Castaneda* as Laying Down an "Across the Board" Rule

In *USAA v. Gordon*, 103 S.W.3d 436 (Tex. App.—San Antonio 2002, no pet.), the court of appeals seem to have read *Castaneda* (and *Parkans*' interpretation of *Castaneda*) as establishing an "across the board" rule requiring damages independent of the policy benefits. There, the Gordons made a claim for foundation damage, alleging it was caused by a plumbing leak. USAA denied the claim, concluding that the damage was not caused by plumbing leaks. The Gordons sued. The jury found that USAA breached its contract, breached the duty of good faith and fair dealing and violated the Insurance Code and DTPA. The same categories of damages—repair costs and additional living expenses—were submitted on each of the theories of recovery and the jury awarded the same amount, i.e. the $100,000 jurisdictional limits applicable to the county court at law, under each claim, both the contract claim and the extra-contractual claims. The court of appeals affirmed the coverage finding. Although that affirmance on coverage/breach of contract made the extra-contractual liability issues moot, the court of appeals nevertheless addressed USAA's argument that the Gordon's failure to prove any damages apart from the denied claim itself was fatal to their extra-contractual claims. Citing *Castaneda* and *Parkans*, the court says "An insured is not entitled to recover extra-contractual damages unless the complained of actions or omissions cause injury independent of the injury resulting from a wrongful denial of policy benefits." *Gordon*, 103 S.W.3d at 442. Accordingly, since the only damages awarded on the extra-contractual claims were the same policy benefit damages awarded under the contract claim, the court held that the Gordons had no valid extra-contractual claims. *Id.*

Although the *Gordon* court did not mention *Vail* or otherwise engage in further dicta as to whether denied policy benefits could constitute extra-contractual damages for a bad faith denial under Chapter 542, it does seem to hold that independent damages are required in any case.

G. *Laird v. CMI* (2008)—Another Texas Court of Appeals Reads *Castaneda* as Establishing an "Across the Board" Rule

Any notion that *Gordon's* broad reading of *Castaneda* was an anomaly or limited to its facts is undermined by the Texarkana Court of Appeals' decision in *Laird v. CMI Lloyds*, 261 S.W.3d 322 (Tex. App.—Texarkana 2008, pet. dism'd w.o.j.). There, the insured made a first-party claim for water leak damage to their home and the insurer paid about $30,000 but denied any further payment. The insured contended that based on an appraisal award the insured was entitled to more. The insurer filed a declaratory judgment action and the insured counterclaimed for contract and extra-contractual damages asserting that the carrier did not have any reasonable basis for denying further payment. The trial court rendered summary judgment that the insurer owed no additional payment. The court of appeals, however, reversed that ruling, finding that

there were fact issues on whether the carrier had paid everything that it owed. The insurer argued that the trial court's summary judgment in its favor on the extra-contractual claims should, nevertheless, be affirmed because the insured had presented "no evidence" of any damages caused by the carrier's conduct independent of the policy claim. *Laird*, 261 S.W.3d at 327-28. Agreeing with the insurer, and citing to *Castaneda, Gordon* and *Parkans,* the court says that the "threshold of bad faith is reached when a breach of contract is accompanied by an independent tort" and that an insured "is not entitled to recover extra-contractual damages unless the complained-of actions or omissions cause injury independent of the injury resulting from a wrongful denial of policy benefits." *Id.* at 328. The court then acknowledged that the insured had asserted that bad faith was shown by his evidence that the insurer initially attempted to treat the claim as involving three separate and distinct leaks so as to give rise to multiple per occurrence deductibles but then later agreed to treat the claim as involving a single occurrence. *Id.* at 328. The court then says "*that may well be,* but Laird fails to bring forth evidence of an injury independent of the unreasonable delay, the element CMI challenged in its no-evidence motion for summary judgment." *Id (*emphasis added).

Thus, *Laird* squarely holds, without mentioning *Vail* or otherwise explaining its holding (other than to cite to *Castaneda*, *Parkans* and *Gordon*) that even if there is some evidence from which a bad faith denial or delay could be found, the insured must have evidence of separate and independent harm beyond the denied or delayed claim itself.

H. *Great American v. AFS* (2010) — Citing *Parkans* to Bar Extra-Contractual Claims Where the Claim was Wrongfully Denied

In *Great American Ins. Co. v. AFS/IBEX Financial Services, Inc.*, 612 F.3d 800 (5th Cir. 2010), the court had to squarely confront the issue of whether there is an "independent injury" requirement when the carrier has been found to have wrongfully denied a first-party claim. At issue was the forgery coverage of a crime protection policy issued to a premium finance company. An insurance agent forged his father's signature endorsement on certain checks resulting in loss to the insured premium finance company. Great American denied the claim as not covered based on its interpretation of certain policy provisions and definitions. The insured sued alleging both breach of contract and extra-contractual claims under the Insurance Code. Both parties moved for summary judgment on the coverage issue. The district court granted summary judgment for the insured on coverage. *AFS/Ibex Financial Services, Inc. v. Great American Ins. Co.,* 2008 WL 2795205 (N.D. Tex. 2008). The breach of contract and extra-contractual claims were tried but at the close of the evidence, the district judge dismissed the extra-contractual claims on the ground that all of the insured's damages flowed from the breach of contract and thus could not qualify as damages on the extra-contractual claims. *Great Am.,* 612 F.3d at 803. However, on the breach of contract claims, the jury awarded damages for both the denied claim itself as well as damages in the form of attorney fees that the insured alleged it had incurred in suing the bank that paid the forged checks. *Id.* at 803-04.

On the insurer's appeal to the 5th Circuit, the 5th Circuit affirmed the district court's summary judgment in favor of the insured on coverage for the claim. *Id.* at 806. The court likewise affirmed the award of 18% penalties under Chapter 542. *Id.* The court, however, vacated the award of consequential breach of contract damages in the form of the attorney fees

incurred by the insured in suing the bank because the evidence showed that the insured filed that suit against the bank 8 months before the insurer denied the claim. *Id.* at 808.

The court then addressed the insured's cross appeal of the trial court's ruling dismissing the extra-contractual claims under Chapter 541. The insured specifically argued that it did not need to prove any separate damages above and beyond the wrongfully denied policy benefits. *Id.* at 808, n. 1. And the 5th Circuit noted that the district court had never addressed the merits of the extra-contractual claims and they were not dismissed for lack of evidence. *Id.* at 808. Nevertheless, in response to the insured's assertion that it need not prove any damages other than the wrongfully denied policy benefits to support its extra-contractual claims, the 5th Circuit, in a footnote, citing only *Parkans*, says "This assertion does not comport with this court's case law." *Id.* However, the court then addressed whether the jury's award of the attorney fees incurred by the insured in suing the bank could qualify as independent damages to support the extra-contractual claims. The court held that while they could not be recovered as consequential damages for breach of contract, "they may provide the separate injury necessary to support" the extra-contractual claims. *Id.* at 808. Accordingly, the court remanded that issue back to the district court. *Id.*

On remand, the district court noted that the 5th Circuit had "determined as a matter of law that AFS was not entitled to extra-contractual claims because they failed to plead and prove injuries separate from those that flowed from GAIC's breach of contract" but had remanded for the court to determine if the attorney fees in the suit against the bank qualified. *Great Am. Ins. Co. v. AFS/Ibex Financial Services, Inc.,* 2011 WL 3163605, *3 (N.D. Tex. 2011). The district court's opinion on remand confirms that the insured asserted Ch. 541 claims based the insurer's alleged failure to attempt in good faith to bring about a prompt, fair and equitable settlement of the claim once the insurer's liability became reasonably clear, among other claims. *Id. The court ultimately concluded that even though it had rendered summary judgment for the insured on coverage, there was a "bona fide" legal interpretation dispute and thus the denial of the claim would not support extra-contractual liability. Id.* at *4. Thus, the case is just like *Castaneda* in that regard. The court then further found, alternatively, that under the 5th Circuit's opinion and the evidence, there was no causation as to the attorney fees incurred by the insured in suing the bank and thus those fees did not constitute an independent damage to support the extra-contractual claims. *Id.* at *8.

In summary, the 5th Circuit in *Great American v. AFS* interpreted *Parkans* as laying down a blanket "independent injury" requirement and thus requiring the insured to prove damages other than wrongfully denied policy benefits in order to assert extra-contractual claims even though *Parkans* involved a situation where the claim was properly denied and thus could not support any extra-contractual recovery itself.

I. *Powell v. Nat. Union* (2011) — The 5th Circuit Dismisses Extra-Contractual Claims Based on a "Separate and Independent Injury/Damages" Requirement

In *Powell Electrical Systems, Inc. v. Nat. Union Fire Ins. Co.*, 2011 WL 3813278 (S.D. Tex. 2011), there was a dispute between the insured and insurer as to whether the insured could unilaterally settle a liability claim under its CGL insurance policy when the claim was likely to

or did exceed the insured's self-insured retention amount ("SIR"). The insured contended that it had the right to make settlement decisions, whereas the insurer asserted that the insurer had to give consent to any such settlement. After the insured demanded that the insurer consent to settlement, but the insurer refused, the insured was hit with a seven figure verdict and then sued the insurer for breach of contract and extra-contractual claims. The district court ruled that under the terms of the policy and the SIR provisions, the policy gave the insured the right to settle claims and thus the insurer breached the policy by its actions. *Id.* at *8-9.

However, the court granted the insurer's motion for summary judgment on the extra-contractual claims, holding that under *Parkans*, the insured could not show any damages other than the damages that flowed from the insurer's breach of contract. *Id.* at *9. Accordingly, just like the court in *Great American v. AFS*, the district court here read *Parkans* as announcing an across the board requirement that any extra-contractual claims require damages that are independent and separate from the denied policy benefits.

IV.
CONCLUSIONS

As the forgoing historical tracing of Texas state and federal court case law shows, there does appear to be an emerging "separate and independent" injury requirement rooted in *Castaneda* even though no court has ever said that *Vail* is overruled on that point. Texas state appellate court opinions make it clear, at a minimum, that where the insurer's denial of the claim was either correct, or at least not in "bad faith" so that it will not support a finding of unreasonable denial, then the only way the insured can nevertheless maintain an extra-contractual claim against the insurer is if the insurer's other potentially actionable acts or omissions (i.e. misrepresentations, inadequate investigation, delay etc.) cause some separate and independent injury or damage. After all, Chapter 541 claims still require that the insurer's wrongful actions cause the damages complained of. Necessarily, if the denial of the claim was proper or otherwise will not support "bad faith" liability, then some other type of damage must be shown to have been caused by the insurer's other claims misconduct. That is at least the teaching of *Castaneda, Seneca* and even *Parkans on their specific facts*. And, to that extent, those holdings in those cases do not call *Vail* into question in the different scenario where there has been a wrongful denial of policy benefits.

But, as noted, at least two courts of appeals, the federal district courts and the 5th Circuit read *Castaneda* more broadly. They appear to have gone further by holding that even extra-contractual claims that are, in fact, based on the wrongful denial of the claim itself, also require some separate and independent damages or injury. And if that is the correct current statement of the Texas law, then is a departure from and, in effect, overrules *Vail* even though neither the Texas Supreme Court nor any courts of appeals have ever expressly said so.

So, back to the question presented: Is there a "separate and independent injury" rule for extra-contractual claims under Texas law? Answer: Absolutely. First, if the denial of the claim was either correct or at least reasonable enough as to not support extra-contractual liability itself. In that case, if the insured cannot show some other separate damages caused by the insurer's handling of the claim beyond the denial of the claim, then the extra-contractual claims should be

dismissed. Second, and at least until and unless the Texas Supreme court or a Texas Court of Appeals in a new decision tackles head on the issue of whether or not *Vail* remains good law or not, there appears to even be an emerging "separate and independent" injury rule, *Vail* notwithstanding, where the extra-contractual claims are, in fact, premised on wrongful denial of policy benefits.