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COZEN O'CONNOR

Does a Bad Faith Cause of Action Survive an Appraisal Award? The Answer May Be, "It Depends."

Two recent federal court decisions – Texas and Utah – examine this issue, reaching the same result based on different analyses.

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Intermodal Equipment Logistics, U.S. District Court for the Southern District of Texas

Earlier this year, the U.S. District Court for the Southern District of Texas ruled an insured can pursue its bad faith claim even where the insurer made timely payment of the appraisal award and the court dismissed the breach of contract claim on summary judgment. *Intermodal Equip. Logistics, LLC and Sea Train Logistics, LLC v. Hartford Accident & Indem. Co.*, No. 3:10-cv-00458 (S.D. Tex. Galveston Div. May, 24, 2012).

Intermodal Equipment Logistics (Intermodal) made claims to Hartford Accident and Indemnity Company (Hartford) for its business income loss caused by Hurricane Ike, which hit the Texas shores in 2008. Hartford valued and paid $208,000 for the loss. Intermodal filed suit against Hartford in September 2010, alleging Hartford grossly, and in bad faith, undervalued Intermodal's losses and breached the insurance contract. The parties agreed to mediate, but when this failed in May 2011, Hartford successfully compelled appraisal in accordance with the standard appraisal provision in its policy. The appraisal finished in January 2012 and awarded Intermodal $705,539, which Hartford timely paid.

The court held that timely payment of the appraisal award negated the breach of contract claim as a matter of law. *Id.* (citing *Franco v. Slavonich Mutual Fire Insurance Ass'n*, 154 S.W.3d 777, 787 (Tex. App. -- Houston, [14th Dist] 2004, no pet.) (payment and acceptance of a binding appraisal award estops further prosecution of a breach of contract claim); *Blum's Furniture Co., Inc. v. Certain Underwriters at Lloyds London*, 2012 WL 181413 (5th Cir. Jan. 24, 2012) (unpublished), and *Breshears v. State Farm Lloyds*, 155 S.W.3d 340 (Tex. App. -- Corpus Christi, 2004, no pet.)). In dismissing Intermodal's breach of contract claim, the court confirmed that an insured may not use the difference between the amount originally paid by the insurer and the appraisal award as evidence of breach of contract.

The general rule provides that an insurance bad faith claim first requires an underlying breach of the insurance contract. However, the court here ruled the bad faith claim survived, citing the following three exceptions to the general rule:

1. An insured proves that a carrier "denied or delayed the payment of the insured's claim when it knew or should have know[n] that it was reasonably clear that the claim was covered."

2. An insured sues under the Texas Insurance Code as well as the Deceptive Trade Practices Act by proving the insurer "unduly delayed payment of its claim after its liability became reasonably clear."

3. An insured demonstrates that the insurer "committed some extreme acts that caused injury independent of the policy claim."

The court held that Intermodal submitted sufficient evidence to create a fact issue as to whether any of the three potential exceptions applied. It further held that in accordance with *Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 49 (Tex. 1987), such an issue was one for the jury (or factfinder) to decide.

Blakely v. USAA Cas. Ins. Co., 10th Circuit – Applying Utah law

In another summary judgment action, this time reviewed by the 10th Circuit Court of Appeals applying Utah law, the court overturned summary judgment in favor of the insurer. Like the Texas court in *Intermodal*, the 10th Circuit held a bad faith cause of action involving pre- and post-appraisal conduct presents a factual issue that is "generally inappropriate for decision as a matter of law" in Utah and, therefore, potentially exposes insurers to defending these claims before a jury. *Blakely v. USAA Cas. Ins. Co.*, 2012 U.S. App. LEXIS 21964 (10th Cir. Oct. 22, 2012).

In *Blakely*, the insureds (Blakely), sought coverage under their homeowners' policy issued by USAA Casualty Insurance Company (USAA), after sealant applied by a flooring contractor caught fire in their basement. The fire damaged floor joists and subflooring exposed in the basement and caused smoke and soot damage throughout the house and to personal property.

Blakely alleged, despite vigorous protestation, USAA refused to replace more than a couple of the charred floor joists or more than two-to-three square feet of the damaged subflooring. Blakely also alleged the adjuster failed to respond to complaints regarding the inadequacy of the covered repairs, inaccurately claimed that the house did not smell like smoke, and delegated his duties to the wife of the contractor who subsequently denied claims for personal property damaged during remedial cleaning.

Blakely originally asserted entitlement to more than $468,000 in damages, while USAA paid out just over $93,000. Two years after the fire, Blakely exercised their contractual right to an appraisal, which determined the true value of the compensation was just over $291,000, that the house still smelled like smoke, and that additional joists required repair. Blakely brought a number of claims against USAA with only the breach of the contractual duty of good faith and fair dealing left unresolved. The district court granted USAA's motion for summary judgment on the basis that the decision to reject Blakely's original claim was "fairly debatable" since the adjuster valued the damages at a figure between the insurer and insured.

Similar to the *Intermodal* court, the 10th Circuit ruled that whether or not the insurer breached its duty of good faith and fair dealing is a factual issue generally inappropriate as a matter of law where "reasonable minds could differ as to whether the [insurer's] conduct measures up to the standard required for insurance claim investigations." It instead evaluated the insurer's conduct throughout investigation, evaluation and rejection of the insured's claims. The court determined that facts on the record suggested the insurer acted unreasonably, including its refusal to replace more of the joists and subfloor than it did, the adjuster's refusal to communicate with the insured, the adjuster's claims that the house did not smell like smoke despite the adjusters determining otherwise years later and the adjuster's delegation of duties to a non-adjuster. Alternatively, the court determined that a jury could find the insurer breached its duties of good faith and fair dealing by undervaluing the insured's loss by the amount it did, even though the insured overvalued his loss.

Conclusion

These two cases involve different policies in different jurisdictions, but both hold that whether or not the insurer breached its duty of good faith and fair dealing is not resolved upon the payment of the appraisal award and the finding of no breach of contract. Instead, according to these courts, and despite case law in these and other jurisdictions to the contrary, an insurer's conduct from the date of the claim until the payment of the appraisal may still be a question for the factfinder to resolve.

To discuss any questions you may have regarding the opinion discussed in this Alert, or how it may apply to your particular circumstances, please contact:
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