

IN THE SUPREME COURT OF TEXAS

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No. D-4095
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STATE FARM FIRE & CASUALTY COMPANY, PETITIONER

v.

JAMES AND CYNTHIA SIMMONS, RESPONDENTS

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ON APPLICATION FOR WRIT OF ERROR TO THE
COURT OF APPEALS FOR THE NINTH DISTRICT OF TEXAS
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Argued October 8, 1997

JUSTICE SPECTOR delivered the opinion of the Court, in which CHIEF JUSTICE PHILLIPS, JUSTICE GONZALEZ, JUSTICE BAKER, JUSTICE ABBOTT, AND JUSTICE HANKINSON join.

JUSTICE HECHT, joined by JUSTICE OWEN, filed a dissenting opinion.

JUSTICE ENOCH filed a dissenting opinion.

The two principal issues in this cause are whether legally sufficient evidence supports a jury's finding that an insurer breached its duty of good faith and fair dealing and whether there is some evidence to support a punitive damages award. The court of appeals answered each question affirmatively. 857 S.W.2d 126, 137. We reverse the punitive damages award, but render judgment awarding the Simmonses enhanced damages under the DTPA. We affirm the court of appeals' judgment in all other respects.

I. Background

James and Cynthia Simmons purchased their first home in 1983, financed by a Veterans Administration loan. The house was located on a large lot in a semi-rural part of Montgomery County. After buying the house, the Simmonses bought a homeowners insurance policy from State Farm Fire & Casualty Insurance.

In the year and a half after the Simmonses and their two young children moved into the house, they substantially improved the property. They installed a driveway and sidewalk, remodeled the bathroom, improved the home's water well, and, for safety's sake, moved a butane fuel tank farther from the house. To indulge his "love for hogs," James constructed a hog pen with the hope of eventually purchasing some stock. He also built a dining room table for his wife and beds for each of his children, as well as a mantel and a number of picture frames.

In the first year after the Simmonses bought the house, James, a construction supervisor, experienced some down-time from work. Consequently, the Simmonses missed several monthly mortgage payments. As a result, in January 1985, to make up for the missed payments, the Simmonses worked out a repayment schedule with the VA that allowed them to make weekly payments of \$185 in lieu of their monthly mortgage obligation of \$603. Thereafter, most of the weekly payments the Simmonses made were for \$190 or \$200. They made their last weekly payment in late April 1985.

In the same month the Simmonses worked out their repayment schedule, someone burglarized their home. Several items, including a television, silverware, a shotgun, and the children's piggy banks, were stolen. Although the burglary occurred during the day, none of the Simmonses' neighbors saw anything amiss. The burglars apparently entered the house through one of two doors at the back of the house. After the burglary, James followed the tracks of a wheelbarrow through the woods abutting the Simmonses' house to the nearby home of eighteen- or nineteen-year-old Tim Mattix. There, James confronted Mattix and another youth, James Wooddell, about the burglary. James Simmons called the police, but the police made no arrest at that time. Mattix later confessed to the police that he had committed the burglary in company with James and Charles Wooddell. State Farm paid the Simmonses \$7,069 for their claim within a few weeks of the

burglary.

After James's confrontation with Mattix and Wooddell, the Simmonses experienced a spate of vandalism: their telephone line was tapped into, eggs were smashed in their mailbox, and their dog died under circumstances that caused James, who had studied animal husbandry at Prairie View A&M University, to suspect that someone had poisoned the dog. Within a couple of weeks of the burglary, Cynthia returned home one day to find that someone had again entered the house, although nothing appeared to have been stolen at that time.

On Sunday, June 2, 1985, some time between 1:30 and 2:00 a.m., the Simmonses, along with James's mother, left the house to take the children to Cynthia's aunt's home in rural Louisiana for the summer. They planned to return that evening so that James could be at work the next day. The Simmonses locked all of the doors and windows before they departed. A short time after the family left, Irene Lawrence, who was delivering newspapers, noticed smoke emanating from the Simmonses' house. Within a few minutes, Lawrence reported the fire. Firefighters responded to the fire, but to no avail. When the Simmonses returned late Sunday afternoon, they found their home totally destroyed.

The Simmonses reported the loss to their State Farm agent the next day. The claim was immediately tagged as "suspicious" because of the relatively recent theft claim. State Farm soon referred the claim to an adjuster in what later came to be known as State Farm's Special Investigation Unit. Four months later, in October, State Farm denied the claim.

Thirteen as an affirmative defense. The jury found that the Simmonses had not burned their home, thus establishing coverage under the policy. State Farm does not contest that finding in this Court. The jury also found that State Farm had breached its duty of good faith and fair dealing in handling the Simmonses' claim and knowingly violated the Deceptive Trade Practice—Consumer Protection Act. Finally, the jury found that State Farm acted with conscious indifference in determining whether there was a reasonable basis to deny the Simmonses' claim. Based upon those findings, the district court rendered judgment for the Simmonses for \$275,000 in actual damages and \$2 million in punitive damages. The court of appeals affirmed that judgment. 857 S.W.2d at 142.

II. Bad faith

State Farm contends that the finding that State Farm breached its duty of good faith and fair dealing is not supported by legally sufficient evidence. We disagree.

This Court recently clarified the standard for recovery in bad faith cases. In *Universe Life Insurance Company v. Giles*, we held that an insurer breaches its duty of good faith and fair dealing by denying a claim when the insurer's liability has become reasonably clear. 950 S.W.2d 48, 56 (Tex. 1997). Evidence establishing only a bona fide coverage dispute does not demonstrate bad faith. *State Farm Lloyds v. Nicolau*, 951 S.W.2d 444, 448 (Tex. 1997); *Transportation Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex. 1994). But an insurer cannot insulate itself from bad faith liability by investigating a claim in a manner calculated to construct a pretextual basis for denial. See *Nicolau*, 951 S.W.2d at 448; *National Union Fire Ins. Co. v. Dominguez*, 873 S.W.2d 373, 376 (Tex. 1994); *Lyons v. Millers Cas. Ins. Co.*, 866 S.W.2d 597, 601 (Tex. 1993).

As State Farm conceded at oral argument, whether an insurer has breached its duty of good faith and fair dealing is a fact issue. See *Giles*, 951 S.W.2d at 56, and *id.* at 81 (Enoch, J., concurring). In determining whether the evidence is legally sufficient to support a bad faith judgment, we resolve all conflicts in the evidence and draw all inferences in favor of the jury's findings. *Id.* at 51. Viewing the evidence in this case in the light most favorable to the judgment, the evidence is legally sufficient that State Farm breached its duty of good faith and fair dealing by denying the Simmonses' claim based upon a biased investigation intended to construct a pretextual basis for denial. An insurance company's obligation to investigate is obviously not unlimited. The scope of the appropriate investigation will vary with the claim's nature and value and the complexity of the factual issues invol documents, established the deficiencies in the company's review of the Simmonses' claim.

A.

The Simmonses produced evidence from which the jury could logically infer that State Farm did not make a good-faith effort to objectively investigate the Simmonses' claim, but instead engaged in an outcome-oriented investigation designed to place the Simmonses at the center of an

“arson triangle.”¹ The Simmonses’ fire loss claim was immediately deemed “suspicious” because of the earlier theft claim. In fact, by the time State Farm denied the fire claim, the legitimacy of the earlier burglary claim was unquestionable. The police had returned a shotgun taken in the burglary to the Simmonses, which James turned over to State Farm because the company had paid for it in settling the burglary claim.

Further, there was evidence that State Farm’s investigation was not reasonable because State Farm failed to investigate the possibility that other potential suspects might have started the fire. At trial, Mike Hvasta, State Farm’s adjuster, testified that revenge and spite are some of the more common motivations for arson. The Montgomery County fire marshal also testified that spite and revenge were the leading motivations for arson fires in the county in 1985. In their statements to State Farm, the Simmonses had identified five people who may have had grudges against them, including Mattix and the Wooddells. Yet, there is evidence that State Farm never attempted to locate or contact any of these potential suspects, even though Hvasta’s preliminary combined fire report listed locating them as an unfinished item of investigation.

State Farm’s explanation for its failure to attempt to contact Mattix and the Wooddells was contradictory. At trial, Hvasta first testified that he did not contact them because he could not locate them. When confronted with his deposition testimony, however, he conceded that his explanation at that time was that he felt that it was “not important” to do so. He also acknowledged that he never learned during his investigation that Mattix, who lived just down the road from the Simmonses, had confessed to burglarizing the Simmonses’ home and been released from jail only two weeks before the fire. In fact, the evidence established that State Farm was unaware of that fact until some four years after it closed its investigatie report, his testimony that spite and revenge are frequent motives for arson, and his testimony that “it was important for [him] to do everything [he] could to get information with regard to th[e] claim before [he] made a final decision,” the jury could logically conclude that State Farm’s investigation was biased and unreasonable.

The testimony about the burglars by State Farm’s claims supervisor, Joe Tabor, provided

¹ Arson is an affirmative defense to an insurance claim for a loss resulting from a fire. The “arson triangle” refers to a means of establishing that defense by offering circumstantial evidence that the insured had a motive and the opportunity to set a fire and that the fire had an incendiary origin.

further evidence from which the jury could infer that State Farm conducted its investigation in a manner designed, not to discover the objective facts, but only to defeat coverage. While Tabor agreed that an insurer should look at the motives of others besides its insureds, he testified that State Farm did not pursue Mattix because of the physical evidence; *i.e.*, the house was locked and there was no evidence of forced entry. Yet State Farm's own report on the fire's cause and origin concluded that "no evidence of forced entry could be established due to the heavy damage throughout the area." Tabor also testified that State Farm had eliminated Mattix as a suspect because "Mattix had confessed to the burglary and certainly had no grievance at this point against the Simmons." The jury may well have rejected this entire explanation as inherently incredible.

B.

Additional evidence suggested that State Farm did not objectively investigate the Simmonses' claim. Hvasta and Tabor described the common indicators of insurance fraud by arson. These include: (1) a recently purchased policy or a recently increased policy; (2) a policy that significantly exceeds the insured property's value; (3) efforts by the insured to sell the property or other concrete indications that the insured intended to move; (4) prior fire losses; (5) a strong alibi for the insured; (6) unusual money problems, such as high medical bills or legal fees; (7) the removal of furniture or personal items before the fire; or, (8) a "huge [financial] burden" resulting from the strain of meeting everyday expenses. The evidence was undisputed that none of the first six criteria were met.

As to the seventh criterion, State Farm attempted to show that the Simmonses had removed their clothing from the house before the fire. However, other evidence put that fact issue in dispute. Cynthia Simmons testified that, although she had packed most of the children's summer clothes for the trip, the Simmonses left behind the children's winter clothes and clothing that they had outgrown. In addition, Hvasta's claim activity log noted that the Simmonses' master bedroom closet did contain clothing and shoes. There was also evidence that the Simmonses lost irreplaceable personal items in the fire, including James's track awards and the family Bible.

Finally, as to the eighth criterion, the jury heard evidence that the Simmonses' financial situation was no different from what they were accustomed to over the course of their marriage.

Although James had experienced some down time from work at about the time the Simmonses first missed some of their monthly mortgage payments, that situation had improved by the time of the fire. The evidence also showed that State Farm had concluded, based upon conversations with the Veterans Administration, that the Seality, the Simmonses were only obliged to make \$185 weekly payments in lieu of their \$603 monthly mortgage payment. State Farm's figure thus overstated the amount the Simmonses were required to pay by more than \$540 a month. State Farm also was under the erroneous impression that the Simmonses had not made any mortgage payments since January 1985. Coupled with evidence of the inadequacies in State Farm's investigation, this evidence tends to support an inference that State Farm denied the claim in bad faith.

C.

State Farm's primary contention at trial was that it properly denied the Simmonses' claim because the company reasonably believed that the Simmonses had a strong financial motive to burn their home. The claims committee report that formed the basis for State Farm's denial of the Simmonses' claim stated that "the motive for this fire was to relieve the financial burden of the mortgage." And Tabor reiterated at trial that "the motive was certainly to get out from under the mortgage." But the evidence at trial called into question the reasonableness and credibility of State Farm's reliance on that motive.

The evidence was undisputed that the Simmonses' mortgage obligation exceeded the policy limits on their homeowners insurance by several thousand dollars. If the Simmonses had actually burned their house, they would have been left with no home and a deficiency owed to their mortgage lender. This fact may have suggested to the jury, in light of the other evidence, that State Farm's fundamental premise about the Simmonses' motivation was so lacking in credibility as to imply bad faith.

D.

At trial, Hvasta, State Farm's adjuster, described an insurer's investigative responsibilities in some detail. He testified that policyholders reasonably expect insurers to thoroughly and adequately investigate claims, to disclose material facts, and to give policyholders the benefit of the doubt. He further testified that an adjuster should approach a policyholder to help resolve apparent

conflicts. However, in this case, both of the Simmonses testified that State Farm never revealed that it believed there was a discrepancy between the information the Simmonses had provided about their mortgage obligation and the information State Farm had obtained from other sources. Based upon Hvasta's description of an insurer's obligations, the jury could have inferred that a reasonable insurer would have approached its insureds to resolve apparently conflicting information and would have eventually concluded that the insureds lacked a sufficient motive to commit arson.

State Farm attempts to minimize the importance of its misunderstanding of the Simmonses' mortgage obligations, as it did at trial, by pointing to other evidence that the Simmonses were under some financial strain, even with a lower monthly mortgage obligation. This contention is inconsistent with Tabor's testimony that the claims committee report, which assumed a \$1,343 obligation in calculating the Simmonses' expenses, was the basis upon which State Farm made its decision. Viewing the evidence in the light most favorable to the judgment, the jury could reasonably have concluded that this was nothing more than *post hoc* rationalization on State Farm's part.

Before this Court, State Farm argues that the deficiencies in its investigation do not support liability because the Simmonses have not identified any particular step that would have made State Farm's liability reasonably clear. In essence, State Farm takes the position that the Simmonses' bad faith claim must fail because insurer that has the duty to reasonably investigate a claim, not the insured. *See Giles*, 950 S.W.2d at 51. To adopt State Farm's position would simply turn that duty on its head. Under the investigation standards State Farm's own experts identified, there was more than a scintilla of evidence that State Farm's investigation was materially deficient. We hold that the evidence is legally sufficient that State Farm breached its duty of good faith and fair dealing.

III. Punitive damages

The trial court awarded the Simmonses punitive damages of \$2 million based upon the jury's finding that State Farm acted with conscious indifference in denying the Simmonses' claim. State Farm asserts that the evidence in the record is legally insufficient to support an award of punitive damages. We agree.

In *Moriel*, we clarified the requirements for the imposition of punitive damages in a bad faith

case. A plaintiff may not recover punitive damages merely because the insurer has breached its duty of good faith and fair dealing. *Moriel*, 879 S.W.2d at 18. Instead, “[o]nly when accompanied by malicious, intentional, fraudulent, or grossly negligent conduct does bad faith justify punitive damages.” *Id.* Accordingly, the Simmonses were required to introduce evidence showing that State Farm “was actually aware that its action would probably result in extraordinary harm not ordinarily associated with breach of contract or bad faith denial of a claim—such as death, grievous physical injury, or financial ruin.” *Id.* at 24.

The Simmonses rely primarily upon the fact that State Farm never paid the lienholder on their property, the VA, in arguing that the punitive damages in this case were awarded in compliance with *Moriel*—that is, State Farm was actually aware that its denial of the claim was likely to result in the Simmonses’ financial ruin. In conjunction with the deficiencies in State Farm’s investigation outlined above, the Simmonses argue, State Farm’s failure to pay the VA establishes that State Farm’s conduct was “guided by an evil mind,” justifying punitive damages. *See Moriel*, 879 S.W.2d at 18 (quoting *Rawlings v. Apodaca*, 726 P.2d 565, 578 (Ariz. 1986)).

The evidence is undisputed, however, that State Farm contacted the VA and agreed to pay it the policy limits of \$47,000 in exchange for an assignment of the VA’s lien. Sam Bernardino, the responsible VA loan er foreclosing on the property in order to establish the deficiency between the policy limits and accrued interest. This transaction was never completed, though, because the VA “failed to monitor; and [the property] went under [the VA’s] property management section, and it was just sold.”

In light of State Farm’s undisputed efforts to settle with the VA, we cannot conclude that State Farm was actually aware that its actions were likely to result in financial ruin to the Simmonses. Thus, we hold that the evidence is legally insufficient to support the punitive damages award in this case.

IV. DTPA liability

The jury also found that State Farm had knowingly violated the DTPA, and that the violation was a producing cause of damages to the Simmonses. However, the Simmonses elected to recover on their common-law bad faith claim. Because we hold that the evidence is legally insufficient to

support a punitive damages award, the Simmonses are entitled to additional damages under the DTPA. Before this Court, State Farm argues that the evidence is legally insufficient to support liability under the DTPA because it did not violate its duty of good faith and fair dealing in denying the Simmonses' claim; as a result, State Farm asserts, any DTPA violations could not have been the producing cause of any damage to the Simmonses. Because we hold that the evidence is legally sufficient to support common-law liability, we need not consider this issue.

V. Conclusion

In summary, we hold that there is some evidence to support the jury's finding that State Farm breached its duty of good faith and fair dealing. We further hold that the evidence is legally insufficient to support the punitive damages award in this case. Accordingly, we affirm the judgment of the court of appeals in part, reverse it in part, and render judgment for additional damages for the Simmonses in accordance with the jury's finding that State Farm knowingly violated the DTPA.

Rose Spector
Justice

OPINION DELIVERED: February 13, 1998