

# **THE INDEPENDENT INJURY RULE: A VIEW FROM BOTH SIDES OF THE AISLE**

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- *Overview of Long Tail Claims for the Texas Practitioner*, in State Bar of Texas 12th Annual Advanced Insurance Law Course, Chapter 7 (2015)
- *Benefits of a Grief Counselor's Testimony*, TRIAL, Oct. 2011, at 41

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- *A Review of the Tripartite Relationship and Considerations in Protecting the Coverage Interests of the Client-Insured*, Texas Association of Defense Counsel 2016 Summer Seminar, Amelia Island, Florida

## THE INDEPENDENT INJURY RULE: A VIEW FROM BOTH SIDES OF THE AISLE

The independent injury rule has evolved over time. Initially, the “rule” related to whether or not an insured making a bad faith claim under common law (or what is now Chapter 541 of the Texas Insurance Code) needed to prove damages independent of owed policy benefits in order to recover

However, a dispute has arisen among Texas courts as well as federal courts sitting in Texas concerning the application of the independent injury rule. This dispute has arisen due to language in more recent authorities that dictate that an insured may not sustain a bad faith (or Chapter 541) cause of action against its insurer in absence of the insurer’s breach of the insurance contract unless the insurer acts in a manner that leads to “injury independent of the policy claim.”

While these issues are related, they are quite separate. One concerns the measure of bad faith (including Chapter 541) damages, while the other concerns circumstances under which a bad faith cause of action may be brought in the first place. This distinction has not always remained clear among the courts, as state and federal courts alike have taken to blending these two concepts to create a single rule. This has led to serious confusion in both theory and practice concerning how one is supposed to apply the independent injury rule.

In the last two years, the Texas Supreme Court has granted certiorari on two independent injury rule cases and has accepted a certified question from the Fifth Circuit on the matter. Unfortunately, two of those cases settled prior to adjudication by the Court. One remains pending, and will hopefully provide some clarity on the issue.

This paper is aimed at discussing the most important historical opinions regarding the independent injury rule and recent cases that have made it to the Texas Supreme Court for adjudication on the issue. In closing, this paper discusses possible outcomes related to the

current independent injury rule case pending in front of the Texas Supreme Court.

### I. A Brief History of the Independent Injury Rule’s Dual Tracks

This paper only details the principal cases that kindled the independent injury rule debate.<sup>1</sup> While many cases have analyzed and discussed the independent injury rule, the entire dispute can be traced back to only a handful of cases.

#### 1. Genesis—*Vail v. Texas Farm Bureau*

In *Vail v. Texas Farm Bureau Mutual*, Melvin and Maryanne Vail insured their home under a fire policy issued by Texas Farm Bureau Mutual Insurance Company (“Texas Farm Bureau”).<sup>2</sup> The home was destroyed by a fire and Texas Farm Bureau refused to pay.<sup>3</sup> Initially, Texas Farm Bureau denied coverage on the basis that the Vails failed to provide an adequate list of the contents of their home.<sup>4</sup> Later, the basis of the denial was revised to arson.<sup>5</sup>

The Vails sued their insurer “seeking recovery on the policy, treble damages, and attorneys’ fees based on unfair claims settlement practices.”<sup>6</sup> Specifically, they alleged a cause of action for violation of the Texas Insurance Code as brought through the Texas Deceptive Trade Practices Act (“TDTPA”).<sup>7</sup> What is unclear is whether the Vails also alleged a breach of contract cause of action. Breach of contract was never substantially discussed in the opinion, and the opinion from the intermediate appellate court notes only that at the time of the appeal, Texas Farm Bureau did not dispute that portion of the award for policy benefits.<sup>8</sup> The jury found that Texas Farm Bureau intentionally failed to exercise good faith in the adjustment of the Vails’ claim by refusing to settle promptly and fairly after liability had become reasonably clear and awarded policy limits, trebling of the limits, attorneys’ fees, and prejudgment interest on the trebled damages.<sup>9</sup> The court of appeals reversed, allowing only recovery of the policy benefits, prejudgment interest on that amount, and attorneys’ fees.

On appeal to the Texas Supreme Court, Texas Farm Bureau contended, among other things, that “the Vails cannot recover on the basis of [its] conduct after the home was destroyed by fire because the Vails only claimed damages recoverable under the insurance contract.”<sup>10</sup> As framed by the Court, Texas Farm Bureau theorized that the amount due under the policy solely represented damages for breach of contract, and did not represent damages for the independent bad faith claims. Accordingly, Texas Farm Bureau argued that because the Vails did not offer evidence specific to the bad faith damages, they were not entitled to damages under the TDTPA. The Court disagreed.

The 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.”<sup>11</sup> It stated that even though the Vails had a breach of contract action against Texas Farm Bureau, this fact would not preclude a cause of action under the TDTPA because the remedies may overlap.<sup>12</sup> It noted that both the remedies under the TDTPA and the Insurance Code were cumulative of other remedies, like breach of contract actions.<sup>13</sup> As to the independent damage issue, the Court reasoned that when Texas Farm Bureau denied the Vails’ claim, the loss they suffered at the time of the fire (for which they were entitled to make a claim under their fire policy) transformed into a legal damage.<sup>14</sup> Thus, the Court found that the Vails did not need to present evidence that they suffered damages separate and apart from the value of their claim under the insurance policy.

*Vail* was the first true independent injury rule Texas Supreme Court case. It framed the “rule” as one concerning damages and found that the actions of the insurer constituting bad faith converted the Vails’ loss under an insurance policy to legal damages sufficient to support extra-contractual damages. Thus, when a claim has been improperly denied in violation of the TDTPA or the Insurance Code, no independent damages are necessary, as the policy proceeds constitute legal damages under the claim. *Vail*’s holding was reaffirmed in 1994.<sup>15</sup>

## 2. The Reckoning—*Stoker* and *Castaneda*

### *Stoker*

*Republic Insurance Co. v. Stoker* concerned a multiple car accident in which the Stokers’ vehicle re-ended another vehicle during a chain reaction accident caused by a third vehicle that dropped a load of furniture on the highway.<sup>16</sup> The Stokers did not have collisions insurance, so they attempted to make a claim under their uninsured/underinsured motorist coverage.<sup>17</sup> However, the Stokers’ uninsured/underinsured coverage would only be implicated if there was a collision between their vehicle and the vehicle carrying the furniture, which there was not.<sup>18</sup> Republic denied coverage and the Stokers filed suit for breach of contract, common law bad faith, and violations of the TDTPA and the Insurance Code.<sup>19</sup>

Republic Insurance Company (“Republic”), the Stokers’ insurer, filed a motion for summary judgment, claiming that because there was no physical contact between the vehicles, there was no coverage and no breach of contract.<sup>20</sup> The trial court granted Republic’s summary judgment motion as to the breach of contract claim, but allowed the Stokers’ TDTPA and good faith and fair dealing causes of action to go to trial.<sup>21</sup> The jury returned a verdict in favor of the Stokers and the court rendered judgment on the verdict. The intermediate appellate court affirmed the summary judgment ruling as well as the verdict.<sup>22</sup>

The issue squarely confronting the Texas Supreme Court was whether an insurer breaches its duty of good faith and fair dealing to an insurer by denying a claim for an invalid reason, when some other, later discovered, valid reason for the denial exists.<sup>23</sup> The court answered this question in the negative, finding that as long as a valid reason for denial existed, no breach of the duty of good faith and fair dealing could be found.

The Stokers also raised an ancillary issue: whether an insured may recover for a bad faith

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