

COMMERCIAL & RESIDENTIAL REAL ESTATE

Black mold judgment reduced: It doesn't pay to act in 'bad faith'

A legal case related to mold — a word that sends chills down the spines of those in the real estate industry — brings some interesting insurance issues to light.

In June 2001, a Travis County jury handed out one of the largest verdicts in the "mold wars": almost \$33 million in damages in connection with a residential claim against Farmers Insurance Co. for breach of the duty of good faith and fair dealing, violations of the Texas Insurance Code and Deceptive Trade Practices Act, fraud and other legal claims.



INSURANCE

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Understandably, this verdict made headlines across the country. On Dec. 19, 2002, the Third Court of Appeals reversed some of the claims in Allison v. Farmers Insurance Exchange and reduced the damages to just over \$4 million. Although the case is known for its large "mold verdict," it has important insurance claims-handling implications as well.

As business owners and risk managers across the state already know, in recent years, the rights of policyholders have been under continued attack. Policyholders are not just individual consumers — they include every form of business in Texas. Business policyholders pay substantial dollars in premiums annually. Many of them find that, when they have a claim and they need their insurance, the insurance company denies coverage or forces them to go through expensive and protracted litigation to claim the benefits for which they have paid premiums.

The facts of the Allison case are complicated, but in sum, Allison and his wife, Melinda Ballard, claimed that the carrier:

- Delayed in paying their homeowners claims, which included claims for numerous leaks over a period of time.
- Engaged in a fraudulent investigation.
- Procured fraudulent repair and remediation bids.

- Made misrepresentations in connection with the homeowner policy.

- Used an appraisal process as a tactic to delay payment of the claims.

While the claim was being investigated and adjusted, and the appraisal went forward, a form of black mold, *stachybotrys*, infested the house and drove Allison and his family out of the residence.

Allison claimed cognitive impairment as a result of exposure to the mold. The jury rendered a verdict for over \$4 million in actual damages, \$5 million for Ballard's mental anguish, \$12 million in punitive damages, and attorneys' fees. On appeal, the mental anguish and punitive damages were reversed, but the actual damages affirmed.

The appellate court upheld the finding that the carrier had engaged in "bad faith" claims handling. A carrier breaches its common law and statutory duty of good faith when it delays or denies payment of a claim after the insurer's "liability has become reasonably clear." Liability for payment of a claim is reasonably clear when it is no longer debatable. In this case, the jury found that the carrier delayed payment of the claim after its adjuster admitted that she had sufficient information to realize that liability was reasonably clear.

Many business policyholders and risk managers are not aware that Texas has a Prompt Payment of Claims Act. This is a powerful statute that requires carriers to meet certain specific deadlines in acknowledging, handling and paying an insurance claim. Failure to meet the statutory guidelines subjects the carrier to penalties and attorneys' fees. In Allison, the jury found that the carrier violated the Texas Prompt Payment of Claims Act, and this finding was upheld.

In order to recover mental anguish and punitive damages, Allison had to prove that the carrier "knowingly" committed deceptive acts or

practices. "Knowingly" means "actual awareness of the falsity, unfairness or deception of the conduct in question." After reviewing the record, the appellate court found that there was no evidence to support this finding. Therefore, these damages were thrown out.

Many property coverage policies contain an appraisal provision. This provides a nonjudicial mechanism for resolving a disputed loss.

Many view this process as "pro-carrier." The appraisal provision typically allows each party to designate an appraiser and then the two appraisers appoint an "umpire." In this case, Allison claimed that the appraisal award was fraudulently obtained. The court of appeal rejected this claim.

Significantly, although the court upheld the appraisal award, it also held that the award for bad faith stood. The court found that the damages were not limited to the appraisal award because the claim for breach of duty of good faith is beyond the insurance policy. It is extra-contractual.

For the business policyholder this case offers several lessons:

- First, the duty of good faith will be enforced. A carrier will not be allowed to delay or deny payment after liability is reasonably clear.

- Second, carriers must comply with the Prompt Payment of Claims Act. Every business policyholder and risk manager should

become familiar with this statute and avail himself of its benefits. This statute requires the carrier to meet specific deadlines in the handling of the claim.

- Finally, the claim for breach of duty of good faith survives the appraisal process. Those damages are not trumped by the appraisal.

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