

INSURANCE LITIGATION™

CONTENTS

FEATURE ARTICLE

Insurer Bad Faith, Expertise, and Appellate Review 774

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Austin, Texas

CASES

Automobile Insurance/Permissive Use

Close v. Ebertz (N.D.) 792
Automobile policy entitlement exclusion applies to a family member of the insured

Bad Faith

Time Ins. Co. v. Burger (Fla.) 793
Florida Supreme Court allows recovery of emotional distress damages under Florida's bad faith statute

St. Paul Surplus Lines Insurance Company, Inc. v. Dal-Worth Tank Company, Inc (Tex.) 793
Award against insurer for decline in insured's credit reputation rejected for lack of proof of injury

Duty to Defend

Cincinnati Cos. v. West American Ins. Co. (Ill.) 794
Actual notice of a claim is sufficient to trigger duty to defend

Health Insurance/ERISA

The Prudential Ins. Co. of America v. National Park Medical Center, Inc. (8th Cir.) 796
ERISA preempts Arkansas Patient Protection

Act designed to allow patients unfettered choice of health care providers and to provide equal opportunity for providers to participate in health plans

Bast v. Prudential Insurance Co. (9th Cir.) 798
State tort claims for health plan administrator's wrongful refusal to authorize potentially life-saving treatment are preempted by ERISA

Danca v. Emerson Hospital (D. Mass.) 800
ERISA preempts action alleging that psychiatric patient attempted suicide following adverse utilization review determination

Lazorko v. Pennsylvania Hospital (E.D. Pa.) 800
ERISA preempts state law claims arising from health maintenance organization's refusal to authorize treatment

Cyr v. Kaiser Foundation Health Plan (N.D. Tex.) 801
Action accusing health maintenance organization of creating financial incentives that discouraged medical tests and referrals is not subject to complete preemption under ERISA

(Continued on Inside Page)



WEST GROUP

Insurer Bad Faith, Expertise, and Appellate Review

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There is an old joke which goes something like this: Insurance is the business of taking premiums and denying claims. Honorable and hard-working officials at good and decent insurance companies find this joke offensive, as well they should, but—as Sigmund Freud observed many decades ago—jokes have a point. Not all insurance companies are good or even decent; sometimes even honorable insurance companies face financial crunches; and temptation looms around every corner. Everyone knows that the insurance company in John Grisham's *The Rainmaker* is a caricature. But verities can be seen even in cartoons. Besides do not insurance bean counters treat the paying of claims as an expense? Are not expenses to be avoided or at least minimized?

The Guardian Mentality

Here is the truth of the matter. Insurance companies take in a lot of money. It is their responsibility to pay out money in accordance with the provisions of the insurance contracts they form. At the same time, legion are those trying to rip off insurance companies, either with fraudulent claims or inflated damage estimates. Where there is money, there is fraud. The more money, the more fraud. Further, claims people are judged as employees, in part, by how carefully they avoid paying inflated claims. Very roughly, from the perspective of the claims department, the insurance company is sitting on a pot of money, and there are a large number of people "out there" clamoring for some of it. To some degree, adjustment officials are the guardians of the pot and its contents. There is a natural—though pernicious—evolution in the consciousness of guardians. It ends up something like this: "This money is mine, and you can't have any." This maxim can guide corporate entities and managers as well as line claims people.

There are sound economic reasons for this psychology. Prima facie, insurance companies look

better when they run trim claims ships. Thus, economic reality reinforces the psychology of withholding described a moment ago. Insurance is a unique business. Like every other business, it sells a product. At the bottom line, the product insurer sells is the making of payments upon the presentation of certain kinds of demands. At this level of generality, banks are (partly) in the same kind of business. A depositor comes to a bank and says, "You have my money. Give it back." While this conceptualization of time and demand deposits is not correct from a legal point of view, it's the way everybody looks at these parts of banking. In contrast, an insurance claim goes like this: "I have suffered a catastrophe. I paid you something for coverage awhile back. Pay me oodles and wads." It is inherent in the nature of things that many claims will be made up; many claims will be exaggerated; and that insurers will feel the temptation to delay or deny even well-founded claims. The Guardian Mentality is inevitable.

Economic forces—the proverbial "market"—cannot be counted upon to combat it. Short term profit motive encourages the Guardian Mentality. It is a corruption of sound insurance personnel practice to judge claims people on the basis of how much money they save the company—as opposed to how much legitimate money they save the company—but that line is not always easy to draw. There are also strategic economic considerations which illegitimately support the Guardian Mentality. Insurance companies are frequently much larger than their insureds. They almost invariably have much larger cash resources readily available for litigation than their insureds, and insurers are often more comfortable with the litigation process than are their insureds. Although insurers complain a good deal about the litigation process, they could short circuit easily by inserting arbitration clauses into insurance contracts. Not even surplus lines carriers, which do not require state approval for their forms, are doing

this, although arbitration is the standard practice in reinsurance disputes and seems to work relatively well there. One wonders why no one seems to propose it seriously for all insurance disputes. Appraisal in homeowner's—and other property—policies seems to work well, but it is limited.¹ Why not expand its use across the board?

An academic economist might suggest that in a perfectly competitive system with a perfect flow of information, market forces would control the irrational component of the Guardian Mentality. In such a system, insurance intermediaries could be counted upon to steer insureds to those insurance companies which best discipline the Guardian's view of the world. We don't live in such a world. There is too little information and too much spin.

Bad Faith: A Legal Antidote

Several decades ago, courts around the country began to realize that common law rules could be used to discipline the Guardian Mentality. Of course, insurance companies should be free to deny claims which are not within the coverage specified in the contract. No one doubts this. Moreover, insurance companies administer thousands upon thousands of claims every year. Thousands of insureds make claims, but the information provided the insurance companies is not always accurate or revealing. Moreover, sometimes the validity of a claim hinges upon the credibility of witnesses, and not all citizens are worthy of whole-hearted belief. Moreover, reinsurance claims involve novelty, complexity, and uncertainty. Thus, an insurance company should be able to deny some claims and be wrong about it without suffering grievous damages in excess of what was owed under the policy plus maybe attorneys' fees. In contrast, sometimes, insurance companies obtusely refuse to listen to reason, obstinately recoil

from believing witnesses who are worthy of belief, or obdurately refrain from performing an even remotely disclosive investigation. The essence of bad faith in irrational recalcitrance.

It is this last area, the Realm of Egregious Error, which invited common law regulation. It is this area which is usually called "insurer bad faith." In addition, Texas restricts common law insurer bad faith to first party policies.² Various courts have proposed different standards for what constitutes bad faith. In general, they look like this:

1. An insurer commits bad faith when it denies a claim arbitrarily and capriciously.

2. An insurer commits bad faith when it unscrupulously denies a claim (say, in order to feather its own nest or because of malice on the part of a claims person).

3. An insurer commits bad faith when it denies a claim and its obligation to pay was not fairly debatable.

4. An insurer commits bad faith when it denies a claim which was valid under the contract and about which there could be no bona fide dispute.

5. An insurer commits bad faith when it denies a claim without a reasonable basis.

6. An insurer commits bad faith when it is negligent in denying the claim.

This essay is about proof under some of these standards, and how at least some appellate courts review trial court decisions which apply these

1. The appraisal process is arbitration as applied to the amount of loss. It does not apply to coverage issues. Strangely, insurance companies frequently refrain from using arbitration. Perhaps claims departments do not like to lose control of the situation. (What is strange here is that many insurance company claims manuals virtually mandate the use of appraisal.)

2. *Maryland Ins. Co. v. Head Industrial Coatings*, 938 S.W.2d 27 (1996). This rule is probably stated too broadly. After all, there are first party aspects to third party policies. The duty to defend is surely a first party duty, and there is no reason why—at least in principle—common law insurer bad faith should not apply to the duty to defend. In *Head*, the Texas Supreme Court indicated that there was already a tort sufficient to take care of tortious breaches of the duty to defend. This is true only when there is a judgment against the insured in excess of policy limits. If the insured—for example, a homeowner—suffers substantial mental anguish while the insurance company is not defending, that should be independently compensable. The Texas Supreme Court may have expressed some doubt about *Head*. See *State Farm v. Travers*, 41 Tex. Sp. Ct. J. 1343 (August 25, 1998).

standards.

Common law insurer bad faith arises in contexts other than the denial of claims. There may be bad faith when an insurer irrationally delays the payment of a claim. There may also be bad faith when an insurer irrationally pays part of a claim and not another part of a claim, or where it underpays a claim without even an arguable reason. Life is short, and essays are even shorter; hence, the focus here is on claim denial. All of the same points can be made about other forms of bad faith. Focusing on claim-denials does not distort the conceptual picture; it merely leaves some of it out.

As befits a new tort which touches thousands upon thousands of transactions every year, and where a vast majority of potential defendants are obviously solvent, there has been a flood of litigation surrounding insurer bad faith, and there have been many, many generative appellate opinions on the subject. The tort is malleable; associated doctrine is changeable; some courts are uncertain about which ways to go; lawyers divide between those who are stridently certain of how the law works and those who are uncertain about what to do; plaintiff litigants are bewildered and hopeful.

Bad Faith: Texas Style—An Introduction

Much bad faith litigation has been in Texas. Between 1988, when the Texas Supreme Court recognized the tort of common law insurer bad faith, and the present, the Texas appellate courts have returned to the matter again and again. The Texas Supreme Court itself has written no fewer than ten major opinions on the subject in turbulent years. From 1988 to 1997, the black-letter standard for common law insurer bad faith in Texas contained

three elements. (Remember: other variants of bad faith involve claim delays, claim under payments, denials of components of claims, and so forth.) First, the insurer denied a claim. (E1) Second, there exists no reasonable basis for denying the claim. (E2) Third, the insurer which denied the claim knew or should have known that there was no reasonable basis for denying the claim.³ (E3) Most cases involving E3 involve situations where it is asserted that the insurer should have known that there was no reasonable basis to deny the claim. This essay will focus on that aspect of E3.

Litigants have repeatedly urged the Texas Supreme Court to assimilate this standard to some of the other standards for insurer bad faith. The court has twice suggested that its standard might be the same as the no-bona-fide-dispute standard.⁴ In 1998 the court considered adopting the "fairly debatable" standard,⁵ but between 1988 and 1997, that was pretty much all the court said about the relationship between the Texas standard and other standards. In 1997, there was a facial change in E2.⁶ This change is probably nothing more than a cosmetic change, and it will be discussed later. Many legal academics have been troubled by the tort of insurer bad faith. An entire issue of the TEXAS LAW REVIEW was devoted to the topic in 1994.⁷

Thus, the tort of insurer bad faith is a troubled one. Perhaps it should have been a contract claim all along. One wonders why so many states have declined this option. Perhaps it is because mental anguish and punitive damages cannot usually be recovered in contract cases.

3. Most Texas courts formulate common law insurer bad faith in terms of two elements, not three. Mostly, they leave out the first element and utilize only the second two. *Arnold v. Nat'l County Mut. Fire Ins. Co.*, 725 S.W.2d 165 (Tex. 1987). *Arnold* manifestly misformulated the elements of the tort. *Id.* at 167. Shortly thereafter, the court revised the elements in *Aranda v. Ins. Co. in Am.*, 748 S.W.2d 210 (Tex. 1998). In *Aranda*, by a vote of 5-4, the court formulated the elements correctly and extended the tort to comp claimants, as well as clear cut policyholders.

4. *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444, 448 (Tex. 1997). ("We have recognized that evidence showing only a bona fide coverage dispute does not, standing alone, demonstrate bad faith." *Id.*)

5. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54-55 (Tex. 1997). See *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 17-18 (Tex. 1994).

6. *Giles*, 950 S.W.2d at 55.

7. Ellen Smith Pryor & Charles Silver, Eds., *Symposium on the Law of Bad Faith in Contract Insurance*, 72 TEX. L. REV. 1203 (1994). Several of the essays in this volume have been cited by courts with some frequency.

Bad Faith: Texas Style—An Elaboration

There are a number of remarkable facts about the Texas Test for bad faith. All of these facts influence the litigation of bad faith cases in Texas. Many of them influence the handling of appellate matters in Texas. Of course, how an appeal is to be handled invariably influences how an underlying case is handled—at least if things are done right.

First, if an insurer denies a claim which was properly deniable under the contract of insurance, then it is not the case that there was no reasonable basis for denying the claim. In other words, if an insurance company's denial of a claim is authorized by the contract, there cannot be bad faith. This conclusion is correct, even if the insurance company denied the claim for the wrong reason,⁸ so long as the insurance company is not estopped from raising the actual valid reason later in the litigation process.

Second, it is important to notice that a *reasonable* basis is not the same as a *valid* basis. If a *valid* basis is a reason for denial which is authorized by the contract of insurance, then an insurance company can deny a claim on a basis which is invalid (in this sense) but which is still reasonable. Insurance companies can be wrong, but reasonable. Not every mistake is unreasonable. Some errors are reasonable. An interesting problem is this: What constitutes a *reasonable basis*, when a basis is reasonable but invalid? Pieces of this matter will be discussed in some detail presently.

Third, bad faith is not the same as negligence.⁹ Insurance company sloppiness is not a sure-fire basis for bad faith. If a poor investigation produces an invalid basis for denying a claim, but that basis is still reasonable, there will be no bad faith, although there will have been negligence. Themes of negligence will loom large in the trial of any bad faith case, however. First, it behooves a plaintiff to try to demonstrate that the insurance company was sloppy: "This is the gang that couldn't shoot straight. They couldn't find a reasonable basis if they went to the Museum of Reasonable Bases." Similarly, it is incumbent upon

insurers to try to demonstrate that they were not a pack of zany nincompoops. Finally, there is a negligence theme to be found in the law of bad faith.

Insurers have a duty to investigate claims.¹⁰ Insurers cannot avoid dealing with reasonable bases by sticking their corporate heads in the proverbial sand. If they fail in that duty, or—more relevantly here—perform lousy investigations, they may get stuck with a bad faith judgment. Deficiencies in investigations are probably—at least in part—judged by a negligent standard. This is the issue in the *Simmons* case which will be discussed toward the end of the paper.¹¹

Fourth, there is a difference between an insurer *having* a reasonable basis for denying a claim, and *there being* a reasonable basis for denying a claim. A reasonable basis for claim denial may exist, even though the insurance company hasn't thought of it, and therefore doesn't *have* it. If there is a reasonable basis for denying a claim, but the insurer does not have it, and the insurer denies a claim for a bad reason, it is not guilty of bad faith. If it is not the case that there exists no reasonable basis for denying a claim, then there cannot be common law insurer bad faith. If it is not the case that there is a total absence of any reasonable basis to deny a claim, then there is no bad faith, even if the insurance company hasn't tapped into that reasonable basis.

The courts have explicitly said that insurance companies have a right to be wrong and that they are not guilty of bad faith when they are right but for the wrong reasons. However, although the courts haven't quite said so, since insurance companies have the right to be wrong, they should have the right to be wrong in good faith, if they were wrong because they relied upon an unreasonable basis, but there was a reasonable basis upon which they could have relied.

Fifth, E2 in the Texas Test, entails this: There was no reasonable basis for denying the claim. This rendition of E2 can be translated as follows: There exists no basis which is reasonable for denying the claim. This is a very odd test which supposes that there can exist a *basis* for denying a claim which has two characteristics: (i) The insurer did not rely upon

8. Republic Ins. Co. v. Stoker, 903 S.W.2d 338, 341 (Tex. 1985). See Viles v. Security Nat'l Ins. Co., 788 S.W.2d 566, 567 (Tex. 1990).

9. Giles, 950 S.W.2d at 64 (Hecht, J. dissenting).

10. Giles, 950 S.W.2d at 56 n. 5.

11. State Farm Fire & Cas. Co. v. Simmons, 963 S.W.2d 42 (Tex. 1998).

it,¹² and (ii) it was not reasonable. Given the standard formulations of the Texas Test there are bases which are both unreasonable and unused.

At this point, a rather esoteric—indeed, arcane—matter must be discussed. Most lawyers hate this kind of discussion, because it smacks with the metaphysical. Most courts hate these kinds of discussions, because it doesn't sound common sensical enough. Courts love to sound down-to-earth wise, and they hate to sound high-flown. Nevertheless, the Texas Test entails that a basis for denying a claim is any proposition upon which any insurer might deny a claim. It may not be obvious at first sight, but the realm of such basis includes every conceivable proposition. Theoretically, under the Texas Test, even the following propositions might be basis for denying the claim:

- The sun rises in the east.
- Kosovo is not a city in Peru.
- The moon is made out of green cheese.
- "Lima" names both a city and a bean.
- It is both raining and not raining here and now.
- A sparrow just flew past my window.
- At least one run-away teenager sells organically grown vegetarian burritos in the town square in Portland, Oregon.
- Susan Scott Hayes has no son named Petunia.

And so forth. No doubt, none of these bases is even remotely reasonable under any hither-to conceived contract of insurance. Moreover, it is highly unlikely that any insurance company has ever denied a claim on any of these bases. Nevertheless, the logical structure of the Texas Test entails that the realm of *bases* is this large. The Texas Test supposes that there are unused bases, unreasonable bases, reasonable

bases, and valid bases (which are ipso facto uniformly reasonable). The logical structure of the Texas Test (what some would call its rhetoric) has caused some headaches, and we will return to this topic. The Texas Supreme Court has recognized at least once in passing that this idea of *unreasonable basis* is fraught with some difficulty. We shall return to this matter, as well.

Sixth, E2 in the Texas Test is not satisfied unless there was a complete and total absence of any reasonable basis for denying a claim. What else could it mean to say that "There was *no* reasonable basis for denying the claim," or "There existed *no* basis for denying the claim which is reasonable"? What else could it mean to say that there is no reasonable basis. Either there was one or there wasn't. If there wasn't a reasonable basis, then there was an absence of a reasonable basis. If there was an absence of *a* reasonable basis, then there was an absence of *any* reasonable basis. If there was an absence of *any* reasonable basis, then there was a *complete* absence of any reasonable basis; and if there was a complete absence of any reasonable basis, then there was a *complete and total* absence of any reasonable basis. After all, "no" means *none*: everything else is mere rhetoric. (There are those who would say that in the area of legal discourse, rhetoric is never "mere rhetoric," since such matters sometimes influence the outcome of lawsuits. Still, for analytical purposes, at least, there are such things as logic, reason, and even pure law.)

When E2 is formulated this way, the no-reasonable-basis standard dissolves into the arbitrary-and-capricious standard. In some areas of the law, if a decision is fairly debatable, then it is not arbitrary and capricious. No stable, nationwide consensus has developed on whether that equation applies in the context of insurance bad faith.

Seventh, to say that a basis is reasonable is to say that it is minimally reasonable. A reasonable basis does not have to be valid, i.e., contractually mandated. It does not have to be almost valid. It has to be a basis upon which a reasonable insurer would deny such a claim. This is very much like a negligence standard, except for three things. First, notice the skew towards insurance companies. There are many observers of

12. Indeed, no insurer may ever have relied upon it.

the insurance scene who believe that reasonable insurance companies are sometimes—as a group—motivated to deny some valid claims by reasons which are quite bogus.¹³ There is such a thing as systemic irrationality. Arguably, insurers and policyholders see the world differently. Perhaps environmental coverage litigation proves this. Why should a test of a reasonable basis be what a reasonable *insurer* would do, rather than what a reasonable and well-informed *person* would do, if it were her decision. Second, someone is negligent if his conduct exhibits a culpable screw up nested in a matrix of prudent conduct. Bad faith is not like that. For an insurer to meet the Texas Test, one good reason to deny will overwhelm six (or twenty) bad ones. Third, Texas bad faith is not about *conduct*, or even *reasoning*, it's about the existence or absence of arguably *good reasons*.

Eighth, no one has the faintest idea how to differentiate, individuate, and therefore how to count *bases*. We seem to have a rough and ready conception of how to divide them up, however. Once we have a list, it is important to notice that if an insurer has two half-way reasonable bases, it still does not have one genuinely reasonable basis. Reasonableness is not additive. Listing lots and lots of bases which are each unreasonable, but none of which is maximally unreasonable, will not create a reasonable basis in the aggregate. "Creep" plays no role in assessing reasonableness. The maxim, *Where there's smoke, there's fire*, does not apply.

Ninth, there is a complication, however. Let us suppose there is a reasonableness index, or scale, which looks very much like a temperature gauge, with numbers running from zero to 100. Let us further suppose that a basis which is maximally unreasonable gets a score of zero while valid (contractually

authorized) bases for claim denials get a score of 100. Let us further suppose that all reasonable bases have a score of 75 or higher, whereas all bases with a score of 74 or lower are unreasonable. In the previous paragraph, it was observed that two bases each with its reasonableness index of 50 would not together constitute a reasonable basis. This point should be obvious.

There is another more subtle point. A basis for denying a claim may consist of several reasons in combination. Let us suppose that an insurer's single basis for denying a claim is p_1 . Let us suppose that p_1 has a reasonableness index of 50. That insurer would be acting in bad faith, assuming that reasonable insurers would realize that acting upon p_1 alone was unreasonable. Suppose further that p_2 alone scores 30 on the scale. Now let us suppose that when p_1 and p_2 occur together, the insurer has a valid reason for denying the claim. In that case, the basis which consists of both p_1 and p_2 together would get a reasonableness score of 100. Moreover, a unitary basis which consists of a conjunction of reasons, may be quite complex. Conjunctions within a single basis do not permit the straightforward addition of reasonableness scores. Particular combinations have to be looked at when in the context of how solid insurance companies treat such combinations of reasons.

Tenth, in bad faith cases, the insured bears the burden of proof. Therefore, because of E2, the insured is required to prove a negative. It is required to prove that no reasonable basis whatsoever existed for denying his claim. This is tantamount to saying that the insured must prove that there is no proposition in all the universe which would constitute a reasonable basis for denying his claim. Notice that

13. Here is my personal favorite. Suppose a commercial entity with construction capabilities sustains a loss to buildings and other insured items. Suppose further that the insured then repairs the loss on an expedited basis. Finally suppose that the insured has both property and business interruption coverage. Many insurance companies will be tempted to disallow the insured overhead and profit in repairing its own facilities. From time to time, insurance adjusters testify that to do otherwise would violate the principle of indemnity, because then an insured would profit from its own loss. Insurance companies take this position even when the insured has foregone profits it could have made by having its construction equipment and crews used elsewhere to its profit and even if the insured has saved the insurance company business interruption dollars. The reasoning of insurance companies on this matter is just plain silly. The insured is not profiting from its loss. It is profiting from deploying its equipment in an economically reasonable manner. Once must grant, of course, that paying profit and overhead to a commercial insured for fixing its own property creates a moral hazard. Then again, so does issuing any insurance at all. In theory, the same set of considerations apply when the insured is not a commercial entity but a homeowner. The practicalities of administration are dicey, however.

this is much stronger than having to prove that the insurance company did not *have* a reasonable basis for denying this claim. This is why estoppel is so important to insureds in bad faith cases. If they can restrict the scope of their proof to reasons the insurance company had, reasons the insurer articulated, or (best yet) reasons the insurer shared with them, their job becomes much easier.¹⁴

Eleventh, many lawyers who represent policyholders object to having to prove a negative, particularly one with such a universalistic scope. "How," such lawyers ask, "can one prove the proposition *No reasonable basis even remotely justified denying the policyholder's claim?*" How can this possibly be done when the universe of bases is all of the propositions that there are, and that is unquestionably an infinite number. The answer is that practical matters pertaining to common sense materiality and relevance rapidly reduce the number of bases which must be considered. Bases for claim denial which have no logical, conceptual, or empirical connection to the terms of the insurance contract can be eliminated immediately. These are the maximally and very unreasonable bases. Also, there are practical ways to reduce the universe of bases which must be shown to be unreasonable. Insurance companies will not put up candidates as potential bases which would make them look silly. Discovery can help here. Also, expert witnesses can be used to delimit even remotely plausible bases. And so forth. As a practical matter, the number of bases which must be reviewed for reasonability starts off somewhat limited and drops very quickly as the litigation evolves.

Twelfth, the relationship between E2 and E3 is not entirely clear. Consider the second element. A basis is reasonable if the reasonable insurer under similar circumstances would have denied the claim upon that basis. Surely, the proverbial reasonable insurer would know what it was doing. Now consider E3. When should a carrier know that there is no reasonable basis for denying a claim? Surely, a carrier should know that there is no reasonable basis for denying a claim when

a reasonable carrier, under the same or similar circumstances, would believe that there was no basis for denying the claim. When the matter is put this way, how can E2 be satisfied and E3 not be satisfied?

Thirteenth, although the foregoing discussion obviously elucidates the literal language of the common law tort of insurer bad faith, hardly anyone takes that language literally, and bases are not usually developed, discovered, tried, and appealed in conformity with the conceptual constitution of bad faith. Instead, lawyers will frequently say that, "The insurance company didn't have any basis for denying a claim, let alone one which was reasonable." Similarly, arguing lawyers will say that "The insurance company had no basis at all for denying the claim; rather, it acted completely arbitrarily and absolutely capriciously. It acted without any basis at all." And there are many permutations on this kind of rhetoric.

Fourteenth, sometimes, it looks as if issues of insurer bad faith are largely resolvable as a matter of law. After all, if there is a reason favoring the denial of coverage—a reason against providing coverage—then there is a reasonable basis for denying the claim.¹⁵ At least in Texas, and probably everywhere, however, this view is too simple. Not only must there be a plausible reason in favor of denying coverage, that reason must overcome any reasons which might exist in favor of granting coverage. In many cases, this competition among reasons never arises. However, when it does arise, there is a fact issue for the jury.

Litigating the Bad Faith Case

Policyholders tend to try bad faith cases by demonstrating that the adjustment was sloppy or that the adjuster was stupid, mean-spirited, malicious, prejudiced, perverse, crazy, or in some other way unattractive. Often this is done by showing that the adjuster was irascible, raised his voice, cussed out the claimant, failed to return phone calls, used the "n-word," or kept a sloppy adjustment file. (Sometimes lawyers argue that adjustment files are like medical records.) The best way for a plaintiff to try a bad faith

14. See Michael Sean Quinn, *Reserving Rights Rightly*, 7 COVERAGE 23 (July/August 1997).

15. See, e.g., *Oulds v. Principal Mut. Life Insurance Co.*, 6 F.3d 1431 (10th Cir. 1993) (existence of conflicting statements from the insured and her insurer's agent about whether the insured misrepresented material facts on her health insurance application entitles the insurer to summary judgment on the insured's bad faith claim, even though a jury concluded the insured was telling the truth and awarded her damages for breach of contract).

case is to try to show in living color not only that the adjuster was unattractive, but that the managerial hierarchy was inattentive, that company procedures and training were wanting, and that all of the bases the insurance company could think of for denying the claim were unreasonable. Of course, much of this is atmospheric rhetoric and does not go to the bottom line issues. Nevertheless, it is absolutely essential that the background be painted in with fauvist colors. (The truth of the matter is that there is a tension in bad faith law between the bottom line elements of the tort and the theme of negligence. Negligence, strictly speaking, is irrelevant to the bottom line, but it is necessary to presentation. This tension, possibly, is one of the things that bothers commentators, judges, and reflective lawyers.)

From the defense point of view, the goal is to try to show that the adjuster was not negligent, that he is not irascible, and that at least one of the reasons on the basis of which the claim was actually denied is at least minimally reasonable. It is probably best to try to show that none of the reasons seriously contemplated by the insurer for denying the claim was in any way unreasonable. In the alternative, one should try to show that as many as possible of the reasons relied upon by the insurer were not just minimally reasonable but quite high on the reasonableness scale. Arguably, insurers should, from a rhetorical point of view, undertake throughout every bad faith litigation affirmatively to demonstrate that it was not negligent. (Obviously, this continues the tension between the Texas Test and the rhetoric of negligence.) Under some circumstances, the insurer should sound the theme *Bad form is not bad faith*.

For both sides, expert witnesses play a key role. Although common law insurer bad faith is not adjuster malpractice, there are similarities. E3 pertains to what a reasonable insurer knew or should have known. Thus, it looks very much like an application of the negligence standard for professional misconduct. Also, when the standard for what constitutes a minimally reasonable basis is conceived in terms of what a reasonable insurer would count as a reasonable basis, professional malpractice themes arise again. This is the proper realm for expert testimony:

1. "I am an expert on what insurance company

claims departments do."

2. "A reasonable insurance company would believe that *p* constitutes a minimally reasonable basis for denying a claim and would—other things being equal—deny a claim on this basis."

3. "A reasonable insurance company would not necessarily know that *p* is not a reasonable basis for denying a claim."

The difficulty in distinguishing E1 and E2 has already been discussed.

One of the best ways to defend an insurance company is for the insurance company to be acting on facially reasonable (i.e., reasonable-looking), externally-provided information. Thus, if the insurance company has engineering reports which are facially reasonable, it is not likely to lose, if the bad faith issue pertains to some relevant empirical issue. If the insurance company has a coverage opinion, it is not likely to lose, if the opinion is facially reasonable, and the bad faith issue is a law matter. Of course, the insurance company must have provided the engineer or the lawyer with adequate information and suitable directions. In addition, the engineering report or the coverage opinion must "look good." This requires that the presentation be sound, though not slick, and it is helpful if the letterhead of the engineering company or of the law firm triggers appreciative recognition in the mind of at least the judge.

Appealing the Bad Faith Case

We now arrive at the appellate problem. Assume that a trial court has entered a judgment finding that an insurance company is guilty of bad faith. Assume further that the insurance company wishes to challenge the evidentiary basis for that judgment.

Texas is a good model for appellate review, so it will be the focus. Appellate courts in Texas review judgments for "factual sufficiency" and for "legal

sufficiency.”¹⁶ The evidence supporting the judgment is factually insufficient if the judgment is against the great weight of the evidence. An appellate court may not reverse a judgment merely because it disagrees with a jury or with a judge. The judgment must be contrary to the *great weight* of the evidence. Only intermediate appellate courts may review judgments for factual sufficiency. The jurisdiction of the Supreme Court of Texas is restricted to legal sufficiency, which is a different matter all together. This results from a provision of the Texas Constitution which restricts the Supreme Court to matters of law only.

In Texas, the test of “legal sufficiency” is tantamount to this. The judgment is wrong, given the evidence, as a matter of law. Evidence is legally insufficient to support a judgment when there is no evidence at all to support the judgment, or when the judgment is supported at most by a “scintilla” of evidence. No one has the faintest idea what a scintilla is, but whatever it is, it’s not very much; in fact, it is probably less than a *mere smidgen*, and may be identical to *nothing-but-a-whiff*.

In any case, the relationship between a judgment and its evidentiary base is legally sufficient if there is any meaningful evidence at all supporting (*i.e.*, tending to establish the facts presupposed by) the judgment, and the relationship between the evidence and judgment is legally insufficient when no meaningful evidence supports the judgment. As a general pattern, legal insufficiency arises under one of two circumstances. Either, one, the jury was so angry at the defendants that they decided to sock it ‘em no matter what (and this usually gets to appellate courts only in cases where local political sensitivities are involved), or two, the trial judge and then the intermediate appellate judges misconceived the law. In the latter case, there may be no evidence to support the judgment when the law is rightly conceived.

No evidence appellate review in Texas starts with a fundamental norm. Appellate courts are to view the evidence in favor of the judgment. This means that any ambiguities or gaps in the evidence are to be resolved in favor of the judgment. More interestingly,

it means that the reviewing court is obligated to look only at disputed evidence which tends to support the judgment. The court is also obligated to ignore all disputed evidence inconsistent with the judgment. Thus, in a red light/green light traffic negligence case, if W_1 said that the light was green, while W_2 said that the light was red, if the testimony of W_2 was inconsistent with the verdict and the judgment entered upon the verdict, the reviewing court, when doing no-evidence review, would be obligated to ignore the testimony of W_2 . It should be remembered that this view applies only to *disputed* evidence—to situations where inconsistent evidence is presented. A court performing a no-evidence review may consider undisputed evidence. Undisputed evidence is a potential gold mine in bad faith cases.

Now suppose that a judgment is entered saying that the insurance company defendant is not guilty of bad faith. This judgment presupposes that the insurer had at least one basis for denying the claim which was (minimally) reasonable. In doing legal sufficiency review, the court would have to determine if there was some evidence to support that judgment. In other words, it would have to determine whether there was any evidence supporting the proposition that at least one basis, p_1 , for denying the claim was minimally reasonable, while ignoring any evidence which suggested that there were bases which were unreasonable, any evidence suggesting that p_1 was unreasonable, and any evidence tending to support the proposition that no basis at all was even minimally reasonable. This process is awkward to talk about, but it is not hard to do.

What is difficult to do is to perform legal sufficiency analysis upon a judgment finding common law insurer bad faith. Such a judgment presupposes a finding of fact—whether a judge or by a jury—that there was a total absence of any reasonable basis at all for the insurer’s denying the claim. The evidence will be legally insufficient for the judgment if and only if there is no evidence at all to support the judgment, *i.e.*, if there is no meaningful evidence at all in support of the proposition that there was no reasonable basis

16. William Powers, Jr. & Jack Ratliff, *Another Look at “No Evidence” and “Insufficient Evidence,”* 69 TEX. L. REV. 515 (1991), and there are many other essays on this topic, some of which are frequently cited by the courts. Rumor has it that the Powers & Ratliff piece is required reading for all new clerks at the Texas Supreme Court.

at all to deny the claim. In short, in a common law insurance bad faith case, the evidence is legally insufficient if there is no evidence to support the view that there was no reasonable basis to deny the claim.

So far so good, even if the prose describing the process cannot be made anything but inelegant. Now the real problem arises. In performing no-evidence review, an appellate court must ignore all evidence inconsistent with the judgment. This suggests that a reviewing court must ignore any evidence tending to suggest that any basis for denying the claim was reasonable. Many lawyers find this limitation troubling. The Texas Supreme Court has been struggling with this problem for several years. It is not a problem peculiar to Texas law. Any jurisdiction which has any test for common law insurer bad faith substantially equivalent to the no-reasonable-basis standard and which has no-evidence review will encounter this problem.

The *Lyons* Case

In 1993, in *Lyons v. Miller's Casualty*, the Texas Supreme Court first tried to find its way out of this conundrum.¹⁷ The factual specifics of the case are unimportant here. Only the logic of the decision matters. This is what the court said:

[W]hen a court is reviewing the legal sufficiency of the evidence supporting a bad faith finding, its focus should be on the relationship of the evidence arguably supporting the bad faith finding to the elements of bad faith. The evidence presented, viewed in the light most favorable to the prevailing party, must be such as to permit the logical inference that the insurer had no reasonable basis to delay or deny payment of the claim, and that it knew or should have known it had no reasonable basis for its actions. The evidence must relate to the tort issue of no reasonable basis for denial or delay in payment of claim, not just to the contract issue of coverage. This is nothing

17. *Lyons v. The Millers Casualty Ins. Co. of Texas*, 866 S.W.2d 597 (Tex. 1993).

more than a particularized application of our traditional no evidence review.¹⁸

The point of this passage seems clear enough. If a policyholder presents evidence that its claim is not covered under the policy and nothing more, then no evidence supports a judgment of bad faith. This conclusion follows from the fact that an insurance company may breach its contract by denying the claim and yet not be guilty of bad faith. If the bad faith alleged against the insurer was a claim denial against unequivocal evidence of coverage, according to the court, exactly the same evidence which tended to prove coverage might tend to prove bad faith.¹⁹ According to the *Lyons* court, when the insurer attends to facts presented by the insured which might establish coverage, but is persuaded by other facts that there is no coverage, evidence merely tending to establish coverage will not establish bad faith. (In *Lyons*, there were facially reasonable expert engineering reports drawing opposite conclusions.)

The implicit argument of the Supreme Court in *Lyons* was this. The plaintiff must produce evidence above and beyond breach of contract. The policyholder claimant must present evidence that there were no reasonable bases upon which to deny the claim. One way to do this is to prove that the bases upon which the insurer relied were unreasonable. That proof will get the policyholder half way home, but only half way. According to the *Lyons* court, the policyholder presented no evidence that the bases relied upon by the insurer were unreasonable. Presumably, such evidence would have been that the engineering reports utilized by the insurer were nonsense, and that it was unreasonable for the insurer not to rely upon the engineering materials produced by the policyholder. Proof that the insurance company was sloppy in its investigation is not sufficient to prove that there was no reasonable basis

18. *Id.* at 600.

19. The court is wrong about this. There must be one additional evidentiary proposition. The plaintiff-policyholder/claimant must demonstrate that there is no other reasonable basis upon which the claim could have been denied. This is a relatively simple matter, but it must be done.

upon which to deny the claim. According to *Lyons*, the plaintiff simply failed to provide any proof of no reasonable basis.²⁰

Lyons also makes it clear that when there are competing engineering reports, if the plaintiff wishes to recover, it had better show two things. First, it must show that the insurer's engineering reports are crap. It can do this in a variety of ways. It can show that the data developed by the engineer stinks. It can show that sound engineering and scientific procedures were not employed. It can show that the engineer is nothing but an insurance company shill. Or it could show that the engineering company was given bad data or erroneous instructions. Second, the plaintiff had better show that insofar as the insurance company refused to rely upon the policyholder's engineering study, it was acting unreasonably. This will require the policyholder to demonstrate that its report was facially reasonable and that the insurance company was unreflective in its handling of the report. Often adjusters do not try to assess the quality of the policyholder's engineering report. Instead, they ask their own engineer for a critique. This is a sound approach, if the engineer for the insurer is thoughtful, careful, and—above all—objective.²¹ Probably, these points slop over onto situations where coverage opinions are what is crucial, as opposed to engineering reports.

The Dominguez Case

The Texas Supreme Court took the matter up again the next year in *National Union v. Dominguez*.²² This was a worker's compensation case, in which there was evidence of a job-related injury, but there was also evidence that the injury was not job-related. In fact, the worker-claimant had

repeatedly signed documents stating that the injury was not work-related. The comp case was settled, and an agreed judgment was signed by the trial court. Thereafter, Dominguez brought a bad faith action. After a jury trial, the trial court rendered a judgment of over \$300,000 for compensatory and exemplary damages. Interestingly, the agreed judgment in the underlying case recited that liability under the worker's compensation statute was "disputed, indefinite, uncertain, and incapable of being exactly established and determined."²³ At the trial of the bad faith case, Dominguez agreed that this recitation was truthful.

The issue before the supreme court was whether there was any evidence at all to support the trial court's judgment that the insurer had breached the duty of good faith and fair dealing it owed Dominguez. Here is the key language of the court:

A legal sufficiency analysis requires the reviewing court to give weight only to evidence supporting the judgment for the insured and reject all evidence to the contrary. However, only after an appellate court has determined what potential basis an insurance company may have had for denying a claim can the court conduct a meaningful review of whether the insured has presented evidence that the insurer lacked a reasonable basis for denying or delaying the claim. The court may then apply the traditional rules of legal sufficiency review, giving weight only to evidence in support of the judgment.²⁴

There are two key phrases in this language. One of them is "potential basis" and one of them is "may have had." What might these phrases mean?

20. Interestingly, the policyholder had apparently not argued that the insurer violated its duty to investigate so badly that a deficient investigation itself constituted a form of bad faith. Implicitly, *Lyons* may suggest that this theme should be developed in the pleadings, discovery, and trial proof explicitly and separately if the policyholder wants to make that form of bad faith part of the basis of the judgment.

21. See *Brief of Amicus Curiae Haag Engineering Co.*, in *State Farm Lloyds v. Nicolau*, No. 94-0287 (decided 1997). This case is discussed later. *Nicolau* centrally concerned the objectivity of the work performed by Haag Engineering and the rationality of the insurer's reliance upon it. Haag filed an "Amicus Brief" in the Texas Supreme Court. It had never been a party to the underlying suit. Is this a great country, or what?

22. *National Union Fire Ins. Co. of Pgh. v. Dominguez*, 873 S.W.2d 373 (Tex. 1994).

23. *Id.* at 375.

24. *Id.* at 376.

Dominguez appears to distinguish between the “basis” for denying the claim (which previous cases had conceptualized as any-reason-an-insurance-company-might-give-for-denying-a-claim) and a “potential basis.” What was formerly a “basis” is now a “potential basis,” and the term “basis” becomes what would have formerly been counted as a-basis-actually-used-by-an-insurer-to-deny-a-claim. Also, the court posits (or at least implies) that in performing a no-evidence review, a reviewing court should look only at the bases for denying the claim upon which the insurer actually relied. What else could it mean to limit the scope of review to bases the insurer actually *may have had*? Having a basis means *using* some proposition as a basis, and that means *relying* upon it to deny the claim.

Dominguez presents itself as nothing more than an application of *Lyons*, but this is probably not true. The no-evidence review methodology proposed in *Dominguez* is quite different. It reviews the bases actually utilized by the insurer to deny the claim. It is to be assumed, right from the start, that none of these bases is valid under the contract. The only question is whether any of these bases—contractually invalid though they are—constitutes an at least minimally reasonable ground for denying the claim.

Suppose there were two grounds for denying the claim. To survive no-evidence review the policyholder (or comp claimant) would be required to produce at least some evidence that each of those two grounds was not minimally reasonable. There must be overt, discreet, actually recognizable evidence that neither basis used by the insurance company is minimally reasonable. This cannot be done simply by showing that they are not authorized by the contract. A basis can be invalid and hence erroneous but reasonable. Bad faith is the Realm of Egregious Error. The appellate court is obligated to ignore all disputed evidence inconsistent with a judgment. In other words, it is obligated to ignore any and all evidence presented by the insurance company that these two bases are reasonable, so long as that evidence is disputed. The appellate court may look only at evidence that they were unreasonable.

At this juncture, we arrive at the crucial point. How can a claimant—whether policyholder or comp

claimant—demonstrate that a basis employed by an insurance company to deny a claim was not only invalid but unreasonable? This is extremely difficult to do with sensory evidence only. As a general rule, it will require expert testimony. Someone will have to take the stand and say four things and elaborate:

1. “I am an expert on sound insurance company claims practices.”
2. “The grounds upon which this insurance company denied the claim are not reasonable. No reasonable insurer would have denied this claim on the basis of those reasons.”
3. “There are no other grounds upon which the claim could be denied which are reasonable.”
4. “Every reasonable insurance company knows what I’m saying is true.”

It is difficult to see how plaintiff can meet his burden under E2 and E3 without using an expert witness. Expert testimony like Points (1)-(4) is important to no-evidence review because it places in dispute all of the insurer’s evidence that it acted reasonably. Consequently, the reviewing court cannot credit any of it.

There is a corresponding problem for the insured-defendant. It too must use an expert witness. Thus, bad faith trials will, to some extent, become battles of the experts. The insurance company expert must say exactly the opposite of what the plaintiff’s expert has said, but she must also say something else. She should probably say the following five things, and elaborate:

1. “I am an expert on these matters.”
2. “The grounds upon which the insurance company denied the claim were reasonable.”
3. “There are reasonable bases upon which this claim could be denied.”²⁵

25. And maybe the insurance company used them or maybe it didn’t.

4. "Reasonable insurance companies recognize these bases as being reasonable, whether or not they are valid."

5. "The so-called experts for the plaintiff are completely wrong—egregiously and stunningly mistaken. Indeed, the views espoused are so quixotic that those witnesses are not really experts at all."

This fifth component of the insurer's expert is designed to try to render the opinions of the plaintiff's expert no more than a scintilla of evidence. The expert hired by the plaintiff can be shown to have employed the wrong methodology, be deficient in his knowledge, or something of the sort, then his opinions will constitute no evidence, when it comes time to appeal. The presentation of expert testimony on behalf of the insurer must concentrate on this component of the case, as well as the others. If the plaintiff's "expert" is not really an expert, then some of the insurer's evidence will (as it were) become undisputed. (Of course, insurers should move to strike the plaintiff's expert, and if they lose in the trial court, they should appeal that ruling.)

It might be conjectured that one of the features of common law insurer bad faith litigation which troubles Texas courts is the extent to which expert testimony is required in insurance bad faith cases. Other things being equal, the presence of expert testimony is not troubling. One sees it in malpractice cases all the time. But, there are a number of problems associated with the presentation of expert testimony in the area of insurance bad faith. First, there is no long-established profession with strict and rigid regulatory norms to which all adjusters belong. State licensing is no substitute. Second, the theoretical underpinning of processing claims is neither complex nor systematic. Consequently, it doesn't have the same technical flavor as law or medicine. Third, many of the expert witnesses employed and deployed in this area of litigation are simply retired adjusters whose professional creden-

tials are uncertain. They are not always articulate. Fourth, it is relatively well-known that there are plaintiff's expert witnesses and defendant's expert witnesses in this area of practice. Hence, it is a "whore"-ridden field. This fact makes courts uncomfortable.²⁶ Fifth, much of the opinion testimony given by expert witnesses in this area is easily confused with conclusions of law, and indeed, many times it may be. Sixth, many people other than life-long adjusters are being presented as expert witnesses. Seventh, experienced insurance lawyers are probably qualified under the evidence rules to testify as experts, and professors of insurance law have been known to testify as experts in this area. There is probably nothing wrong with this, so long as the candidates who testify are actually experts. Nevertheless, lawyers are advocates, and that can raise questions. Perhaps the lack of a recognizable adjustment specialization is making courts most nervous. Perhaps courts are bothered by the commercialization of the expert witness "racket." There are now people who specialize in providing these services. Some of them buy ads in trade papers and rent booths at places like state bar conventions. The fact that some who are making their living as expert witnesses go out of their way to present slick, over-done ersatz objective reports doesn't help matters any.

The Giles Case

Trial judges and courts of appeals were not satisfied with *Lyons* and *Dominguez*. Therefore, in 1997, the Texas Supreme Court ruled again. This time, it basically said, "Look. The lower courts are finding *Lyons* and *Dominguez* unwieldy. We give up. Our courts want a different standard. We'll give it to them."²⁷ Here is exactly what the court said:

It has been argued . . . that if the reviewing court must give no weight to the insurer's evidence of a reasonable basis for the denial . . . of a claim, no judgment can be reversed for

26. Of course, what is true of the many is not true of everyone. Counter examples come easily to mind. Consider the following open remark from Haag's Amicus Brief in *Nicolau*: "Haag...is a Texas corporation engaged principally in forensic engineering. Engineers from Haag regularly testify as expert witnesses..."

27. *Giles*, 950 S.W.2d at 51-52.

want of evidence because there will never be any evidence of a reasonable basis. A review of the cases applying the traditional no-evidence standard to bad-faith findings suggests that this argument has some merit.

Of course, this statement contains a logical fallacy. In order for there to be no evidence that there was no reasonable basis for the denial of a claim, there does not need to be evidence that there was a reasonable basis. All there needs to be is an entire lack of evidence that the bases at issue were unreasonable. This is a perfectly orthodox point. It applies to all sorts of appellate review where the issue is legal sufficiency. The question is never: Has the defendant presented some evidence on behalf of his view of the case? The question is always: Has the plaintiff produced any evidence on behalf of its view of the case?

The fact that this fallacy is so obvious is itself significance. The real problems in appellate review do not lie in the logic of the review process. They lie elsewhere. First, as any reader of this paper can testify, double negative after double negative gets confusing. The verbiage of the element of the tort made matters awkward, if not obscure. Lurching and disjointed discourse suggests defective and illogical thought. Second, when dealing with relatively amorphous administrative matters, precise, technical, non-mushy, certain-sounding expert testimony is hard to get. Mostly what the courts are getting from expert witnesses in insurance bad faith cases is empty rhetoric. This was never the true function of expertise in law. Third, because the tort is new, its contours have not been worked out. Because insurance company decision-making has never been reviewed for rationality, that new process is still cumbersome.

The *Giles* decision was quite an unusual one. All of the justices agreed on the bottom line holding. Four members of the court revised the elements of common law insurer bad faith. Four other members of the court would have adopted another standard, and a lone member of the court thought that *Lyons* and *Dominguez* were just fine.

The new elements of common law insurer bad faith as laid down by the plurality may be reconstructed as follows. First, the insurer denied a claim. Second, the insurer's liability on the claim had become reasonably clear. Third, a reasonable insurance company would have known that its liability was reasonably clear, that the claim needed to be timely paid, and what amount should be paid.

Justice Spector, who reformulated the elements, suggested that the "reasonably clear" standard was preferable to the no-reasonable-basis standard. "First, and foremost," she wrote, "requiring a bad faith claimant to prove that a carrier failed to attempt to effectuate a settlement after its liability has become reasonably clear eliminates the conflict with our no-evidence standard of review."²⁸ Second, because this standard comes from the Texas statute, and also from a uniform proposed statute, the "solution unifies the common law and statutory standards for bad faith."²⁹ Third, the new "reasonably clear" standard facilitates factual inquiry and allows for the intelligent grafting of a jury charge. Fourth, and finally, because Texas lawyers have dealt with the "reasonably clear" standard for some time, there will be substantial familiarity with it.

Another block of four judges, lead by Justice Hecht, concurred in the judgment but rejected the view that the "reasonably clear" standard is in any way helpful.³⁰ In any case where there is a bad faith judgment against an insurer, there will be a finding of fact that the insurer's liability to the claimant on the claim had become reasonably clear, that the insurer had not made prompt, fair and equitable payment, and that a reasonable insurer would have known (a) that liability on the claim was reasonably clear, (b) that it was time to pay the claim, and (c) what amount should be paid. The question will be whether there is any evidence to support these findings of fact. All disputed evidence tending to support the proposition that the insurer-defendant reasonably believed otherwise will have to be ignored. Hence, no-evidence review under the new standard will suffer from all the problems of no-evidence review under the old standard. The question will remain: Does any

28. *Giles*, 950 S.W.2d at 55.

29. *Id.*

30. *Id.* at 58-59.

evidence support the policyholder's view of the case which eventuated in a judgment in its favor. Thus, the insurer is still extremely well-advised to focus explicitly on deconstructing the policyholder's evidence (especially the plaintiff's expert and his conclusions), as well as providing discrete bits of positive evidence that it acted reasonably.

So far so good. Justice Hecht is perfectly right. He continues, however, and at this point really makes a truly profound observation. It is this:

The reasonableness of the insurer's decision can be judged only by weighing the evidence for and against the claim. But no-evidence review of a jury finding forbids weighing of evidence by an appellate court. The court is permitted to consider only undisputed evidence and evidence supportive of the finding. Thus, by definition, no-evidence review of a jury finding of bad faith based on conflicting evidence is impossible. Excluding such review deprives courts of their role in defining bad-faith liability, making bad faith whatever any particular jury thinks it is. Moreover, creating a cause of action that cannot be fully reviewed on appeal thwarts appellate courts from discharging their obligation to exercise the jurisdiction constitutionally assigned them, which includes evidentiary review.³¹

The claim is that an insurance company in assessing a claim must balance evidence which points in several directions. In bad faith cases, juries are called upon to determine whether insurance companies have performed this balancing in a rational manner. Appellate courts should be able to review jury findings in this context. But, because balancing involves considerations pointing in (roughly) opposite directions, no-evidence appellate review of bad faith findings of insurance company balancing is possible.

This is really a deep point. It appreciates the structure of evidence and reasoning facing insurance companies, and it observes that if courts cannot

perform no-evidence review of subtle, multi-faceted, and multi-dimensional claims decisions, then perhaps the standard of review should be reformulated in order to preserve the fundamental thrust of appellate review. Profundity, however, does not always imply rectitude. Plato and Aristotle were both profound, but on many points at least one of them was wrong. Hume and Kant are both profound, but with respect to the nature of the world as it is in itself, at least one of them is wrong. Judge Posner and Professor Dworkin are probably both profound, but they cannot both be right.³² Perhaps Justice Hecht is wrong, even though his observations are deep, troubling, and meaningful.

Let us go back to a point which was made much earlier. Under the "no-reasonable basis" standard, *being reasonable* is not additive. If an insurance company has two reasons for denying a claim, neither of which is minimally reasonable, it cannot add the reasonableness scores of each basis together and get up over whatever line it is that constitutes minimal reasonableness—75 in the early hypo. At the same time, some bases for denying claims are internally compound. An insurer may deny a claim because p_1 and p_2 are both true. There may be something about p_1 and p_2 being true together which makes the reasonableness factor associated with the both of them higher than it would be if only one was true or if only the other was true. It might even be true that if p_1 , p_2 and p_3 all three occur together, then the reasonableness factor is higher than if p_1 and p_3 occur together or if p_2 and p_3 occur together. The idea of reasonableness scores was introduced earlier. Suppose p_3 alone has a reasonableness score of 30. By itself, p_3 would be a very unreasonable basis for denying a claim. Now suppose that when p_1 and p_2 occur together they have a reasonableness score of exactly 73. Further suppose that if p_1 and p_3 occur together, they have a reasonableness score of 74. Now, finally, suppose that when p_1 , p_2 and p_3 all three appear together, there is a reasonableness score of 84. Such a configuration is clearly possible, and it is a

31. Id. at 58.

32. See Richard A. Posner, *The Problematic of Moral and Legal Theory*, 111 Harv. L. Rev. 1637 (1998). There are responses from Ronald Dworkin, Charles Fried, Anthony T. Kronman, John T. Noonan, Jr., and Martha C. Nussbaum.

terribly important phenomenon. Given the world as it is, how factors are concatenated together may matter. Thus, the basis upon which an insurance company denies a claim—or the basis which may exist and upon which an insurance company could rely—may be quite complex. The insurers balancing of reasons for and against may very well be thought about in terms of appreciating the force a single complex basis consisting of a series of reasons some of which favor denial and some of which favor acceptance. Therefore, although Justice Hecht is certainly right—and, indeed, profoundly right—about the need to appreciate the role of balancing an insurance company's decision-making, he is not right that a traditional no-evidence standard cannot accommodate this fact. Nor is he right that insurance companies are thereby automatically deprived of appellate review. Much of appellate appreciation and critique of insurance company balancing falls within the purview of factual sufficiency and not legal sufficiency. It must be remembered, Texas has intermediate appellate courts, as well as the supreme court.³³

Justice Enoch, writing for himself alone, and suffering a good deal of abuse for his views, thinks that *Lyons* and *Domínguez* have it right and should not be disturbed. He believes that a new standard is nothing but a

semantic recasting of the elements of bad faith [which] in no way alters the character or proof necessary for a plaintiff to prevail, nor...change[s] the manner in which an appellate court ought to conduct a legal sufficiency review in a bad faith case. Liability is 'reasonably clear' only when there is no reasonable basis for an insurer to deny

coverage (or, if one prefers the converse, if there exists a reasonable basis to deny coverage, liability is not "reasonably clear").³⁴

In this matter, Justice Enoch is almost certainly correct. Justice Enoch is also rather impatient with Justice Hecht's concern about appellate courts being able to review balancing-type reasoning performed by insurance companies. Justice Enoch points out, quite straightforwardly, that this is a job for the trier of fact, and not for appellate courts.³⁵

The *Simmons* Case

In *Simmons*,³⁶ the trial court entered a judgment which presupposed a finding of fact that the insurance company had performed a pretextual investigation. The issues in *Simmons* revolved around the pretextuality of the insurer's investigation of an arson case. One of the deep issues of the case was whether there can be bad faith when there is an investigation which is certainly negligent and possibly pretextual, but there is a mix of factors which, in the aggregate, may add up to the existence of a reasonable basis for the denial of the claim. Or, to put the matter another way, what do the courts do when an insurance company botches an investigation very badly, but still has some factors which might suggest to a reasonable insurer that the claim could be denied.

From the point of view of our topic, the dissenting opinions are more interesting than the opinion of the court. This is true for several reasons. First, Justice Hecht, who was quite critical of the "no reasonable basis" standard in his *Giles* concurrence, blended the "no reasonable basis standard" with the new "reasonably clear" standard:

33. Justice Hecht, and other judges, may be concerned that the idea of an internally complex basis is an idea which is subject to much manipulation. Of course, this is true, but then so is every other idea which is not firmly rooted in mathematical or physical reality.

34. *Id.* at 80.

35. At the same time *Giles* was decided, the Texas Supreme Court decided *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444 (Tex. 1997). From a factual point of view, *Nicolau* is a much more interesting case than *Giles*, since the insurance company had to do some balancing, and since the court split 4-1-4 on whether the underlying judgment should have been affirmed. Nevertheless, from the point of view of discussing standards of appellate review and from the point of view of discussing the elements of the tort of common law insurer bad faith, *Nicolau* does not contain much interesting. Its application of the elements to the facts, however, is quite interesting.

36. *State Farm Fire & Cas. Co. v. Simmons*, 963 S.W.2d 42, 48 (Tex. 1998).

The tort of bad faith has two elements, one objective and the other subjective. Plaintiff must prove both 'that the insurer had no reasonable basis for denying . . . payment of the claim, and it knew or should have known that fact.' The court has recently held that the objective element is satisfied by proof that an insurer denied. . . payment of a claim after liability was reasonably clear.³⁷

Under this formulation, it is as if *Giles* never happened. The standard for bad faith in Texas is what it always was, but there is now a rule for one way to satisfy one of the elements. In addition, according to Justice Hecht, there will be some evidence that an insurance company denied a claim based upon a pretext only if "the basis for denying the claim actually *is* pretextual." This requires both subjective evidence and objective evidence:

Before an insurer can be in bad faith for the way it investigated a claim, there must be evidence not only that it was wrongly motivated but that a differently conducted investigation would have shown the claim to be reasonably clear.³⁸

This is the classical formulation of the Texas Test with a vengeance. An insurance company can be wrong and not guilty of bad faith when it denies a claim on an unreasonable basis, but there exists a reasonable (though invalid) basis upon which the claim might have been denied. Furthermore:

An insurer who sets out to fabricate a basis for denying a claim but finds instead solid grounds for denial is no more in bad faith than the insurer who seeks a pretext for denial but then decides to allow the claim after all. The insurer's bias and intent become relevant only when it appears that the insurer denied a claim when liability was reasonably clear. Then the fact that the insurer was not simply

mistaken but wrongly motivated becomes important.³⁹

According to Justice Hecht, these observations entail that if an insurer "wilfully ignores evidence supportive of a claim," then the insurer risks bad faith liability, although it does not risk bad faith liability if it wilfully ignores evidence which is irrelevant, even if the insurer (unreasonably) believes that the evidence is relevant.

Justice Enoch also dissents from the court's holding on the basis that although

an insurer has a duty to investigate its insured's claims, this duty can form the basis of bad-faith liability only if the plaintiff presents evidence that the insurer's breach of this duty results in denial of a claim that no reasonable insurer could have denied.⁴⁰

Justice Enoch's critique of the majority's view is that "it does not link the duty to investigate to the objective element of the bad-faith tort—whether the insurer's liability is reasonably clear." Justice Enoch appears to agree with Justice Hecht that it is not enough for an investigation to be outcome-oriented, "there must [also] be some evidence that a reasonable insurer could not have denied the claim, the particular insurer's subjective orientation notwithstanding." In other words, negligence, pernicious wilfulness, hatefulness, or spite will not generate bad faith judgments, if there exists a reasonable basis upon which the claim could have been denied.

A Penultimate Thought

No-evidence appellate review is released from the obligation to consult only favorable evidence when the evidence is undisputed. This point has been made several times. It behooves appellate counsel for an insurance company to scour the record looking for undisputed evidence that at least one basis upon which the insurer could have denied the claim is

37. Id. at 48.

38. Id.

39. Id.

40. Id. at 51.

undisputedly reasonable. Appellate counsel will be able to argue that it is undisputedly reasonable if there is any evidence tending to suggest that the basis was reasonable and no evidence to suggest that it was not. If there is any basis the reasonableness of which the plaintiff has not expressly disputed, it is a likely candidate for this kind of argumentation.

The sort of argument being suggested here is possible in any one of three circumstances. First, if the claimant has left it open to inference that a basis is unreasonable, in other words, if it has not presented discrete and affirmative evidence that a particular basis is unreasonable, but rather has described the basis and left it to the jury whether the basis is reasonable or unreasonable, undisputed evidence may under mine the claimant's position. Second, if the plaintiff's expert has not expressly negated the reasonableness of each basis utilized by or available to the insurer, then there will be a gap in the testimony sufficient to utilize on behalf of the insurer. Third, if the claimant's expert witness is subject to sufficient impeachment either as to credentials or as to knowledge about a particular area of insurance law, it may be possible to claim that the expert's express opinion is no more than a scintilla of evidence in support of reasonableness, because of incompetence on the part of the expert.

Each of these argumentative strategies needs to be set up in discovery and trial, before anyone ever gets to the appellate process. Nevertheless, as in almost all things related to litigation, how things need to be handled on appeal should shape how they are handled early in the suit. An attack on the plaintiff's expert illustrates this point. If an insurer wishes to claim an opinion admitted into evidence does not constitute any evidence (and hence flunks the no-evidence test), it might wish to include a point of error on appeal that the witness who espoused the opinion was not really an expert and hence that the trial court erred in admitting the evidence. But this point of error requires that a he's-no-expert objection to the witness have been made and that a similar objection

to the testimony have been made. Perhaps there should have been a pre-trial motion to strike and maybe some sort of objection (or motion in response to) to the expert-identifying interrogatory answer.

Conclusion

For a decade, insurance companies did not commit the tort of bad faith in Texas when they denied claims, if there existed a reasonable basis upon which the claim could have been denied. This was true even if an insurance company did not avail of itself of that reason, but relied upon a bad one. No-evidence appellate review of affirmative bad faith finding of this standard has proved troublesome for Texas courts, although there is no real logical difficulty in them. The real difficulty is political. Some judges are ideologically disposed towards affirming bad faith judgments, while some are not. The drift of the judiciary in Texas is presently away from willy-nilly affirming bad faith judgments when insurance companies have performed their duties with anything less than a pristine record.

The change in the elements of common law insurer bad faith brought about by *Giles, Nicolau and Simmons* in 1997 and 1998 will probably not affect the problem of appellate review in Texas. That problem will work itself out as lawyers get better at presenting these cases in court, as district judges become more confident about granting dispositive motions, and as the appellate judiciary becomes more experienced in sifting the admittedly mushy and sometimes amorphous evidence which is presented in insurance bad faith cases. In other words, the logic of no-evidence review is just fine. The real difficulty lies in a weak and fallen condition of man. Original sin has had consequences not only for conduct and ethics but also for reasoning, cognitive faculties, and practical epistemology. That's a problem we'll just have to struggle with, and with a little grace we may get the job done right, at least most of the time.