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What 5th Circ. Ruling Means For Insurers' Post-Award Liability

By **Karl Schulz** (September 15, 2021, 4:07 PM EDT)

Just a few short years ago, there was a bright-line rule under Texas law concerning appraisal awards. If an insurer timely paid an appraisal award, that payment extinguished all of the insurer's contractual and extracontractual liability to the insured.[1]

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The U.S. Court of Appeals for the Fifth Circuit had previously agreed, making an Erie guess[2] in its 2017 decision, Mainali v. Covington Specialty Insurance Co., that the Texas Supreme Court would not find a violation of Chapter 542 if the timely preappraisal payment of the claim was for a reasonable amount.[3]

But when faced with the issue in the 2019 cases Ortiz v. State Farm Lloyds and Barbara Technologies Corp. v. State Farm Lloyds, the Texas Supreme Court overturned precedent.[4]

Although the Texas Supreme Court affirmed the traditional rule that the insurer's timely payment of the appraisal award extinguished contractual liability, it held that the insurer's liability under Chapter 542 of the Texas Insurance Code, the Prompt Payment of Claims Act, may survive the insurer's timely payment of an appraisal award.[5]

Even so, the insured still has to prove coverage and a violation of Chapter 542.[6]

Since Ortiz and Barbara Technologies, Texas courts have been grappling with this new landscape concerning the application of Chapter 542 damages. The Fifth Circuit just added to the discussion with its recent decision in Randel v. Travelers Lloyds of Texas Insurance Co.[7]

Briefly stated, the Fifth Circuit held that where a preappraisal payment did not roughly correspond to the amount ultimately owed, the preappraisal payment was not a defense to liability under Chapter 542.

In Randel, the insured sustained a fire loss. The insurer made various payments over the following months for the dwelling, personal property and loss of use totaling $204,437.68, net of the deductible and depreciation. A public adjuster put forward a much higher estimate of damage to the dwelling, but the insurer performed a reinspection and declined to issue any further payment. The insured invoked appraisal as to the dwelling and personal property.

The insured sued the insurer in the 295th District Court of Harris County, Texas, alleging underpayment of the claim, bad faith and violation of Chapter 542. The insurer removed the matter to the U.S. District Court for the Southern District of Texas.

During the federal district court case, the appraisal panel issued an award in the amount of $417,361.72 and Travelers also paid additional loss-of-use amounts, with Travelers' total payments equaling $533,529.88 — over twice the amount of its original payment, with $185,000 additional payments just for the dwelling and personal property.

The insurer paid the award within five days, less deductible and prior payments. Travelers moved for summary judgment on all claims and won.

On appeal, the Fifth Circuit affirmed the traditional rule that the timely payment of the appraisal award extinguished the contract claim and statutory and common law bad faith claims.

The Fifth Circuit then addressed the Chapter 542 claim, reciting Section 542.058(a) that an insurer must pay a claim within 60 days after receiving all requested information necessary to evaluate the claim, and Section 542.060(a) that failure to pay within that deadline makes the insurer responsible for damages pursuant to the act in the amount of 18% interest and attorney fees.

Further, the Fifth Circuit observed that in a March 19 decision, Hinojos v. State Farm Lloyds, the Texas Supreme Court provided guidance regarding the effect of preappraisal payments since the Fifth Circuit's Erie guess in Mainali.[8]

In Hinojos, the Texas Supreme Court held that:

> A reasonable [preappraisal] payment should roughly correspond to the amount owed on the claim. When it does not, a partial payment mitigates the damage resulting from a Chapter 542 violation. Interest accrues only on the unpaid portion of the claim.

It then addressed the facts in Randel, deciding that there was a substantial gap of $185,000 between the preappraisal dwelling and personal property payments versus the appraisal award. The court decided that such a gap meant that the preappraisal payments did not roughly correspond to the appraisal award. The preappraisal payment, therefore, was not a defense to liability under Chapter 542.

The Fifth Circuit expressly declined to determine how close a preappraisal payment needs to be to roughly correspond with the amount owed. However, the Fifth Circuit also left the door wide open for a case in which the insurer did make a preappraisal payment that roughly corresponds to the appraisal award, which would allow the Fifth Circuit to announce a rule and factual circumstances by which such a payment would provide a defense to liability under Chapter 542.

Randel means that even more scrutiny will be directed toward an insurer's early actions on a claim. The initial inspection of a loss should be thorough and accurate. Payments should be prompt and accurate. Getting it right the first time around will help insurers avoid the fact-intensive analysis and potential for the Chapter 542 liability explained in Randel.

Policyholder attorneys tend to treat Chapter 542 liability as strict liability after an appraisal award is issued. That is most certainly not the case. As mentioned, the policyholder must still prove coverage and a violation of Chapter 542. The policyholder also still has the burden to adequately plead facts supporting a Chapter 542 claim.[9]

In the case of a Chapter 542 claim premised on an appraisal award, the omission of dates, alleged deadlines and a description of alleged covered damages from pleadings could be enough to support a motion to dismiss the claim in federal court.

Also, even if an insured prevails on a Chapter 542 claim, it is not strict liability against an insurer for any amount of attorney fees that the insured's counsel may wish to assert. The attorney fee claim is still subject to the traditional limits for reasonableness and necessity, as stated in the disciplinary rules for lawyers and Texas common law.[10]

Additionally, insurers can take full advantage of Chapter 542A of the Texas Insurance Code with regard to early actions on a claim caused by forces of nature. Chapter 542A places additional presuit notice requirements on the insured and authorizes mandatory reinspections.[11]

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[1] See, e.g., Garcia v. State Farm Lloyds, 514 S.W.3d 257, 264-273 (Tex. App.—San Antonio

2016, pet. denied); Anderson v. Am Risk Ins. Co., 2016 Tex. App. LEXIS 6538, *10 (Tex. App.—Houston [1st Dist.] 2016, no pet.); Perry v. United Servs. Auto Ass'n, 2018 Tex. App. LEXIS 10108, *7 (Tex. App.—Amarillo 2018, no pet.); Gonzales v. Allstate Vehicle and Property Ins. Co., 2019 U.S. Dist. LEXIS 26203, *3 (S.D. Tex. 2019).

[2] Briefly stated, an "Erie guess" is when a federal court "wager[s] a guess about how a state court might fill in" undeveloped areas of state law, but the federal court is not allowed to invent new state law. See In re DePuy Orthopedics, Inc., 888 F.3d 753, 781 (5th Cir. 2018).

[3] Mainali v. Covington Specialty Ins. Co., 872 F.3d 255, 259 (5th Cir. 2017). Chapter 542 of the Texas Insurance Code includes requirements for insurers to communicate acceptance or rejection of claims, as well as deadlines for making payments.

[4] See Ortiz v. State Farm Lloyds, 589 S.W.3d 127 (Tex. 2019); Barbara Technologies Corp. v. State Farm Lloyds, 589 S.W.3d 806 (Tex. 2019).

[5] See Ortiz v. State Farm Lloyds, 589 S.W.3d at 135; Barbara Technologies Corp. v. State Farm Lloyds, 589 S.W.3d at 822.

[6] See id.

[7] Randel v. Travelers Lloyds of Texas Ins. Co., 2021 U.S. App. LEXIS 24098 (5th Cir. August 12, 2021).

[8] Hinojos v. State Farm Lloyds, 619 S.W.3d 651, 658 (Tex. Mar. 19, 2021).

[9] Electrostim Med. Servs. v. Health Care Serv. Corp., 962 F. Supp.2d 887, 898 (S.D. Tex. 2013)affirmed in part, reversed in part on other grounds, 614 Fed. Appx. 731, 736 (5th Cir. 2015).

[10] See Ware v. United Fire Lloyds, 2013 Tex. App. LEXIS 5730, *5 (Tex. App.—Beaumont 2013, no pet.).

[11] Tex. Ins. Code §542A.001 et seq.

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