

**No. 14-0721**

---

**IN THE SUPREME COURT OF TEXAS**

---

**USAA TEXAS LLOYDS COMPANY,**

**Petitioner,**

**v.**

**GAIL MENCHACA,**

**Respondent.**

---

On Petition for Review from the  
Thirteenth Court of Appeals at Corpus Christi/Edinburg, Texas  
Cause No. 13-13-00046-CV

---

**REPLY TO RESPONSE TO PETITION FOR REVIEW**

---

Charles T. Frazier, Jr.  
State Bar No. 07403100  
cfrazier@adjtlaw.com  
ALEXANDER DUBOSE  
JEFFERSON & TOWNSEND LLP  
4925 Greenville Avenue, Suite 510  
Dallas, Texas 75206-4087  
Telephone: (214) 369-2358  
Telecopier: (214) 369-2359

Wallace B. Jefferson  
State Bar No. 00000019  
wjjefferson@adjtlaw.com  
Rachel A. Ekery  
State Bar No. 00787424  
rekery@adjtlaw.com  
ALEXANDER DUBOSE  
JEFFERSON & TOWNSEND LLP  
515 Congress Avenue, Suite 2350  
Austin, Texas 78701-3562  
Telephone: (512) 482-9300  
Telecopier: (512) 482-9303

**COUNSEL FOR PETITIONER  
USAA TEXAS LLOYDS COMPANY**

## TABLE OF CONTENTS

Index of Authorities .....	ii
Record References .....	iii
Summary of the Argument in Reply .....	1
Argument.....	3
I.    The differences Menchaca identifies are only semantic .....	3
II.   This Court should reject Menchaca’s argument that USAA is liable for policy benefits even though she failed to prove that it breached the policy .....	5
III.  Menchaca’s attempts to distinguish <i>Castañeda</i> are unavailing .....	7
IV.  USAA has preserved the issues it presents to this Court .....	8
A.   USAA moved for judgment that Menchaca could not recover as a matter of law .....	9
B.   To the extent necessary, USAA timely and correctly objected to the jury charge .....	10
Conclusion and Prayer .....	11
Certificate of Service .....	13
Certificate of Compliance .....	14

## INDEX OF AUTHORITIES

### Cases

<i>In re Allstate Cnty. Mut. Ins. Co.</i> , 447 S.W.3d 497 (Tex. App.—Houston [1st Dist.] 2014, orig. proceeding) .....	4
<i>Felton v. Lovett</i> , 388 S.W.3d 656 (Tex. 2012) .....	10
<i>Gulf States Utils. Co. v. Low</i> , 79 S.W.3d 561 (Tex. 2002).....	7
<i>Holland v. Wal-Mart Stores, Inc.</i> , 1 S.W.3d 91 (Tex. 1999) (per curiam).....	9, 10
<i>Liberty Nat’l Fire Ins. Co. v. Akin</i> , 927 S.W.2d 627 (Tex. 1996) .....	3
<i>Progressive Cnty. Mut. Ins. Co. v. Boyd</i> , 177 S.W.3d 919 (Tex. 2005) .....	4
<i>Provident Am. Ins. Co. v. Castañeda</i> , 988 S.W.2d 189 (Tex. 1998) .....	1, 5, 7-10
<i>State Dep’t of Highways &amp; Public Transp. v. Payne</i> , 838 S.W.2d 235 (Tex. 1992) .....	11
<i>Transp. Ins. Co. v. Moriel</i> , 879 S.W.2d 10 (Tex. 1994).....	3
<i>USAA Texas Lloyd’s Co., v. Menchaca</i> , No. 13-13-00046-CV, 2014 WL 3804602 (Tex. App.—Corpus Christi July 31, 2014, pet. filed) .....	3

### Rule

TEX. R. CIV. P. 274.....	11
--------------------------	----

## **RECORD REFERENCES**

References to the Clerk's Record are in the form "CR[Vol#]:[Page#]."

References to the Reporter's Record are in the form "RR[Vol#]:[Page#]."

References to Plaintiff's Exhibits are in the form "PX[#]."

References to Defendant's Exhibits are in the form "DX[#]."

## SUMMARY OF THE ARGUMENT IN REPLY

From its inception, this lawsuit has centered on Menchaca's claim that USAA breached the insurance policy by not paying her any policy benefits. *See, e.g.*, CR1:11-12 (petition alleging that "USAA wrongfully denied Plaintiff's claim," "refused to pay the full proceeds of the Policy," and "breach[ed] the insurance contract"). But after the jury rejected her contract claim, Menchaca pinned her right to policy benefits only on a purported failure to investigate. The salient question is whether this Court's declaration—that the "failure to properly investigate a claim is not a basis for obtaining policy benefits"—remains true. *Provident Am. Ins. Co. v. Castañeda*, 988 S.W.2d 189, 198 (Tex. 1998).

Menchaca thinks *Castañeda* is beside the point because that claim involved an insurer's outright denial of coverage. But whether a claim is not covered due to a policy exclusion, or because the assessed damages fall below the deductible, as in this case, *Castañeda*'s holding is equally applicable—a failure to conduct a reasonable investigation is not a lawful basis for recovering policy benefits. Thus, Menchaca's argument that the jury's award of \$11,350 for Hurricane Ike damage is recoverable based on the jury's failure-to-conduct-a-reasonable-investigation finding runs counter to *Castañeda*.

Menchaca also argues that the Court need not dwell on the legal proposition that "failure to properly investigate a claim is not a basis for obtaining policy

benefits,” because during the charge conference USAA forfeited its right to enlist that precedent. But this case does not turn on charge waiver, as this Court’s precedent, the charge, and the charge objections demonstrate.

The arguments Menchaca advances, and those the court of appeals adopted, are incompatible with this Court’s decrees. The court of appeals’ opinion should not stand.

## ARGUMENT

### I. The differences Menchaca identifies are only semantic.

Menchaca observes that the jury’s refusal to find a breach is not equivalent to a finding that USAA complied with the contract. That is true, but immaterial. Menchaca was required to prove, as a prerequisite to recovering policy benefits, that USAA was contractually obligated to pay. To prove a contractual obligation to pay, Menchaca needed an affirmative finding that USAA breached its contract by refusing to pay. Her arguments to the contrary ignore this Court’s direct precedent:

- “The threshold of bad faith is reached when a breach of contract is accompanied by an independent tort.” *Transp. Ins. Co. v. Moriel*, 879 S.W.2d 10, 17 (Tex. 1994).
- “In most circumstances, an insured may not prevail on a bad faith claim without first showing that the insurer breached the contract.” *Liberty Nat’l Fire Ins. Co. v. Akin*, 927 S.W.2d 627, 629 (Tex. 1996).

Menchaca perceives a “critical distinction” between refusing to pay a claim that is not covered, and refusing to pay a “covered” claim because it falls below the deductible. Resp. at 1. The court of appeals agreed, noting that “[t]he disagreement here does not involve the extent of coverage afforded under the policy; rather, it is about the precise amount of damages inflicted by the storm on the covered property.” *USAA Texas Lloyd’s Co., v. Menchaca*, No. 13-13-00046-CV, 2014 WL 3804602, at \*6 (Tex. App.—Corpus Christi July 31, 2014, pet.

filed). Neither Menchaca nor the court of appeals explains why that distinction would permit recovery of policy benefits for bad faith when the insurer's rejection of benefits offends no policy provision.

A jury may reject an insured's claim for breach of the contract because there is no coverage. A jury may reject an insured's claim for breach because, although the type of loss is covered under the policy, the loss is below the deductible. In neither case is the insurer contractually obligated to pay policy benefits. Menchaca's wordplay on the meaning of "coverage" thus fails when the law's consequences meet undisputed facts.

Nor does Menchaca cite authority supporting the distinction she urges, and this Court's precedent cannot be read so narrowly. In *Progressive County Mutual Insurance Co. v. Boyd*, 177 S.W.3d 919, 922 (Tex. 2005), the insured sued for breach of contract and for extra-contractual claims, including a failure to fairly investigate his accident, when the insurer denied his claim. This Court held that Boyd's unsuccessful breach-of-contract claim barred his extra-contractual claims. It spoke broadly about the relationship between the insurance policy and damages tied to bad faith. The opinion explored "an insurer's denial of a claim it was not obligated to pay." *Id.* That is consistent with the way other courts have interpreted the rule. *See, e.g., In re Allstate Cnty. Mut. Ins. Co.*, 447 S.W.3d 497, 501 (Tex. App.—Houston [1st Dist.] 2014, orig. proceeding) ("An insurer generally cannot

be liable for failing to settle or investigate a claim that it has no contractual duty to pay.”).

Here, the jury said “No” when asked whether USAA breached the policy. Because Menchaca lost on that question, USAA has no obligation to pay policy benefits. The only question is whether the law still holds that the “failure to properly investigate a claim is not a basis for obtaining policy benefits.” *Castañeda*, 988 S.W.2d at 198.

**II. This Court should reject Menchaca’s argument that USAA is liable for policy benefits even though she failed to prove that it breached the policy.**

Menchaca has asserted that Question 2 (the Insurance Code question), which asked whether USAA refused to pay her claim without conducting a reasonable investigation, implicitly includes a breach finding: “the evidence and the jury’s answer to Question No. 2(D) *conclusively establish USAA’s failure to comply with its insurance policy.*” CR1:689 (emphasis added). In the court of appeals she argued that Question 3—the damages question—established not just damages, but contract liability: “it is in response to Question 3 that the jury affirmatively found the Hurricane Ike damages covered by the policy.” Brief of Appellee/Cross-Appellant at 22. In this Court, she contends that “[t]ogether, the jury’s liability and damage findings support the judgment against USAA.” Resp. at 10.

Those arguments contradict the charge’s plain language and this Court’s precedent. Question 2(D) asked only whether USAA refused to pay a claim without conducting a reasonable investigation. Question 3 asked the jury to determine the difference between what USAA should have paid and the amount that was actually paid. CR1:667. The only question about breach was Question 1, to which the jury answered, “No.” CR1:665 (“Did USAA . . . fail to comply with the terms of the insurance policy with respect to the claim for damages filed by Gail Menchaca resulting from Hurricane Ike?”).

If a jury question about failing to investigate also inquires about contractual breach, or if a damage finding of policy benefits is the equivalent of a finding that the insurer ignored its obligations under the policy, then *Castañeda* could not have been decided the way it was. *Castañeda* rejected the insured’s recovery of damages equivalent to policy benefits for her insurer’s failure to adequately investigate a claim. If, as Menchaca argues, the failure-to-investigate finding included an implicit breach determination, *Castañeda* would have been entitled to judgment on that basis. If the jury’s award of policy benefits were proper for a failure to properly investigate, judgment for *Castañeda* also would have been appropriate. But this Court rendered a take-nothing judgment despite the jury findings on those issues, because *Castañeda* “did not plead and did not obtain a determination from the trial court that Provident American was liable for breach of

the insurance contract.” *Castañeda*, 988 S.W.2d at 201 (noting that “there is no basis on which Castañeda may recover based on this record”).

Menchaca asks the Court to deem findings in favor of the judgment. Resp. at 13. She has argued that “[e]ven if the jury’s findings in response to Question Number 3 were not a finding of covered losses, the issue of coverage must be deemed in support of the trial court’s judgment.” Brief of Appellee/Cross-Appellant at 23. But that rule applies only when an incomplete theory is submitted without complaint, which is not the case here. *See, e.g., Gulf States Utils. Co. v. Low*, 79 S.W.3d 561, 565 (Tex. 2002) (rejecting deemed finding that defendant acted knowingly under DTPA). Second, if such findings were appropriate, this Court would have deemed them in *Castañeda*. If the Court did not do so there, when breach was not submitted to the jury, it certainly should not do so here, where the jury soundly rejected that theory.

### **III. Menchaca’s attempts to distinguish *Castañeda* are unavailing.**

Menchaca argues that “the absence of contract findings was not deemed fatal to the Castañedas’ extra-contractual claims.” Resp. at 16-17. Instead, she argues, “the *Castañeda* court disallowed recovery because the evidence did not support the jury’s findings on the inadequate-investigation claim ....” *Id.* at 17.

But the absence of contract findings *was* fatal to Castañeda’s claims for *policy benefits*: that claim failed because she “did not plead and did not obtain a

determination from the trial court that Provident American was liable for breach of the insurance contract.” *Castañeda*, 988 S.W.2d at 201. Accordingly, “there [was] no basis on which Castañeda may recover based on this record.” *Id.*

The reason the evidence in *Castañeda* did not support the jury’s findings on the inadequate-investigation claim is that the only damages proven were benefits owed under the policy. Because an inadequate investigation could not have caused those damages, Castaneda could not recover them. *Id.* at 199. In the same way, USAA’s investigation, which occurred after the storm, obviously could not have caused Menchaca’s Hurricane Ike damage. Menchaca’s arguments ignore *Castañeda*’s direct holding.

#### **IV. USAA has preserved the issues it presents to this Court.**

Menchaca believes USAA waived any complaint that her failure to prove a breach bars recovery. She argues that USAA waived error by not objecting to a failure to predicate the Insurance Code question on an affirmative answer to the contract question; waived error by not requesting an instruction directing the jury not to answer the Insurance Code question if it answered “no” to the contract question; waived error by not objecting to the predication instructing the jury to award damages if it found an Insurance Code violation but not a breach of contract; and waived error by not requesting an instruction directing the jury not to

answer the damages question if it answered “no” to the contract question. Resp. at 1-2.

But none of those predicates (or lack thereof) matter here. *See, e.g., Castañeda*, 988 S.W.2d at 198 (rendering judgment in insurer’s favor despite jury’s answer awarding policy benefits for Insurance Code claims). USAA’s petition presents a legal issue that USAA preserved in its post-trial motions. To the extent charge-error preservation was necessary, USAA achieved it.

**A. USAA moved for judgment that Menchaca could not recover as a matter of law.**

USAA’s issues do not implicate the intricacies of charge submission. As a matter of law, Menchaca cannot recover damages because the jury rejected her assertion that USAA breached the policy. USAA preserved this legal issue in its motion for entry of a take-nothing judgment and motion to alter or amend the judgment. CR1:675-79, 723-25. In both motions, USAA asserted the same legal arguments it asserted in the court of appeals and presents to this Court.

This Court has embraced USAA’s argument before. In *Holland v. Wal-Mart Stores, Inc.*, 1 S.W.3d 91 (Tex. 1999) (per curiam), Wal-Mart contended that Holland could not recover attorney’s fees as a matter of law. *Id.* at 92. The court of appeals held the argument was waived because Wal-Mart did not object to the submission of a jury question on attorney’s fees. *Id.* at 94. This Court disagreed, holding that no objection was necessary, and the complaint was preserved in Wal-

Mart's post-verdict motion because the matter involved a question of law for the court. *Id.* See also *Felton v. Lovett*, 388 S.W.3d 656, 660 n.9 (Tex. 2012) (post-verdict motion preserved error on a “purely legal issue which does not affect the jury’s role as fact-finder”).

Likewise, whether Menchaca can recover policy benefits under her bad-faith claim when she lost on her contract claim presents a purely legal issue that USAA fully preserved in its post-trial motions.

**B. To the extent necessary, USAA timely and correctly objected to the jury charge.**

Menchaca’s contention that USAA waived all of its legal arguments misconstrues USAA’s primary stance. USAA’s objection to the charge was not that the Insurance Code question must be conditioned on a “yes” answer to the contract question. Instead, USAA twice urged the trial court to submit separate damage questions related to the contract and Insurance Code questions because, as this Court has made clear,<sup>1</sup> bad-faith damages must be independent of damages that are recoverable for breach of the policy—policy benefits.

First, USAA timely objected to the damages question.

With respect to Question No. 3, we object to the combining of contractual damages from Question 1 and statutory damages from

---

<sup>1</sup> *Provident Am. Ins. Co. v. Castañeda*, 988 S.W.2d 189, 198 (Tex. 1998) (holding that inadequate investigation was not a basis for obtaining policy benefits but recognizing theoretical possibility of recovering for conduct that causes “injury independent of the policy claim”).

Question 2 for the reason that the Texas courts have held that extra contractual damages need to be independent from policy damages.

And it's going to be unclear potentially if we get "yes" answers to 1 and 2 what the damages are based on. So we object to 3 as submitted by the plaintiffs.

RR10:36-37. The trial court overruled this objection. RR10:38. USAA's objection complied with Rule 274 and *State Department of Highways & Public Transportation v. Payne*, 838 S.W.2d 235, 240, 241 (Tex. 1992), because it apprised the court (a) that it should have submitted separate damages questions for the contract claim and the Insurance Code claims, and (2) *why* the damages question should not have been based on a "yes" answer to either or both Questions 1 and 2. TEX. R. CIV. P. 274.

USAA also submitted proposed questions regarding Menchaca's breach and Insurance Code claims. CR1:595-99. USAA requested separate damage questions for each claim. *Id.* The trial court refused these requests. RR10:38.

Accordingly, to the extent USAA was required to preserve error in the charge in order to present its issues to this Court, USAA did.

### **CONCLUSION AND PRAYER**

USAA requests that the Court grant this petition for review, reverse the court of appeals' judgment, and render judgment that Menchaca take nothing.

Respectfully submitted,

ALEXANDER DUBOSE  
JEFFERSON & TOWNSEND LLP  
515 Congress Avenue, Suite 2350  
Austin, Texas 78701-3562  
Telephone: (512) 482-9300  
Telecopier: (512) 482-9303

By: /s/ Wallace B. Jefferson

Wallace B. Jefferson  
State Bar No. 00000019  
wjefferson@adjtlaw.com  
Rachel A. Ekery  
State Bar No. 00787424  
rekery@adjtlaw.com

Charles T. Frazier, Jr.  
State Bar No. 07403100  
cfrazier@adjtlaw.com  
ALEXANDER DUBOSE  
JEFFERSON & TOWNSEND LLP  
4925 Greenville Avenue, Suite 510  
Dallas, Texas 75206-4087  
Telephone: (214) 369-2358  
Telecopier: (214) 369-2359

COUNSEL FOR PETITIONER  
USAA TEXAS LLOYDS COMPANY

## CERTIFICATE OF SERVICE

On March 26, 2015, I electronically filed this reply to response to petition for review with the Clerk of Court using the eFile.TXCourts.gov electronic filing system which will send notification of such filing to the following:

Gilberto Hinojosa  
State Bar No. 09701100  
ghinojosa@ghinojosalaw.net  
LAW OFFICE OF GILBERTO  
HINOJOSA & ASSOCIATES, P.C.  
622 E. Saint Charles Street  
Brownsville, Texas 78520  
Telephone: (956) 544-4218  
Facsimile: (956) 544-1335

Richard P. Hogan, Jr.  
State Bar No. 09802010  
rhogan@hoganfirm.com  
Jennifer Bruch Hogan  
State Bar No. 03239100  
jhogan@hoganfirm.com  
HOGAN & HOGAN  
Two Houston Center  
909 Fannin, Suite 2700  
Houston, Texas 77010  
Telephone: (713) 222-8800  
Facsimile: (713) 222-8810

J. Steven Mostyn  
State Bar No. 00798389  
jmostyn@mostynlaw.com  
THE MOSTYN LAW FIRM  
3810 West Alabama Street  
Houston, Texas 77027  
Telephone: (713) 861-6616  
Facsimile: (713) 861-8084

Randal Cashiola  
State Bar No. 3966802  
rcashiola@cashiolalaw.com  
CASHIOLA & BEAN  
2090 Broadway Street, Suite A  
Beaumont, Texas 77701-1944  
Telephone: (409) 813-1443  
Facsimile (409) 813-1467

Bruce E. Ramage  
State Bar No. 16492500  
ramage@mdjwlaw.com  
Levon G. Hovnatanian  
State Bar No. 10059825  
hovnatanian@mdjwlaw.com  
Robert T. Owen  
State Bar No. 24060370  
owen@mdjwlaw.com  
MARTIN, DISIERE, JEFFERSON  
& WISDOM, LLP  
808 Travis, 20th Floor  
Houston, Texas 77002  
Telephone: (713) 632-1700  
Facsimile: (713) 222-0101

*Attorneys for Petitioner  
in the Trial Court and  
Court of Appeals*

/s/Wallace B. Jefferson  
Wallace B. Jefferson

### **CERTIFICATE OF COMPLIANCE**

Based on a word count run in Microsoft Word 2013, this brief contains 2,388 words, excluding the portions of the brief exempt from the word count under Texas Rule of Appellate Procedure 9.4(i)(1).

/s/Wallace B. Jefferson  
Wallace B. Jefferson