

INSURANCE LITIGATION™

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WEST GROUP

Struggle, Confusion, And Diversity: Insurance Bad Faith In Texas—Recent Rapid Evolution

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For a little more than a decade, the Texas Supreme Court has held up a mirror to the nation on the topic of insurance bad faith, whether common law or statutory. The last decade of Texas legal history has been marked by confusion, false-starts, back-tracking, regrets over the past, agonizing over where to go next, and taking baby-steps—sometimes quite halting. The controversies over an insurance bad faith in Texas courts reflect the direction of nationwide jurisprudence, the doubts many courts have experienced in trying to work with bad faith, and the legal and logical complexities which bad faith cases have created.

To be sure, Texas did not create common law insurer bad faith. California and other states originally led the way. Indeed, in 1983, the Texas Supreme Court rejected the idea that there was such a thing as an implied covenant of good faith and fair dealing¹ contained in insurance contracts. Very shortly thereafter, however, that court endorsed the idea that there was a tort of bad faith which arose out of the *special relationship* between insurers and insureds.² This special relationship generated a duty of good faith and fair dealing running from insurers to insureds. This *special relationship* is not a full-fledged fiduciary relationship. It falls somewhere between an arms-length relationship and a fiduciary relationship. Maybe it tends towards the fiduciary end of the continuum.

The gist of the new common law tort was that an insurer would be liable to its insured if it denied (or delayed paying) a claim when (1) there was no reasonable basis to deny (or delay paying) the claim and, (2) the insurer knew or should have known that there was no such reasonable basis. In other words,

the courts called attention to a difference between *there existing* (or, *there being*) a reasonable basis, and the insurer *having* and *using* a reasonable basis. Some judges have indicated that the absence of a reasonable basis means that if there was a reasonable basis to deny the claim, there could be no common law liability, even if the insurer did not deny the claim for that reason, but denied the claim for a bad reason.³ Another court has said that the tort applies only to first-party insurance and therefore does not apply to liability insurance.⁴ The reason given by the court was that insureds under liability policies had all the remedies they needed against the insurers which behaved improperly: insureds could sue in contract, if—for example—an insurer failed to defend, and they could sue under the *Stowers* Doctrine if the insurer failed to settle within policy limits after having received a reasonable and unconditional offer of settlement within policy limits.⁵

The bar has been puzzled by how to conduct appeals of common law insurer bad faith cases when the insured is entitled to recover only if there was no reasonable basis for denial (or delay). The problem is that the insured must prove a universal negative

1. English v. Fischer, 660 S.W.2d 521 (Tex. 1983).

2. Arnold v. Nat'l County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987).

3. Viles v. Security Nat'l Ins. Co., 788 S.W.2d 566 (Tex. 1990). (Justice Hecht wrote the following in his concurring opinion in which Chief Justice Phillips, Justice Gonzales, and Justice Cook joined: "[T]here may be a reasonable basis for denying a claim even if the adjuster who actually makes the decision is not aware of it and denies the claim for some other reason, even an invalid one.")

4. Maryland Insurance Company v. Head Indus. Coatings & Servs., Inc., 938 S.W.2d 27 (Tex. 1996) (per curiam).

5. Stowers Furniture Co. v. Am. Indem. Co., 15 S.W.2d 544 (Tex. Comm'n App. 1929, holding approved). See Am. Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842 (Tex. 1994).

statement, to wit: *No good reasons support the denial of this claim*, and the appellate process is concerned with whether the plaintiff has proved that statement. There are two standards of proof upon appeal: the *insufficient evidence* standard and the *no evidence* standard. The bar has wondered how you demonstrate to an appellate court that there is no evidence that there was no reasonable grounds upon which to deny a claim, and how one demonstrates that there was insufficient evidence that there was no reasonable basis upon which to deny a claim. These are legal conundrums which only an appellate lawyer can love. They are even a bit like tongue-twisters.

In addition, the insurance industry has wondered what constitutes a reasonable basis for denying a claim, and either seeking adjudication or waiting to be sued. For a number of years, there have been three major alternatives recognized by various courts. First, some states have said that there is a reasonable basis for denying a claim when denial of the claim is *fairly debatable*. A claims decision is not fairly debatable when it is arbitrary. At least one Texas court has hinted that insurer claims decisions which violate the *no reasonable basis* standard are those which are arbitrary.⁶ Second, some courts have said that there is a reasonable basis for denying a claim when there is a *bona fide dispute*. This standard sounds very much like the *fairly debatable* standard. And third, some courts have said that there is a reasonable basis for denying a claim when a reasonable insurer would deny the claim.

Each approach has had its advocates, at different times, on the Texas Supreme Court. In general, however, the court has avoided a third alternative, because it collapses the tort of insurer bad faith into negligent adjustment by an insurer (i.e., insurer malpractice). Not long ago, the bare majority of the court indicated dissatisfaction with the *fairly debatable* standard, although a substantial minority of the court thought the standard appropriate.⁷ The court has come close to adopting the *bona fide dispute* standard, although it did not do so with the customary signal that a full-fledged holding was in the

offing.⁸ That standard is very much alive, however. Indeed, as we shall see, it is employed in the case discussed here.⁹

As a result of the concerns of insurers and attorneys, last year the court revised part of the standard for common law insurer bad faith. The question was, "When is there no reasonable basis for denying a claim?" The revised answer to be found in *Giles*¹⁰ and in *Nicolau*¹¹ is that,

There is a reasonable basis to deny a claim when liability under the policy is not yet clear, and there is no reasonable basis to deny a claim when liability under the policy is reasonably clear.

The *Giles* majority adopted this rule because it is also a statutory rule of liability. Art. 21.21 of Texas Insurance Code states that an insurer may face damages when it fails to make prompt, fair, and equitable payment to an insured once liability becomes reasonably clear.¹² Many other statutes have

8. *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10 (Tex. 1994). ("The threshold of bad faith is reached when a breach of contract is accompanied by an independent tort. Evidence that merely shows a bona fide dispute about the insurer's liability on the contract does not rise to the level of bad faith. Nor is bad faith established if the evidence shows the insurer was merely incorrect about the factual basis for its denial of the claim, or about the proper construction of the policy. A simple disagreement among experts about whether the cause of the loss is one covered by the policy will not support a judgment for bad faith. To the contrary, an insured claiming bad faith must prove that the insurer had no reasonable basis for denying or delaying payment of the claim, and that it knew or should have known that fact." *Id.* at 18. (Citations omitted.) Thus, if there is a bona fide dispute, there cannot be bad faith.)

9. *State Farm Fire & Casualty Co. v. Simmons*, 41 Tex. S. Ct. J. 371 (February 13, 1998). All further references to this case will be by parenthetical page numbers in the text of the article. The curse of footnotes must be reduced somehow. (Consider the following verse from visionary pseudo-Scripture: "To hell with footnotes. Steve Austin, *THE STONE-COLD*, 3:16).

10. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48 (Tex. 1997).

11. *State Farm Lloyds Ins. Co. v. Nicolau*, 951 S.W.2d 444 (Tex. 1997).

6. *Arnold*, 725 S.W.2d at 167. See *Aranda v. Ins. Co. of N. Am.*, 748 S.W.2d 210, 212 (Tex. 1988).

7. *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 54-55 (Tex. 1997).

adopted this language, as have some Model Codes. That is where matters rested at the end of 1997—a full decade after the Texas Supreme Court created the common law tort of insurer bad faith.

The year 1998 has opened with a bang.¹³ The court was presented with an arson bad faith case, the unadorned facts of which are relatively simple. Probably, the court created no new law, but it certainly suggested that the quality of insurance company investigations should be a focal point for bad faith litigation. What is exquisite about this case is that many have thought that epistemology of arson investigations has been well understood for some time. Insurance companies have been performing them for many years—often quite well. Moreover, there are frequently well-established guidelines inside the adjustment bureaucracies of insurers prescribing how these investigations should go forward. Thus, the court had plenty of evidentiary material in the light of which to review the insurers investigation. At the same time, the *Simmons* case serves notice upon insurance companies, lawyers, and observers alike that procedural norms governing arson investigations should not be understood remindedly or mechanically.

I. THE SIMMONS CASE

In order to understand the opinions in the supreme court, it is necessary to understand both what happened in the trial court and what happened in the court of appeals.

12. Art. 21.21 of the Texas Insurance Code is entitled "Unfair Competition and Unfair Practices." Section 4 defines a series of "unfair methods of competition and unfair and deceptive acts or practices in the business of insurance." Subsection (10) thereof finds a number of "Unfair Settlement Practices," one of which is this: "Failing to attempt in good faith to effectuate a prompt, fair, and equitable settlement of a claim with respects to which the insurer's liability has become reasonably clear[.]" Art. 21.21 § 4(10)(a)(ii).

13. Several other bad faith cases were decided at the same time *Simmons* was decided. *St. Paul Surplus Lines Ins. Co., Inc. v. Dal-Worth Tank Co.*, 41 Tex. Sp. Ct. J. 380 (February 13, 1998) and *Associated Indem. Corp. v. CAT Contracting, Ind.*, 41 Tex. Sp. Ct. J. 389 (February 13, 1998).

A. Trial Court

The Simmons family purchased a home in 1983. The family consisted of a father, a mother, and two children. The husband and father was a construction supervisor. The case contains no information as to whether the mother and wife was regularly employed.

The Simmons improved their homestead in a number of ways. Mr. Simmons built a driveway and a sidewalk; he remodeled a bathroom; he built a hog pen, so that he might keep pigs; and he built various items for the house, such as a dining room table, beds for the children, and a mantel. He made other improvements as well.

In 1984, the construction industry slowed down. As a result, the Simmons missed some payments to their mortgagee, the Veterans Administration. However, mortgagor and mortgagee worked out a repayment schedule, substituting weekly for monthly payments.

Shortly thereafter, the Simmons' home suffered a burglary. The robbers took a television set, some silverware, a shotgun, and at least one child's piggy bank. Mr. Simmons noticed that there were wheelbarrow tracks leading away from the house. He followed those tracks and found that they led to the nearby home of an adolescent male. He confronted the boy, who denied the crime. Mr. Simmons reported the matter to the police, but not much happened immediately. Eventually, the boy confessed the burglary to the police, as did another, and the law took its course. State Farm paid the Simmons \$7,069 on the loss. Thereafter, the Simmons residence suffered vandalism, including smashed eggs in the bottom of the mailbox. The Simmons' dog died under mysterious circumstances, and Mr. Simmons, who had studied animal husbandry for a while in college, concluded that the dog had been poisoned. There was also another break-in, but this time nothing was taken.

Finally, on Sunday, June 2, 1985, the house burned. The Simmons were to take their children to Louisiana to spend the summer with an aunt. The family left at 1:30 or 2:00 in the morning. The parents intended to return that night, so that Mr. Simmons could go to work again on Monday morning. Shortly after the Simmons left, a newspaper carrier noticed that smoke was coming from the house. She called the volunteer fire department, but they could not put

out the blaze. The house was a total loss.

The following day, the Simmons reported the loss to State Farm. It almost immediately classified the loss as a suspicious one, and after a short interval, the case was assigned to the Special Investigations Unit. The purpose of SIUs is to investigate arson (and other fraudulent) claims.

In late 1986, the Simmons sued State Farm. They proceeded upon a number of theories: contract, common law bad faith, Insurance Code violations, and violations of the Texas Deceptive Trade Practices-Consumer Protection Act ("DTPA").¹⁴ State Farm set up arson as an affirmative defense. (Of course, arson-by-the-insured is not an express exclusion under the policy. Instead, courts universally treat it as an implied exclusion, required by the principle of fortuity and by the necessity of eliminating the moral hazard of "self-torchure."¹⁵)

The jury found against State Farm on the arson defense. Everyone agreed that the house was covered. Consequently, Simmons straight-away prevailed upon the contract theory. The jury also found that State Farm had committed the common law tort of insurer bad faith, that it had knowingly violated the DTPA, and that it had acted with conscious indifference to the rights of the Simmons. The jury prescribed actual damages of \$275,000 and punitive damages of \$2 million. The verdict which gave rise to the judgment was unanimous.

B. Court of Appeals

The Beaumont Court of Appeals found that the bad faith verdict was supported by legally and factually sufficient evidence. In addition, the court of appeals found that State Farm's investigation of the fire loss was conducted in a biased and self-serving manner and was recklessly indifferent to the rights of the Simmons. The court of appeals found that State Farm humiliated the Simmons and caused them mental anguish. Upon these grounds, the court affirmed the jury's award of punitive damages. Finally, the court of appeals found that State Farm violated the DTPA and did so knowingly.

14. Texas Business and Commerce Code § 17.46, et seq. (1997). (This act has been amended many times over the last two decades.)

15. Spencer Kimball, *INSURANCE LAW*, 158-60 (1992).

The court of appeals opinion contains a number of interesting tidbits. When the Simmons returned from Louisiana, for example, they returned with Mr. Simmons' mother and a nephew. According to Mrs. Simmons, late on that Sunday evening she observed her husband weeping for the first time since her mother's funeral. She also testified that she saw her husband break down and cry when State Farm denied their fire loss claim.

According to the court of appeals, the Simmons cooperated fully with State Farm in its investigation. For example, they authorized "State Farm to obtain all of the financial information it might desire."¹⁶

II. COMMON LAW BAD FAITH: SUPREME COURT TREATMENT

Justice Rose Spector wrote for the six-person majority, which consisted of Chief Justice Phillips and Justices Gonzales, Baker, Abbott and Hankinson. She reiterated *Giles*-standard, according to which there can be no insurer bad faith unless the insurer's liability under the policy is reasonably clear. She went on to gloss this standard as follows: "Evidence establishing only a bona fide coverage dispute does not demonstrate bad faith." (372).¹⁷ Although this sentence is not a model of clarity, it probably means that if the evidence vindicates no more than the proposition that there was a bona fide dispute between the insurer and the insured as to coverage, then that evidence does not tend to prove bad faith. In other words, evidence which demonstrates no more than a bona fide coverage dispute constitutes no evidence at all of common law bad faith. Thus, the

16. *State Farm Fire & Cas. Co. v. Simmons*, 857 S.W.2d 126, 129 (Tex. App.—Beaumont 1993, aff'd in part, rv'd in part, and remanded with directions, 41 Tex. S. Ct. J. 371).

17. Notice how closely the language in *Simmons* resembles the language in *Moriel*, which was this: "Evidence that merely shows a bona fide dispute about the insurer's liability on the contract does not rise to the level of bad faith." In other words, both cases stand for the proposition that the presence of a bona fide dispute completely defeats insurer bad faith. Thus, the existence of a bona fide dispute entails that the insurance company's liability under the policy is not reasonably clear.

bona fide dispute standard mentioned in *Moriel*, but not mentioned in either *Giles* or *Nicolau*, is back, if it was ever gone, and diversity in the way the law is formulated remains a generative force.

A. Duty to Investigate

Unfortunately, these standards do not indicate how the tort of insurer bad faith is linked to the insurer's obligation to investigate the claims of their insureds. Everyone agrees that first-party insurers have a duty to investigate. The stem-cases which established the common law tort of insurer bad faith referred to that duty expressly. In *Aranda* the supreme court said that insurer bad faith involved two elements. The first one was objective and required "the absence of a reasonable basis for denying or delaying payment of the benefits of the policy," while the second was subjective and required "that the carrier knew or should have known that there was not a reasonable basis for denying the claim or delaying payment of the claim."¹⁸ The *Aranda* court said that the second element balanced the right of an insurance company to reject an invalid (or doubtful) claim and "the duty of the carrier to investigate and pay compensable claims." A plaintiff may establish the second, subjective element by establishing that a carrier actually knew that there was no reasonable basis for denying or delaying the payment of a claim, or "by establishing that the carrier, based on its duty to investigate, should have known that there was no reasonable basis for denial or delay."¹⁹ The matter came up again in *Giles*, where Justice Spector, writing for the majority, made it clear that the change *Giles* effected in the elements of the common law tort did not affect insurers' duty to investigate.²⁰

The majority in *Simmons* formulated the duty to investigate broadly and comprehensively. Insurers have a duty to investigate claims fairly, comprehensively, empirically, and in an appropriate manner. Investigative duties are not unlimited, however. "Yugo" claims are not entitled to "Ferrari" investigations. Investigations need to be no more than appropriate. In short, insurers must exercise judgment about investigations, but they must do so reasonably.

Whatever else is true, investigations by insurance companies must be designed to discover objective facts, and investigations should be conducted objectively. (374). At the same time, insurers should give their insureds the benefit of the doubt. So, insurers should resolve uneliminable ambiguities in the evidence in favor of their insureds; unfillable gaps should apparently be filled with assumptions favoring the insured; and so forth. At least this is what State Farm claims witnesses said or implied, and the majority apparently judged State Farm against its own standards.

This requirement means that an entire range of investigations is unacceptable and actionable. These include "out-come oriented" investigations, investigations "designed" to demonstrate (for example) arson by the insured, investigations (more generally) designed to defeat coverage, and investigations engineered to create plausible-looking but actually bogus reasons for denying coverage. *Post hoc* rationalizations should not be accepted as genuine fruits of real investigations.

Insureds do not have a duty to disprove express and implied exclusions. Thus, Simmons did not have a duty to prove that he did not burn his own house. He did not have a duty to prove that someone else burned his house. In the bad faith case, the insured must prove that there was no reasonable basis for the insurance company to deny coverage. This does not require that the insured prove that somebody else burned the house. It requires him to prove that there was no really good reason to believe that he burned the house and (perhaps) that there were other likely candidates. It was not his obligation to prove these propositions in the coverage case, and it was not his

20. *Giles*, 950 S.W.2d at 56 n. 5. ("An insurer will not escape liability merely by failing to investigate a claim so that it can contend that liability was never reasonably clear. Instead, we reaffirm that an insurance company may also breach its duty of good faith and fair dealing by failing to reasonably investigate a claim." Justice Spector relies upon the *Arnold* case stated in part as follows: "A cause of action for breach of the duty of good faith and fair dealing is stated when it is alleged that there is no reasonable basis for denial of a claim or delay in payment or a failure on the part of the insurer to determine whether there is any reasonable basis for the denial or delay." *Arnold*, 725 S.W.2d at 167.)

18. *Aranda*, 748 S.W.2d at 213.

19. *Id.* at 213.

obligation to prove them in the bad faith case either.

B. Investigative Deficiencies

The majority opinion was sharply critical of State Farm's investigation. The insurer started with inappropriate assumptions, failed to look into factual matters, drew the wrong inferences, dogmatically adhered to conclusions which were unsupported by evidence, and—inflexibly—refused to abandon conclusions and characterizations when they were inconsistent with evidence.²¹

First, State Farm rushed to judgment in classifying the case as arson by the insured. It did this principally on the basis of the previous burglary claim. That claim was bona fide, of course, since there actually was a burglary, and the Simmons in fact sustained the losses they claimed. Indeed, as Justice Spector points out, the Simmons apparently acted honorably in that claim. After the claim was paid, the police returned Mr. Simmons shotgun to him. Since State Farm had already paid for it, he turned it over to State Farm.

Second, State Farm did not investigate other suspects. The State Farm adjuster himself set the standard. He testified that insurance companies have a duty to investigate alleged arsons thoroughly. State Farm's own adjusters agreed that in investigating an arson case it is important to investigate others who may have had a motive to burn the house. When the State Farm adjuster was asked why he didn't interview the neighbor boy who burglarized the house and to whose home wheelbarrow tracks led, he testified that the young man could not have had a motive to burn the house. The majority found this statement "inherently incredible."²²

State Farm did not interview a number of people whom the Simmons had identified as having grudges

against them. This list included the very "neighborhood hooligans" who had confessed to burglarizing their home and who Simmons turned over to the police. State Farm officials attempted to vindicate their lack of curiosity by saying they couldn't locate them and by saying that their testimony was unimportant. The court implicitly rejected this reasoning resoundingly. In addition, the file of the Special Investigations Unit contained uninformed and outdated material about the burglary and its aftermath. Apparently, the file continued to contain these errors for four years.

Third, insurance companies have developed various indicia of arson. These are well known to every arson investigator, and there is an elaborate literature about them.²³ The supreme court set them forth in an eight item list, as follows:

- (1) recent purchase of a property insurance policy covering the burned property, a recent increase in the policy limits of such a contract, or a recent attempt to increase the limits;
- (2) policy limits substantially exceed the value of the property destroyed;
- (3) the insured has attempted to sell the property or has indicated an intention to move;
- (4) previous losses due to fire;
- (5) "a strong alibi for the insured;"
- (6) "unusual money problems" besetting the insured;
- (7) removal of valued personal items before the fire;
- (8) a huge financial strain from everyday expenses. (373).

21. The Beaumont Court of Appeals was even more critical of the State Farm investigation. The court of appeals was even critical of the lawyers who assisted State Farm in performing the investigation. Simmons, 857 S.W.2d at 139.

22. As did the Beaumont Court of Appeals. The State Farm SIU investigator himself also testified that "the characteristics of the spite and revenge arsonist and juvenile arsonist. Significantly, these were characterized by youth, threats or altercations. [That investigator] acknowledged that there were a lot of fires set by juveniles." Simmons, 857 S.W.2d at 131.

23. See Michael Sean Quinn, *Closing Arguments and Insurance Fraud Cases*, 28 TORT & INS. L. J. 744 (1988). (This article was especially concerned with processing arson cases, and it discusses some of this literature.)

Items (1)-(6) were not satisfied at all, and State Farm never suggested that they were. Item 7 was not satisfied, although State Farm thought for a while that it was. Of course, the children's summer clothes were gone. They were spending the summer in Louisiana. Their winter clothes were in the house, and there was evidence that that was true. State Farm suggested that clothes were missing from the master bedroom, but this proposition was simply false. Moreover, items having sentimental value were present in the house, including Mr. Simmons' school-days track awards and the family bible.

Item (8) concerns a deteriorating financial condition. While the Simmons were pressed for money, they did not have a deteriorating financial situation; the mortgage on the house exceeded the value of the insurance policy; and—at least for a time—State Farm substantially misunderstood the Simmons financial picture.

On the basis of its critique of State Farm's investigation, the majority affirmed the trial court's judgment that State Farm committed common law tort of insurer bad faith. Apparently, the parties had not disputed the actual damage figure, and so the matter stopped there.

III. PUNITIVE DAMAGES

Under the standard set forth in *Moriel*, awards of punitive damages are justified only if the tortious conduct of the defendant was undertaken in reckless disregard of the rights and interests of the plaintiff and only if the tortfeasor actually knew that its conduct would probably cause "extraordinary [and unusual] harm"—such as death, great bodily harm, or financial ruin.²⁴ A probable infliction of mental anguish just by itself is not grounds for the imposition of punitive damages.

Obviously, the only category relevant here is *financial ruin*. There was no danger of death or severe bodily injury. According to the Simmons, there was evidence that State Farm's conduct would probably cause financial ruin. It was the fact that State Farm never paid the mortgagee, an independent insured under the policy. The supreme court rejected

this view. The reason why State Farm did not pay the VA was to be found in administrative snafu's in dealings between State Farm and the VA. State Farm in fact offered to pay the VA, and it was merely accidental that the VA did not get paid. There was no evidence that the VA ever caused—or even threatened to cause—Simmons any trouble about this matter. Consequently, the supreme court reversed the trial court's judgment awarding \$2 million in punitive damages.

State Farm may regard this case as a loss—after all, no insurer likes to be described as having acted in bad faith. At the same time, its elimination of the punitive damage was a stunning victory. It is important to notice that the plaintiffs were not deprived of the punitive damage element of their judgment because State Farm's conduct was immune from criticism. Rather, they were deprived of that part of the judgment because reckless conduct plus some injury are not sufficient to vindicate such awards. The conduct must not be judged by the state of mind of the reckless actor only. It must also be judged by the type of objective dangers it creates. Texas punitive damage law requires *special, extraordinary* dangers.

IV. DTPA

State Farm attempted to defeat the plaintiffs' claims under the DTPA by saying that since it did not commit common law bad faith, it could not possibly have violated the DTPA. The majority simply said that, since they had decided State Farm did commit common law bad faith, it had nothing to talk about under the DTPA points of error. It is important to see what this opinion says and what it does not say about the relationship between the common law tort of bad faith and DTPA violations. The court does not say that if an insurer commits that tort, then it has violated the DTPA. The decision of the supreme court is much more contextual than that. It rests upon the fact that State Farm's only argument on behalf of the proposition that it did not violate the DTPA was that it did not commit the common law tort of insurer bad faith. Thus, according to the majority opinion, State Farm made its own bed, and there it must lie. In retrospect, one wonders about the wisdom of deciding to try to defeat the DTPA claims on the basis of simply arguing no bad faith. Then again, second-

24. *Moriel*, 879 S.W.2d at 24.

guessing decisions made by litigation control groups based on complex considerations is often nothing more than cheap-shooting.

V. RESOLUTION

The resolution of this case in the supreme court was quite simple. When there is a knowing violation of the DTPA, the plaintiff is entitled to treble damages under the statute. In this case, however, the punitive damages were larger than the DTPA-trebling, so the plaintiff elected to recover the punitive damages. But, observed the supreme court, the punitive damages are now gone. Therefore, the plaintiff had a right to recover actual damages, plus the DTPA statutory trebling, presumably, plus attorney's fees and pre-judgment interest. (In Texas, prevailing plaintiffs do not have the right to attorney's fees when they recover on common law tort theories. They do have a right to attorney's fees under the DTPA, however.) Therefore, the court not only reversed the judgment, but remanded it for the entry of a judgment consistent with its opinion. Neither side has filed a Motion for Rehearing. Consequently, the judgment of the supreme court is final, and that phase of the case is over. Only the calculation of damages remains.

VI. HECHT'S DISSENT

Justice Nathan Hecht wrote a concise, challenging, and incisive dissent, in which Justice Priscilla Owen joined. Justice Hecht began with fundamentals, and then analyzed State Farm's investigation in the light of those fundamentals.

A. First Principles

The common law tort of insurer bad faith has always consisted of two components: one objective and one subjective. The objective component is satisfied when there is no reasonable basis upon which an insurer might deny a claim, and the subjective basis is satisfied when the insurer either knew or should have known that there was no such basis. (Of course, since *Giles* the objective component is satisfied when the insurer's obligation to pay its insured under the insurance contract is

reasonably clear.)

When liability is predicated upon a shoddy investigation, the focus is on the subjective component of the tort of bad faith. Thus, an investigation is unacceptably poor when a proper investigation would have revealed that there was no reasonable basis upon which to deny payment, i.e., when a legally satisfactory investigation would have revealed that the insurer's liability under the contract was reasonably clear.

But, says Justice Hecht, an insurer may not be found liable for having committed the tort of bad faith, unless there actually was no reasonable basis upon which to deny the claim. The performance of a legally unsatisfactory investigation, or even the performance of no investigation at all, will not entitle the insured to damages, if the truth of the matter is that there was good reason on the basis of which the claim could have been denied, even though the insurer relied upon a bad reason produced by a defective—even pretextual—investigation. (We will return to this matter presently.)

Justice Hecht criticizes the majority opinion upon the grounds that it concentrates exclusively on the deficiencies in the investigation. It never demonstrates that there was no evidence that there was no reasonable basis upon which the claim could have been denied. (It never demonstrates that there was no evidence tending to negate the proposition that the insurer's duty to pay under the contract was reasonably clear.)

B. First Principles Applied

Justice Hecht analyzes the facts of the case in the light of these observations. Along the way, he tries to show that the investigation was not as bad as the majority claims, and that deficiencies in an investigation are not always relevant to the legal evaluation of the bad faith claim.

First, the fact that State Farm classified the fire as "suspicious" and referred it to its SIU is not really relevant. The fire, after all, was suspicious. Even the plaintiffs believe that the fire resulted from arson—just not their arson. Moreover, although this point is not crystal clear in the opinion, Justice Hecht seems to suggest that the initial hypotheses of an investigating insurer are irrelevant to evaluating the conclusion of the investigation. After all, one can

almost hear him say, all investigations have to begin with some hypothesis or other, and one grand theory of sound empirical inquiry claims that the best way to establish truth is to hypothesize something and then set out to prove it false.²⁵ If this view of inquiry is correct, the insurance company's investigation began on the right foot, not the wrong one.²⁶

Second, State Farm should not be faulted for failing to interview the neighborhood hooligans. It is reasonable to assume that they would have denied burning the house. Why else interview them? One of those hooligans was the very person who had earlier burglarized the house. There's hardly any question as to what he would say. The Simmons had also complained that State Farm did not interview the newspaper carrier. At argument, counsel for the Simmons admitted that he had interviewed her, and she had nothing to say. He also admitted that he himself had not interviewed the people on Simmons "grudge list." Justice Hecht's point is that Simmons cannot prove that interviewing the neighborhood hooligans would have made a difference. Surely, he implies, the plaintiff must be able to prove that counter-factual proposition to prevail in a bad faith case.

Third, State Farm's mistakes regarding the financial situation of the Simmons were corrected before State Farm denied the claim. Moreover, although the Simmons family finances were not deteriorating, they were pressed for money. They could have believed that torching the house might alleviate their financial situation. This would have been inherently implausible, only if they knew that the limits on their homeowners policy were less than

the principal amount of the mortgage. Since there was no evidence in the record as to whether the Simmons realized this, or not, the evidence cannot be used to prove bad faith.

C. The Thrust

Justice Hecht concludes that liability under the policy was not clear. The truth of the matter is that the fire was set. The only question was, "Who set it?" Under those circumstances, at least where the insured has not been otherwise removed from suspicion, liability under the policy is not clear, and there can be no bad faith. This conclusion, at least, is what Justice Hecht implies.

In *Giles* and in *Nicolau*, Justice Hecht complained that common law tort of insurer bad faith is bereft of stable, meaningful elements, and so is without intersubjective reliability. He returns to these themes in his dissent in *Simmons*. His view is that bad faith is being treated as a you-know-it-when-you-see-it type of tort, and this he thinks is jurisprudentially dangerous.²⁷ Given the way the majority wrote its opinion, Justice Hecht has a point.

VII. ENOCH'S DISSENT

Justice Craig Enoch also dissented upon the grounds that "there is no evidence that a reasonable insurer could not deny the Simmons' claim based on the investigation State Farm performed." (378)

A. Standards

In his dissenting opinion in *Giles*, Justice Enoch contends that the new standard of bad faith created in that case was no change at all when compared to

25. Karl Popper, *THE LOGIC OF SCIENTIFIC DISCOVERY* (1968) (arguing that falsifiability is the essence of testability and that proper scientific procedure strives to falsify initial hypothesis). The work of Sir Karl has been mentioned favorably in recent cases (the proper use of expert witnesses). See Michael Sean Quinn, *Memory, Repression and Expertise*, 3 TEXAS FORUM 1, 28-54 (1997).

26. (Of course, if this were the insurer's methodology, then it would immediately have to set out trying to *disprove* the hypothesis that the Simmons burned their house. Although none of the *Simmons* opinions argue in this way, one wonders if the facts of the State Farm investigation would support Popper's theory of sound scientific investigation.)

27. What Justice Hecht says is this: "The decision in this case, as in most bad faith cases, lamentably, is driven not nearly so much by legal principles as by the belief of individual judges that State Farm was not entirely fair and should pay the Simmons some money. There is bad faith in insurance claims processing, and when it occurs, insureds should have a remedy. Until we formulate a body of law that defines bad faith sufficiently, we continue with our we-know-it-when-we-can-see-it approach that does little to change the lottery-like nature of the bad faith cause of action." (377-378).

the "no reasonable basis" standard laid down in previous cases. He thinks there has been but a single standard. Justice Enoch suggests that the *Simmons* court is creating a new and different standard, to wit: "that an insurer may breach the duty of good faith and fair dealing if it 'investigat[es] a claim in a manner calculated to construct a pretextual basis for denial.'" (378)

Justice Enoch agrees that insurers have a duty to investigate the claims of their insureds. He agrees that this investigative duty can form a basis of bad faith liability, but he contends that there is evidence that an investigation constitutes bad faith "only if the plaintiff presents evidence that the insurer's breach of [its investigative duties] results in [the] denial of a claim that no reasonable insurer would have denied."²⁸ Justice Enoch's fundamental critique of the majority opinion is that there was no evidence presented that "a reasonable insurer could not have denied the claim, the particular insurer's subjective orientation notwithstanding." (378)

B. Enoch's Standard Applied

In the context of *Simmons*, Justice Enoch believes that there was no evidence that a reasonable insurer would not have denied the Simmons' claim upon the grounds that some member of the Simmons' family set the fire.

Justice Enoch gives several examples of his concern. For example, everyone agreed that the Simmons fire was a set fire. For that reason, the court's

no evidence review must consist of a search of the record for some evidence that State

28. Justice Hecht is much troubled by this formulation. He believes that Justice Enoch has fallen into the trap of equating common law insurer bad faith with the reasonable insurer conduct. According to Justice Hecht, this would collapse common law insurer bad faith into some version of negligence—perhaps a type of professional negligence. Here is Justice Hecht's evaluation: "I do not agree with [Justice Enoch,] that bad faith liability is based on a failure to act as a reasonable insurer would. That is a negligence test which is not and should not apply in the context of bad faith. Bad faith is no more negligence than accidentally causing a car wreck is bad faith." (378).

Farm could not have reasonably concluded that the Simmons set the fire. Close analysis of the evidence cited by the Court reveals that there is no evidence that a reasonable insurer could not have denied the Simmons' claim. (378-79)

Justice Enoch is quite impatient with the argument that State Farm classified the Simmons fire as a "suspicious" fire. "Surely insurers are not precluded from being 'suspicious' of claims." (379) In any case, the insurer's initial hypotheses—its "subjectively-held suspicions"—are irrelevant whether a reasonable insurer could have denied a claim. Further, according to Justice Enoch, there is no evidence in the record "that a reasonable insurer could not deny coverage without" interviewing other potential suspects. Finally, he observes that the majority made much out of the fact that six out of eight indicia of arson were not satisfied. According to Justice Enoch, there is no evidence indicating that "a reasonable insurer could not deny a claim if six of these eight criteria are not met." There must be evidence linking the absence of evidence on these criteria to the conduct of reasonable insurers.

Justice Enoch was profoundly dissatisfied with the majority's reliance on the various standards enunciated by State Farm adjusters. He classified these as no more than "aspirational" statements, and rejected the proposition that they constituted the formulation of a minimum standard. In short, the duty insurers have to investigate claims must be construed in the light of its tort-based duty to pay claims once liability is reasonably clear. An insurer can have liability for bad faith failure to pay a claim only when "there is some evidence that a reasonable insurer could not have denied the claim." Thus, even the most egregious failure to investigate can give rise to liability for committing the common law tort of insurer bad faith only if there is evidence connecting the insurer's failure to investigate to the proposition that "a reasonable insurer could not have denied the claim."

VIII. COMMENTARY AND EVALUATION

This case is worthy of much law school debate. The facts are simple; the legal doctrines are apparently simple; and yet the court is fractured; and

the logic of the decisions is unclear. Part of the problem may lie in the logic of common law bad faith when combined with the *no evidence* standard of review. The Texas Supreme Court—even before *Giles*—struggled with this several times.²⁹ But there are other problems as well. There are a number of interesting difficulties in the *Simmons* case which bear some comment. Some of them are isolated, and some of them systemic.

A. "Suspicious" Fires

The majority accuses State Farm of a rush to judgment by immediately classifying the *Simmons*' fire as a "suspicious" fire. The two dissenting opinions point out that there was something suspicious about the fire. Although it is not mentioned in the supreme court opinion, State Farm's cause and origin expert believed that accelerants were present after the fire. The plaintiffs did not contest this at the trial, although the plaintiffs' lawyer now says he would dispute that proposition, if he were to try the case again.

Arguably, at least, there is a semantic problem in both the majority and dissenting opinions. According to the jargon of the insurance trade, a fire is "suspicious" when there is good reason to believe that the fire was set *by the insured*. The mere fact that a fire was a set fire does not mean that it is suspicious. This may look like a trivial, merely verbal, quibble. In fact, it is not. Sound reasoning requires that insurance companies in general, and Special Investigative Units, in particular, refrain from inferring from the fact that someone set a fire, that—quite likely—the insured set the fire.

A loss is "suspicious" when there is some reason to believe that the insured caused the loss intentionally and hence that the insurance claim is fraudulent.³⁰ The mere fact that a personal residence is subjected to arson does not even tend to establish that the insured started the fire. If the fire is not a set-fire, then an insurance company should not be inquiring as to whether the insured set it. If the fire is a set-fire, then the insurance company should be

inquiring who set it. The literature on arson does not contain reliable data to the effect that if a fire is a set-fire and the owner of the property files an insurance claim, then, *more probably than not* the insured set the fire. If an insurance company, its regular adjusters, or its specialized SIU adjusters believe this is a scientifically established law of social science, they are wrong. And yet, it is tempting to embrace that view, and the more one works on or for arson squads, the more tempting it is to do so. The problem is that one doesn't know whether arson investigators tend to believe this proposition on the basis of their experience or because they have become "True Believers."

B. Racial Atmospherics

Although it is not explicitly discussed in the supreme court opinion or in the court of appeals opinion, the *Simmons* family was black. They lived in an otherwise all white neighborhood. They lived in Montgomery County, just north of Houston, where there has been during the last decade or so, some racial tension.³¹ Counsel for the plaintiff elected not to inject race into this case, because it could not be done with (as it were) square corners. The plaintiff's lawyer made this decision even though the State Farm adjuster admitted that the possibility of racial animosity was one of the things which arson investigators ought to look into, and stated that State Farm did not look into that aspect of the *Simmons*

29. *Lyons v. Millers Cas. Ins. Co. of Texas*, 866 S.W.2d 597 (Tex. 1993). See *Nat'l Union Fire Ins. Co. of Pgh., Pa. v. Dominguez*, 873 S.W.2d 373 (Tex. 1994).

30. The Court of Appeals understood this point. *Simmons*, 857 S.W.2d at 130.

31. On August 23, 1980, Cheryl D. Ferguson, then 16, of Bellville, Texas was raped and strangled while she attended a volleyball tournament at Conroe High School. Clarence Lee Brandley worked at the school as a janitor. Brandley was accused and convicted of the murder. He was sentenced to be executed and twice came within days of being just that. In 1990, the Texas Court of Criminal Appeals reversed his conviction by a vote of six to three, and the supreme court declined to accept certiorari. The case became something of a *cause celebre* around the state, and it was hotly debated in Montgomery County, of which Conroe is the county seat. "The imprisonment of Brandley, who is black, has repeatedly provoked the anger of blacks in the Houston area as his defenders have depicted him as a victim of racism in Conroe, a small, overwhelmingly white town 30 miles north of Houston." Wednesday, January 24, 1990, AUSTIN AMERICAN STATESMAN [1990 WL 3047384].

case.

Nevertheless, I would conjecture that race played some role in the development and trial of this case. Obviously, what I am saying is guess-work, and I am not suggesting that anyone at State Farm was guilty of overt, conscious racism. Like many other honorable American companies, State Farm attempts to combat racism in its ranks, stands fore-square against racist decision-making; and would never tolerate a denial of a claim on racial grounds. Many of its adjuster-employees feel the same way. Nevertheless, this case had quiet racial dimensions. A black family was the only minority family in an otherwise working-class, all-white neighborhood. The case was tried to an all-white jury in a county where there had been racial controversy. The case was tried for the Simmons by a lawyer who is black, and for State Farm by a lawyer who is white. Under those circumstances, when an insurance company forthrightly states that racial animosity is something that arson investigators should inquire into, it is inconceivable in the late twentieth century in Texas that there were not racial atmospherics.³²

C. The Meaning of "Pretext"

The majority does not say that a *sloppy insurance investigation* equals *insurer bad faith*. The thrust of the court's opinion must be understood against the procedural posture of the case. First, the jury found State Farm guilty of bad faith, and the district court entered a judgment based upon their verdict. Second, the supreme court has jurisdiction only to consider whether the evidence is legally sufficient to support the verdict. Another way to put this second

32. Arguably, the prose in the supreme court opinion "signals" that there was a subtle racial dimension. The opinion contains no express reference to racial themes. However, at one point, the majority opinion mentions that James Simmons had studied animal husbandry at Prairie View A&M University. (372) Anyone who has been around Texas for a while knows that, historically, Prairie View A&M is a predominately black college. In the context of the opinion, it was entirely unnecessary to mention precisely where Mr. Simmons went to college. Hence, it is reasonable to conclude that the language constituted some sort of signal to those who have what Clifford Geertz, the anthropologist, calls "local knowledge." Clifford Geertz, *LOCAL KNOWLEDGE*, 167 ff (1983).

point is to say that the supreme court has jurisdiction only over *no evidence* issues. Third, in analyzing the evidence, the verdict, and the judgment to determine whether there is any evidence (i.e., more than a scintilla) to support the verdict (and therefore the judgment), the supreme court must view the evidence in the light most favorable to the judgment. In other words, the supreme court must view the evidence in the light most favorable to the Simmons. The court must look at evidence supporting the verdict and ignore evidence pointing the other direction. These procedural rules shape and restrict the court's jurisdiction.

Given those procedural constraints, the majority held that there was some evidence to support the proposition that State Farm committed the common law tort of insurer bad faith, "by denying the Simmons' claim based upon a biased investigation intended to construct a pretextual basis for denial." (372) The supreme court has thus held that there was some evidence to support the proposition that the investigation was biased. More significantly, and independently, the court held that there was some evidence to support the proposition that the insurance company designed the investigation *in order to find a pretext* on the basis of which to deny the claim. Of course, if an insurance company designed an investigation to achieve a certain result, it would have acted quite deliberately. If an insurance company is looking for a pretextual reason for denying a claim, then it is looking for a phony reason. If an insurance company is deliberately looking for a pretextual reason for denying a claim, it is deliberately looking for a phony reason. It is looking for something that it can present as reason, which is not really genuine. Pretexts, by definition, are not mistakes. They are lies. A leading dictionary, which is found in the libraries of many law offices is WEBSTER'S [UNABRIDGED] THIRD NEW INTERNATIONAL DICTIONARY, which was published in 1986. In that dictionary, the term "pretext" is defined as "a purpose or motive alleged or an appearance assumed in order to cloak the real intention or state of affairs." Obviously, *cloaking* is something one does deliberately.

To say that an investigation was designed to reach a pretextual reason to deny a claim is not the same thing as to say that an investigation was biased. Investigations can be biased for unconscious reasons.

Investigations can be biased because the investigators are “gung-ho” when they should be careful, restrained, judicious, and skeptical. Investigations can be biased because investigators exaggerate the significance of some types of empirical investigation, or simply make mistakes.³³ The critique of the claims process in *Simmons* is much more radical. The court is saying that there is some evidence to support the proposition that the insurance company quite deliberately set out to come up with phony reasons for denying Simmons’ claims and designed its investigation to achieve that end. If that’s what happened, it would be hard to find insurer conduct more paradigmatically undertaken in bad faith.

The majority does not say that that is what *did, in fact*, happen. Such an assertion is outside the supreme court’s jurisdiction. Factual determinations are for the jury. It is for twelve citizens to say what actually happened. In Texas, intermediate appellate courts may evaluate questions of factual sufficiency and questions of legal sufficiency. In analyzing the relationship between evidence and verdict, the Texas Supreme Court can only evaluate legal sufficiency (i.e., no evidence questions). Thus, all it can say is that there is some evidence to support the proposition. Of course, if there is some evidence to support the proposition that the insurance company conducted (what would have to be called) a lying

investigation, then the subjective component of the elements of the tort of insurer bad faith would be satisfied. After all, if an insurance company deliberately designs a lying investigation designed to deprive the insured of coverage, then it would be true that the insurer knew or should have known that it was denying a claim without a good reason.

The characterization of the insurer’s conduct for which the majority believes there is some evidence (i.e., that the insurance company conducted a lying evaluation) is a hard one to swallow. This is not an accusation of sloppiness. It is not an accusation that somebody had their shoe laces tied together and then bumbled around. It is not an accusation of blunders and bungling. It is not even an accusation of block-headedness, ignorance, or even stupidity. It is a characterization tantamount to suggesting that the insurer was conducting a fraudulent claims process. I have never witnessed such a thing. I have also evaluated a number of insurance company adjustment files where my instructions were look for bad faith. I don’t think I’ve ever found a file from which I would draw the conclusion that the investigation, taken as a whole, was fraudulent. At the same time, it should be repeated that the supreme court is not saying that the investigation and the claims process were in fact fraudulent. It is saying that there is some evidence to support the proposition that they were.

What is that evidence? Surely the most prominent piece of evidence is the fact that the insurance company did not interview the neighborhood hooligans whom the Simmons said might have a grudge against them. (It is perfectly clear that the boys who broke into their house and stole things who were subsequently apprehended where in an archetypal grudge position.) It is to be recalled that the State Farm adjuster said that it was unnecessary to interview these boys. It is difficult to see how one could believe that.

Of course, the chances are that these boys would deny that they torched the house. On the other hand, one never knows. Occasionally, people are ashamed of what they have done and confess. Moreover, these boys might be able to provide information that could be valuable to the investigation. They might for example give the investigator leads as to someone else who might have burned the house. They might not have alibis, or they might claim to have alibis which didn’t work out. One or more of these boys

33. This was a problem in *Nicolau*. In that case, State Farm Lloyd relied upon the investigations and the expertise of Haag Engineering Company. Very roughly, Haag thought it had evidence that plumbing leaks do not cause foundation damage. Most other participants in the case believe that Haag exaggerated the significance of some testing it had done independently several years before. In addition, Haag asserted that the moisture contact of soil beneath the Nicolau home as observed by another engineering company should not be considered high. “Three of the Nicolaus’ experts strongly disagreed with this conclusion, and even State Farm’s own expert. . . testified that he disagreed with it. The Haag report also suggested that the water [the other] engineer had observed—which had flowed upward through a hole in the foundation for three to five minutes—could be explained as condensation that had accumulated naturally. [One expert witness] testified that this suggestion was ‘the most ridiculous thing I’ve ever heard.’ [A second expert], an expert called by State Farm, agreed that the suggestion was unreasonable.” *Nicolau*, 951 S.W.2d at 450.

might treat the adjuster to a torrent of racial epithets. That would certainly be interesting! An up-front deliberate refraining from pursuing that avenue of investigation is a stunning lapse in sound investigative procedure. That deliberate refraining alone, when compounded with a lame-brain excuse for not pursuing them may constitute some evidence for the proposition that the investigation, when taken as a whole, was pretextual.

It is also troubling that State Farm apparently did not interview some of the people on the Simmons' grudge list, because it could not find them. If the evidence in the adjustment file was that the insurance company did not put out a great deal of effort to find these people, then that lapse might constitute some evidence of bad faith. The Simmons' list included young males. In general, such people can be found. Their parents usually know where they are; often their friends know where they are. If parents really don't know where their adolescent children are, the parents are usually distraught about it, and that fact too is generally known in a neighborhood. If an insurance company has genuinely tried to find someone, and has failed, usually, the adjustment file will be filled with information about the company's efforts. From my experience, it is quite abnormal in a serious insurance fraud investigation for the insurer not to try to track down genuine alternative perpetrators. This is a crucial part of an arson investigation.

Apparently, State Farm suggested that the police couldn't find these young men either, and insurance companies should not be held to higher standards than police. This suggested inference is entirely fallacious. If the police do not have a pressing reason to find somebody, and an insurance company does, then the insurance company should be held to a higher standard. Moreover, insurance companies frequently have more financial and investigative resources than do the police. Neither the supreme court opinion nor the court of appeals opinion explores this matter at any length, and its issue worthy of consideration.

When the central fact that important players were not interviewed is combined with other features of the investigation and other features of the insurance company's decision-making, the quality of the investigation gets even worse, when it is judged by the *no evidence* standard. The standardized lingo in the property insurance trade is that there is an "Arson

Triangle." In general, if the insured falls within the perimeter of the triangle, then there is some reason to believe that the insured set the fire. The points of the triangle are: motive, means, and opportunity. At the same time, it must be remembered that whether or not a person falls within the triangle is not a purely mechanical matter. Almost everyone has access to the means of setting a fire. Usually, when a member of a reasonably healthy, intact family is suspected of setting a fire, the motive is monetary. Hence, if the insured family is facing a downward financial spiral, there is a motive. In the alternative, if the family would profit considerably from setting the fire, then there is a motive. But how much financial strain must there be before there is a motive? Most people don't think they have enough money. Most American families see themselves as financially pressed to one degree or another. But surely, it is not the case that most American families have a motive to burn their houses. Obviously, an insured has a financial motive to destroy property only when he is in serious financial trouble or where he at least believes that his financial up-side is quite substantial. The much vaunted "Arson Triangle" is not to be understood simplistically.

Unquestionably, during the claims process, the insurance company had misinformation as to the financial situation of the Simmons family, and the insurance company did not check that information with the Simmons in an appropriate way. When these factors are taken together, said the majority, there was some evidence to support the proposition that the insurer engaged in a pretextual investigation. It is for the jury to say whether the insurer actually did or did not engage in such an investigation. The sole jurisdiction of the supreme court is whether or not there was some evidence that it did. What the court had before it was significant investigative lapses and absurd explanations for those lapses. It found that those constituted some evidence. Justice Hecht was not so sure, but that was not really his point.

D. Justice Hecht Redux

Justice Hecht did not think the investigation was as bad as the majority thought. His main point, however, was that even if the investigation was terrible, that spoke only to the subjective component of bad faith. There still had to be some evidence tending to support the fact that there was no

reasonable basis. In other words, Justice Hecht thought that the two elements of common law insurer bad faith are logically independent of one another under all circumstances.

Implicitly, the majority posited that under some circumstances, the subjective component and the objective component of bad faith were not independent. Of course, the following is not expressly what the majority said, but the logic seems fairly clear. According to the majority, there was some evidence supporting the view that State Farm consciously designed an investigation which would vindicate a pretextual denial of the Simmons' claim. A pretextual denial is a phony denial. The preceding investigation is a charade. The denial would have to be based on the proposition *Some Simmons committed arson*. That would be the pretext for the denial. Every basis for a denial which is pretextual is known by the insurer to be false. Otherwise, it's not a pretext. In other words, the majority is saying that there is some evidence to support the proposition that State Farm knew that the proposition *Some Simmons committed arson* was false.

We now arrive at the key (unstated) premise in the (implicit) argument of the majority. If a person knows that a proposition is false, then it is false. That is one of the key distinctions between knowledge and belief. One can believe that a proposition is false and be wrong. One cannot know that a proposition is false and be wrong. If a person knows a proposition, then the person knows that the proposition is true, and if the person knows that the proposition is true, then it is. If a person knows that a proposition is false, then it is; if a person knows the denial of a proposition, then the proposition whose denial is known to be true is itself false.

In other words, a logical consequence of the majority's view is that some evidence supports the proposition that State Farm knew that Simmons did not burn down his own house. But, that was precisely the grounds upon which it denied the claim. In other words, some evidence supports the thesis that State Farm denied the claim on grounds it knew to be false. It follows, by iron-clad deductive logic, that there is some evidence that State Farm *could not* have had a good reason for denying the claim. Indeed, some evidence supports the view it denied the claim on the basis of what it knew to be a bad reason.

Of course, Justice Hecht is correct to point out

that there is all the difference in the world between not-having-a-good-reason (or, not-relying-on-a-good-reason), and there not *being* (or, there not *existing*) a good reason. It is perfectly true that an insurer may deny a claim for a bad reason, and may not have a good reason, and yet there actually exists a good reason—a reason the insurer hasn't thought of.

But the logic of the arson-situation makes exploiting this distinction difficult. Letters from insurance companies denying claims frequently cite many reasons why the claim is being denied, and in a complex situation, there may be a number of still other reasons not cited in the denial letter.³⁴ In the arson situation, however, there is only one potential reason for denying the claim, to-wit: the insured deliberately destroyed the property. There are no other reasons. Hence, either arson is a bona fide reason which is fairly debatable, or there are no arguably good reasons, and so, of necessity, the insurer has acted arbitrarily.

Justice Hecht attempts to circumvent the logic of this argument by pointing out that several of the considerations from which State Farm drew the inference that arson-by-the-insured was quite possible were themselves plausible. From the point of view of the majority, Justice Hecht's argument is question-begging, however. If the investigation was nothing but a charade, then State Farm knew that Simmons didn't set fire to his house deliberately. Yet that is exactly the proposition which the majority says is supported by some evidence. From the point of view of Justice Hecht, it is the majority which is begging the question. His view must be that there is no evidence to support the view that State Farm knew that the proposition *Some Simmons burned the house* was false.

Of course, when stated boldly, it is difficult to believe that a nationally reputable insurance company

34. Of course, insurers try to mention all potential reasons for denying a claim in their denial letters. The danger is that if an insured knows of a potential reason and doesn't mention it, it may be estopped from relying upon it later. Nevertheless, in complex cases—such as environmental cases—there may be reasons for claim denial which have not yet come to light. What is true of denial letters, of course, is also true of reservation of rights letters. See Michael Sean Quinn, *Reserving Rights Rightly*, 7 COVERAGE 23 (1997).

would ever deny anybody's claim when it knew that the foundation in its denial was wrong. One is tempted to say that an insurance company might do this if it faced only contract damages. But when it faces the prospect of statutory and common law bad faith damages, the position becomes even more implausible. Bad faith is a specter which haunts insurance companies. In general, in personal lines cases, it costs more to defend bad faith cases than it does to pay them. That is almost certainly true in the Simmons case, even setting aside the amount that State Farm will have to pay in damages. Perhaps this is how Justice Hecht looked at the case. That perspective is certainly straight-forward, honorable, reasonable, and down-to-earth.

At the same time, the investigation was defective, and the investigators characterized their failures in such a way that it looked like they were trying to cover up something. From the point of view of the bad faith case, as it is characterized by the majority opinion, it might have been better for the investigators to confess incompetence, bias, inattention, and so forth. Of course, it is highly improbable that human beings will do that. And it might have been a bad thing, because there is another way to look at Texas insurance bad faith law.

E. Another Perspective

The Texas common law of insurer bad faith is usually conceived as involving two elements: an objective one and a subjective one. That matter has already been discussed in this essay. The original case which created the common law tort of insurer bad faith, the *Arnold* case, actually supposed that there were two independent routes by means of which one could get to the tort of bad faith. One of the routes is the one just mentioned. The other route was to prove that there was a poor investigation. The *Aranda* case—the second case through the Texas Supreme Court's pipeline—recast *Arnold's* conceptualization of bad faith law, and reduced the avenues to bad faith from two to one.

If one takes *Arnold* seriously, then Justice Spector's remarks in *Giles* about bad faith investigations take on a new significance. Perhaps Justice Spector is trying to keep alive the possibility that proof of a really wretched investigation by itself constitutes proof of bad faith. If that were Justice Spector's

strategy, one might wonder why she didn't come out with it. Why didn't she simply say what she intended? Of course, majority decisions are based upon the building of coalitions, and everyone knows that coalition-formation sometimes involves toning down (or submerging) one's actual views.

Moreover, if the supreme court took the view that a really wretched investigation was itself bad faith, Justice Hecht would almost certainly point out that successful plaintiffs would still have to prove causation. A really wretched investigation does not cause an insured a tort injury, if there exists a good reason on the basis of which the claim could have been denied. Of course, it is precisely here that Justice Spector would have to disagree with Justice Hecht, if she were genuinely trying to establish the really-wretched investigation route to bad faith recoveries. She would have to say the *mere existence* of a good reason is insufficient to defeat the plaintiff's claim. She would have to say that if the insurance company does not *have* a good reason, then proof of causation is complete. No wonder this matter did not surface.

F. Justice Enoch's Dissent

Justice Enoch's lone dissent contains three extremely interesting topics.

First, Justice Hecht seems right. Justice Enoch does permit insurer bad faith to veer towards negligence. Then again, perhaps Justice Enoch's comments are focused upon the subjective component of bad faith. If his remarks are not directed to the objective component, then the assimilation of bad faith through negligence is avoided. Questionably, throughout the last decade, since *Arnold*, the objective component of bad faith has sounded very much like negligence, although the objective component has not.

Second, Justice Enoch appears to be implying that plaintiffs in bad faith cases should utilize expert witnesses. This thesis presupposes that the insurance adjustment process is removed enough from daily life—technical enough—that juries need to have the process explained to them.

Third, and most deeply, Justice Enoch's opinion presupposes that the so-called "Arson Triangle" is really quite a flexible instrument and that juries need to have its proper use delineated and evaluated by

experts. Justice Enoch may be quite right about this. It cannot be applied mechanically. Judgment is always important. At the same time, judgment is not identical to intuition. The use of judgment by investigators and especially by adjusters needs to be rationalized and linked to reasonable foundations.

IX. CONCLUSION

There are several important lessons in this case for insurers and for lawyers. For insurers, the lessons pertain to how not to investigate a claim. For lawyers, they pertain to the preparation of both insurance fraud and bad faith cases, both before and after suit is filed.

A. Lessons for Insurers

Here are some lessons for insurers. First, check all facts with the insured. This approach to investigation runs contrary to standard police procedure, where you try to hold facts back in the hopes that suspects will lie and hence be subject to impeachment. This is not sound insurance company practice. It does not conform to the maxim *Look for coverage*, and it does not conform to the principle *Give the insured the benefit of the doubt*.³⁵

Second, if the insured presents a bona fide grudge list, run it down. Interview as many people on the list as possible. Follow up those leads. Third, if there is a racial dimension to the case, explore it. Fourth, do not rest until persons on the grudge list are located. Insurers should not assume that they will not be held to stricter standards than the police. Just because the sheriff's department can't find somebody doesn't mean that an insurance company can't.

Fifth, SIU investigators must learn to have a "double consciousness." They must be suspicious and skeptical, as befits quasi-policemen. At the same time, must not see arson everywhere, and they must be willing to concede that their hunches and intuitions can be wrong. Self-confidence and self-assurance motivate. Dogmatism, however, produces bad faith, and skepticism is healthy.

Sixth, insurers need to mandate that claims

committees squarely and forthrightly consider and vindicate upon the basis of evidence the ultimate questions upon which coverage hangs. The Beaumont Court of Appeals was quite critical of the State Farm Claim Committee Report:

Prior to denying the Simmons' claim, State Farm determined that the Simmons, if they were to obtain insurance benefits, would have to fight State Farm for such benefits. Nowhere in the Claim Committee Report, which was the culmination of its entire investigation, did that committee [conclude] that the Simmons burned their home. State Farm believed that any claim brought by the Simmons would be "defensible." According to the record, defensible meant a favorable venue, the strength and availability of counsel, and other factors [un]related to the truth of the arson accusation. State Farm mistakenly believed that the Simmons would have to show at trial that someone other than themselves burned their home.³⁶

What are the lessons here? Claims committees should consider directly and explicitly whether there is evidence to support the proposition that the insurer destroyed the property. Whether such a position is "defensible" is a subordinate matter, to be taken up only after the ultimate facts upon which coverage hangs are considered. Moreover, engaging defensibility of its position on coverage, the insurer should get the law right. This may mean that it needs to get coverage opinions, even when it thinks it doesn't need them.

Seventh, one wonders if claims departments should not be both formally and—more importantly—informally organized so that SIUs are separate from and subordinate to actual adjustment departments. Perhaps the function of SIU departments should be to investigate quite possibly fraudulent losses, but they should have nothing to do with determining whether to pay the claim. Perhaps they shouldn't even know. The extent that this is done, both formally and in reality, (1) SIU operatives would be trained in investigative techniques and the frames

³⁵ See Michael Sean Quinn, *The Ethical Habitat of the Adjuster—Part I*, 10 ENV. CLAIMS J. 91 (1997).

³⁶ Simmons, 8857 S.W.2d at 38.

of mind that go with them, and (2) adjusters could then be trained to respect SIU outcomes, if they are supported by sound investigations, but could also be trained to be skeptical of SIU conclusions, because of the "True Believer" phenomenon.³⁷

Eighth, insurers need to watch their language. I refer to the Claims Committee Report which characterized State Farm's position as "defensible." I have seen this locution many times in insurer documents, and I have heard claims people speak this way. The usage is somewhat disconcerting. There are really two concepts involved in the way lawyers, at any rate, use the idea of *defensibility*. One of the components of this idea is *meritoriousness*. Thus, a legal position is defensible to the extent that it is meritorious. An insurer's position on an arson case is "defensible," in this sense, if the insurer's assertion of arson is meritorious. There is another sense of "defensible," however, which is less connected to the idea of merit. In this second sense, a legal position is defensible when, from a practical standpoint, it is *winnable*. Of course, all sorts of practical considerations influence the idea of *winnability* other than *meritoriousness*. Thus, jurisdiction, venue, the identity of the judge, the predilections of the judge, the quality of the other lawyer, the quality of one's own lawyer, the purse of the other side, and other matters are all considerations relating to defensibility considered as *winnability*. These two components of the idea of *defensibility* should not be confused or conflated in the mind of any insurance company decision-maker. Nor should they be run together in claims department prose. If those ideas are run together in some document, that suggests an actionable confusion which may not of actually happened. (Of course, only defensibility-as-meritoriousness is relevant to claims decision-making. Relying on defensibility-as-winnability, without reference to merit, is bad faith.)

Ninth, adjustment management structures must take seriously the idea that adjusters and lawyers need

to work together in preparing testimony, whether it be in the context of discovery or in the context of trial. No adjuster should ever find himself saying that a young man, accurately accused of burglary by an insured, and incarcerated therefore, did not have a motive to commit arson, simply because the young man had gotten out of jail. This statement cannot be true. Proper deposition preparation makes it very improbable that someone would say such a thing. Proper preparation for trial would have the same effect. Usually, the absence of proper preparation is not the fault of either the lawyer or the adjuster. It is the fault of the intersection of two systems. Insurance company managers frequently do not understand why much time must be taken in witness preparation, especially if the witness is experienced. Institutional management structures should support witness preparation enthusiastically. This requires that they be willing to pay for it. In my experience, some insurance companies are willing to devote time to this, but others are not. Of course, the unwillingness is not overt and obvious. Nevertheless, it exists.

B. Lessons for Lawyers

This case perhaps also contains some lessons for lawyers. First, senior members of influential firms need to work closely with senior members of adjustment management structures to encourage cooperation in the discovery process. Adjusters and investigators need to spend a lot of time working with lawyers in preparing and polishing their testimony. Second, lawyers who assist adjusters in investigating arson claims need to be careful about how they conduct statements under oath. The court of appeals characterized State Farm's investigation as reckless partly upon the grounds of how State Farm's lawyer conducted the examination under oath mandated by the insurance policy. The lawyer apparently examined the Simmons "without the benefit of documents, records, or a transcript of their prior recorded statement nor disclosure that there were conflicts or unresolved questions and by misrepresenting facts to the insured."³⁸ Obviously, lawyers need to avoid this sort of *N.Y.P.D. Blue* approach. Insurance adjusters, even SIU investigators, are not policemen, and

37. Of course, I am not suggesting that formal and informal separation is an industry standard. Furthermore, it might be a managerial bad dream. Nevertheless, it would help combat problems like the one which arose in *Simmons*. It's an idea worth considering.

38. *Simmons*, 857 S.W.2d at 139.

lawyers representing insurance companies are not special agents.

Third, lawyers who prepare investigative reservation of rights letters, or teach adjusters how to do them, need to be very careful to stick close to black-letter truth. The Beaumont Court of Appeals found that the investigative reservation of rights letter State Farm dispatched to the Simmons supported a finding of a knowing violation of the DTPA. The insurer stated that there was a question as to whether the company was obligated under the insurance policy because "it is questionable whether the cause and origin of this loss was accidental in nature."³⁹ The court of appeals observed that this letter was false and misleading because non-accidental fires are covered, if they are deliberately set by someone other than an insured. State Farm's letter left the impression that there would be no coverage if some neighborhood hooligan had burned the house.

Fourth, it seems fairly clear that this is a case that should have been settled early on. Attorneys, of course, do not control the behavior of their clients. Nor should they try to intimidate, dragoon, or

manipulate their clients into doing what the attorneys want them to do. Clients are the masters. Lawyers are the servants. Nevertheless, lawyers are hired to give advice and give it persuasively. For all I know, that was done in this case. Nevertheless, the client was unsusceptible to listening to the advice. And here is the point. Lawyers who represent institutional clients, such as insurers, need to think long and hard about how to give advice. Our advice should not be restricted to narrow ends-means technicalities. We have a moral, if not an ethical, obligation to attempt energetically to help clients to dispose of questionable cases without undermining the morale of good and decent claims employees. Even more, it is surely part of the legitimate function of lawyers to help educate the adjustment bureaucracies of insurers as to the right balance between trying to prevent fraud and the careful evaluation of evidence. Insurers don't always actively solicit this kind of advice. Sometimes, in periods of cost-cutting, they don't want to pay for it. Part of the reason for this, no doubt, is that lawyers may not have given systematic and long-range thought to this balancing process. Perhaps it is time for insurers and their lawyers to find ways to participate together in long-range, adverse judgment-avoiding education and dialogue.

39. Simmons, 857 S.W.2d at 141.