INSURANCE LAW

A History, an Update and a Preview of Coming Attractions

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I. INTRODUCTION

A history, an update and a preview of coming attractions. Rarely do the appellate courts in Iowa choose to timely address the specific topic on your desk at the moment. Therefore, stop me in the hall or give me a call and we'll discuss. I don't have all the answers – or even close. But, collectively with others we might be able to find an approach or a place to look. And the search is part of the fun.

II. BAD FAITH

After years of relative obscurity (with a couple notable exceptions), bad faith has found its way into the reported cases in significant numbers this year. Let's start with the history!

A. History

Acceptance of the bad faith cause of action is usually premised on one of two theories: (1) the concept of a contractual duty of good faith and fair dealing; or, (2) the existence of a fiduciary relationship, particularly in view of the fact that the insurer retains the right to control the defense and settlement negotiations. Both rationales appear to have found approval before the Iowa Supreme Court. *See, e.g., Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30 (Iowa 1982) and *Pirkl v. Northwestern Mut. Ins. Ass'n*, 348 N.W.2d 633 (Iowa 1984). It is therefore critical to differentiate the relationships between and among the parties in order to ascertain the applicable legal obligations. Is there a contractual relationship? Is there a fiduciary duty?

So, let's separate bad faith claims into the various types of relationships, obligations and contractual duties and see where we have been.

1. Insured's Claim for Bad Faith Against Own Insurer

a. Excess Judgment Cases

Before 1988, the majority of bad faith actions arose out of the entry of a judgment in favor of an injured third party against the insured tortfeasor in excess of the limits of the liability insurance policy. A cause of action based upon the insurer's failure to adequately represent the insured's interest against a third party has long been recognized under Iowa law. *See Henke v. Iowa Home Mutual Casualty Co.*, 250 Iowa 1123, 97 N.W.2d 168 (1959).

The burden is on the insured to prove bad faith by a preponderance of the evidence and to support the case with substantial evidence. *Kohlstedt v. Farm Bureau Mut. Ins. Co.*, 139 N.W.2d 184 (Iowa 1965). A liability carrier is not required to pay every offer of settlement within policy limits. In order to recover, the insured must establish: (1) that an offer was made to settle within policy limits and would have settled on that basis; (2) that the offer was reasonable; and, (3) that the insurer had no reasonable basis for its judgment that the offer was not reasonable. *Kohlstedt v. Farm Bureau Mut. Ins. Co.*, 139 N.W.2d 184 (Iowa 1965); *Kooyman v. Farm Bureau Mut. Ins. Co.*, 315 N.W.2d 30 (Iowa 1982). The reasonableness of the insurer's judgment is determined based upon the circumstances existing at that time and not in light of subsequent events.

b. First Party Actions

First party and excess judgment claims of bad faith against an insurer must be clearly distinguished. While both are claims of an insured against the insurer, the similarity ends there. In a claim for bad faith based upon the entry of an excess judgment, the insurer has agreed to indemnify the insured for liability to a third party. In a first-party claim, however, the policy at issue requires the insurer to compensate the insured directly for a loss by the insured. While excess judgment claims involve liability policies of one form or another, first-party claims will usually arise out of coverages for health, life, disability, accident, title or property damage. A first-party action involves the insured's direct claim for benefits under the policy.

In spite of the fact that it was given numerous opportunities to do so, the Iowa Supreme Court delayed recognition of the tort of bad faith in first-party actions for many years. In *Long v. McAllister*, 319 N.W.2d 256 (Iowa 1982), the Court specifically stated that:

> In a first-party action, the issue is whether the insurer was guilty of bad faith in failing to pay the insured's own claim. *See, e.g., Noble v. National American Life Insurance Co.*, 128 Ariz. 1988, 624 P.2d 866 (1981). We have not recognized the first-party tort in Iowa.

The Court maintained that position without much further discussion in *M-Z Enterprises v. Hawkeye-Security Ins. Co.*, 318 N.W.2d 408, 415 (Iowa 1982) and *Higgins v. Blue Cross of Western Iowa and South Dakota*, 319 N.W.2d 232 (Iowa 1982). Again in *Brown Tp. Mut. Ins. Ass'n v. Kress*, 330 N.W.2d 291 (Iowa 1983), the Court stated:

> The present claim does not involve a third party claim. This Court has refused to recognize an independent tort action based on allegations of bad-faith failure of an insurer to settle an insurance claim with its own insured. . . . [n]ot finding an independent tort action here, we are left with the breach of an insurance contract. 330 N.W.2d at 298.

Finally, however, in *Pirkl v. Northwestern Mut. Ins. Ass'n*, 348 N.W.2d 633 (Iowa 1984) the Court made a concerted effort to discuss the law and theory of first-party bad faith actions, summarizing the theory and the history as follows:

> While we noted in *Kress* that we had in other cases declined to recognize such a theory of recovery, it appears that in those cases in which the issue had previously been considered, the claims which the insurer failed to pay were as a matter of law 'fairly debatable.' (citations omitted). We also inferred that this was the situation in *Kress* in denying the right to recover punitive damages in that case.
>
> As a result of our previous approach to claims of this nature, our law has been shaped on the basis of identifying the type of situation which does not permit recovery on an independent tort theory rather than identifying the type of situations, if any, which would support recovery on such a theory. Because of the apparent frequency with which this type of claim is being asserted, we conclude that some

effort should be made to clarify its status under our law.

The Court then went on to analyze the difference between an excess liability claim and a first-party claim:

> The relationship between the insurer and its insured in the two situations is markedly different. In the former situation, a clear fiduciary duty arises which places an affirmative duty on the insurer to investigate the claim and take such additional affirmative action as is required in the best interests of its insured. In the casualty insurance situation, the relationship between insurer and insured is for many purposes at arms-length. The insurer has no clearly defined duty of investigation and may require the insured to present adequate proof of loss before paying the claim. The two parties are on opposite sides of the issue rather than being partners on the same side as in the liability insurance situation.
>
> If the issue were simply a theoretical one of whether the nature of this type of claim is one which should probably be recognized as a tort action we would be inclined to respond in the negative. Clearly, however, that is not the real issue presented. The real issue is whether punitive damages may be recovered in some circumstances for denial of a first-party casualty loss claim by an insurer for other than legitimate reasons. 348 N.W.2d at 635-636.

While not, therefore, directly recognizing or rejecting a separate first-party bad faith claim, the Court did leave open the possibility that denial of a valid claim by a casualty insurer would support a claim for punitive damages, in addition to recovery of the loss which should have been paid under the policy. In fact, the Court specifically rejected the insurer's argument that punitive damages could never be awarded. Such a recovery may not, however, be predicated on an action which involves no more than upsetting the justified expectations of the insured.

In *Pirkl*, the Court sustained the trial court's setting aside of the jury's award of punitive damages as there was neither a claim for fraud nor any indication in the record that the insurer acted with malice in denial of the claim. As long as a claim is "fairly debatable", it is clear that the Court will not permit recovery against the insurer for a first-party bad faith claim. To the same effect, see *Hoekstra v. Farm Bureau Mut. Ins. Co.*, 382 N.W.2d 100, 105 (Iowa 1986) (“Farm Bureau invites us to end all speculation and issue a declaratory ruling that the tort of bad faith failure to settle a first-party claim will never be recognized in Iowa. Although we have yet to encounter a case that convinces us to adopt the remedy, we are unwilling, in our limited experience with such situations, to say one could not exist. Perhaps, as Mr. Justice Stewart said about pornography, we shall know it when we see it.”) and *Amco Insurance Co. v. Stammer*, 411 N.W.2d 709, 712 (Iowa App. 1987) ("Whatever the precise parameters of a first-party bad faith cause of action, assuming our supreme court chooses eventually to recognize such a tort, situations presenting a 'fairly debatable' claim lie unequivocally outside the theory's ambit.")

And then came *Dolan v. Aid Insurance Company*, 431 N.W.2d 790 (Iowa 1988). Having repeatedly stated that the Court would not give advisory opinions concerning the availability of the bad faith claim in the first-party situation and having repeatedly declined the opportunity to adopt

such a theory because the facts presented did not warrant the adoption, the Court in *Dolan* declared, "For the reasons discussed below, we now recognize first-party as well as third-party bad faith claims." 431 N.W.2d at 790.

The rationale of the Court is noteworthy. The Court spent considerable effort outlining the arguments for and against the adoption of a first-party bad faith action. Quoting from other sources, the Court identified the arguments for the adoption as follows:

1. Without the tort, "an insurance company can arbitrarily deny coverage and delay payment of a claim" to its insured "with no more penalty than interest on the amount owed;"

2. Due to the "uneven bargaining power between an insured and its insurer, the insured needs the extra leverage the tort of bad faith would provide to even the positions;"

3. "Insurance contracts are contracts of adhesion;"

4. The bad faith tort "is justified because of the nature of the insurance industry, which is imbued with the public interest;"

5. An insured is often "suffering from physical injury or economic loss when bargaining with the insurance company" and, hence, "the vulnerable position justifies the additional remedy of a bad faith cause of action;"

6. "The recognition of the bad faith tort in third-party situations justifies its recognition in first-party situations;"

7. "When an insured purchases insurance, she is purchasing more than financial security; she is purchasing peace of mind," and "therefore, the extra remedy of bad faith is needed to insure she receives the benefit of her bargain."

In adopting the tort of bad faith in first-party situations, the Court emphasized the following arguments for adoption:

1. Traditional damages for breach of contract will not always adequately compensate an insured for an insurer's bad faith conduct.

2. Iowa Code Chapter 507B, while serving to deter nearly all bad faith conduct, is not adequate for those situations which it does not, in fact, deter such conduct.

3. The availability to the insured of extra-contractual damages should not be dependent upon the insured sustaining severe emotional distress. The Court noted the limited applicability of this theory of recovery.

4. The recognition is justified by the nature of the contractual relationship between the insurer and insured. "Although we do not believe this relationship involves the same

fiduciary duties as in the third-party situations, *Pirkl*, 348 N.W.2d at 653, we have frequently noted that insurance policies are contracts of adhesion." (citations omitted) 431 N.W.2d at 794.

5. The parties have inherently unequal bargaining power which persists throughout the parties' relationship and becomes particularly acute when the insured sustains a physical injury or economic loss for which coverage is sought.

In determining the standard to be used to establish bad faith in the first-party context, the Court adopted the *Anderson* test from the Wisconsin Supreme Court: "To show a claim for bad faith, a plaintiff must show the absence of a reasonable basis for denying benefits of the policy and defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim." The Court went on to state as follows:

> Where a claim is 'fairly debatable,' the insurer is entitled to debate it, whether the debate concerns a matter of fact or law. . . . This test creates an objective standard and makes clear the intentional nature of the tort. Also, as noted in *Anderson*, '(i)t is appropriate, in applying the test, to determine whether a claim was properly investigated and whether the results of the investigation were subjected to a reasonable evaluation and review.' (citation omitted) With regard to the recovery of punitive damages, we adhere to the standards applied in *Pirkl*, 348 N.W.2d at 636.

Yet, for many years, there were no successful first-party bad faith claims. See, e.g., *Kirk v. Farm & City Insurance Co.*, 457 N.W.2d 906 (Iowa 1990) (Court found the record insufficient to warrant a recovery); *Dirks v. Farm Bureau Mut. Ins. Co.*, 465 N.W.2d 857, 861 (Iowa 1991) ("Where a claim is fairly debatable, the insurer is entitled to debate it and there is no bad faith on its part in doing so."); *Reuter v. State Farm Mutual Automobile Ins. Co.*, 469 N.W.2d 250 (Iowa 1991) (Mere denial of a plaintiff's motion for directed verdict does not necessarily mean that a claim is "fairly debatable" but an improper investigation, standing alone, is not sufficient cause for recovery if the insurer in fact has an objectively reasonable basis for denying the claim.); *North Iowa State Bank v. Allied Mutual Ins. Co.*, 471 N.W.2d 824 (Iowa 1991) (failure to provide liability coverage and a defense is judged by the "fairly debatable" standard of a first-party claim).

There have, however, been successful first-party bad faith claims. The facts supporting a first-party bad faith claim have, however, generally been rather egregious. In *Nassen v. National States Insurance Company*, 494 N.W.2d 231 (Iowa 1992), the Court permitted a first-party bad faith judgment to stand, but sustained a remittitur of $40,000 on a verdict of $623,800 in actual and punitive damages. The judgment was supported by the following facts.

In April, 1988, the plaintiff, then 85, purchased a nursing home insurance policy from National States. At the time of the application, the plaintiff made reference to a hospitalization in the previous year. At the time of that hospitalization, the admitting physician had noted the possibility of confusion and hypothyroidism, although the tests did not sustain the diagnoses and the diagnoses remained unconfirmed.

Shortly after issuance of the nursing home policy, the plaintiff was again hospitalized and

subsequently admitted to a nursing home. The plaintiff's good friend and attorney in fact, Mrs. Crippen, promptly submitted a completed claim for nursing home benefits in July.

In August and September, Mrs. Crippen called the insurance company a number of times, but never received a response. In October, the insurance company sent a letter asking for another signed claim form which was promptly completed and again submitted by Mrs. Crippen. Eleven days later the insurance company sent another form asking for another signed claim form. That form, too, was promptly completed and submitted. A few days later, the insurance company sent yet another letter requesting yet another signed claim form. Mrs. Crippen responded that she had already sent three forms and implied that she was getting the "runaround."

In January 1989, Mrs. Crippen again called the insurance company for information. Her call was returned the following week when she was told that the company was waiting for a doctor's report. The report was sent on February 7, 1989.

In March 1989, the plaintiff's counsel wrote to the insurance company. He was told that they were still waiting for the doctor's report which had, in fact, already been received.

On April 4, 1989, the insurance company wrote to the plaintiff's counsel and denied coverage for the claim on the grounds of inaccurate information in the application; namely, the plaintiff's allegedly pre-existing hypothyroidism and confusion. The company was notified of Dr. Anderson's report which disputed the pre-existing nature of those complaints. National States, however, returned the premium and purported to rescind the policy retroactive to the date of its issuance.

The jury returned a special verdict awarding damages of $43,800 for breach of contract, $40,000 for bad faith, $40,000 for fraudulent misrepresentation, and $500,000 in punitive damages. The trial court ordered a $40,000 remittitur on the fraud count.

A major issue in the case was the admissibility of testimony of a proffered expert witness by the plaintiff. The witness, Marshall Reavis, testified that the insurance company engaged in "cash flow underwriting" and "post claim underwriting", pursuant to which the company would run a large amount of cash through that could be invested and ultimately paid out to the company's principals prior to the company's collapse from an unreasonably low premium structure. While acknowledging that the issues raised by defense counsel had some merit, the Court concluded that those arguments would go to the weight rather than the admissibility of the testimony.

The sufficiency of the evidence required to sustain the verdict of first-party bad faith is the most intriguing aspect of the case. Until *Nassen*, the Supreme Court had been reluctant to acknowledge the existence of behavior which would sustain an award for bad faith. While the Court did not change the standard by which bad faith is measured ("fairly debatable"), it did, for the first time, find a factual scenario which arguably met the requirement. In relevant part the Court stated:

> The "fairly debatable" test approved in *Dolan* required plaintiff to establish to the satisfaction of a reasonable fact finder that National States' decision to rescind her policy was not based on an honest and informed judgment. National States based its decision on a single reference found among several pages of hospital records.

> Any question concerning the validity of the references to "confusion" and "hypothyroidism" contained in the November 10, 1987, hospital record could have been cleared up by a reading of the company's own claim file. National States ignored crucial information in that file and shunned any information that plaintiff's representatives sought to provide on this question. Under the circumstances, the question of bad faith was for the jury to decide.

2. Injured Party's Claim of Bad Faith Against Tortfeasor's Insurer

There are essentially two legal theories upon which a third-party tort victim could bring a common law action for bad faith against the tortfeasor's insurer for bad faith: (1) an argument that the insured party is a third-party beneficiary under the contract; or, (2) general tort concepts. Both theories were rejected by the Iowa Supreme Court in *Long v. McAllister*, 319 N.W.2d 256 (Iowa 1982), wherein the Court stated:

> The contract basis would recognize the victim as a third-party beneficiary of the insurance contract. We have reviewed principles relating to third-party beneficiaries in *Khabbaz v. Swartz*, 319 N.W.2d 279, 284 (Iowa 1982), filed separately this date. The determinative question is "whether the contracting parties intended that a third person receive a benefit which might be enforced in the courts." (Citation omitted). The insurance contract is not part of the record in the present case. Therefore, we have no basis for determining that it contains an express or implied intention to make the victim a policy beneficiary.
>
> . . . Because plaintiff relies only on the fact that he will benefit if the contract is carried out in accordance with its terms, he has alleged only a basis for finding he is an incidental beneficiary. See *Khabbaz*, 319 N.W.2d at 285. We refuse to extend the third-party beneficiary concept to the limits advocated by plaintiff.
>
> We also decline to recognize a duty of the insurer to the victim under general tort concepts. The insurer has a fiduciary duty to the insured but an adversary relationship with the victim. The effect of the policy is to align the insurer's interests with those of the insured. In meeting its duty to the insured, the insurer must give as much consideration to the insured's interests as it does to its own. It has no such relationship with a third-party. Instead the insurer stands in the shoes of the insured in dealing with the victim. Because the insured has a right to require liability to be proven as a predicate for payment of the loss, the victim cannot compel the insured to negotiate and settle the loss beforehand. No basis exists for giving the victim a greater right when negotiating with the tortfeasor's insurer than exists when the victim negotiates with the tortfeasor directly. See Kranzush, 307 N.W.2d at 265. In either event, the victim has a remedy for his injury through a tort action against the insured. That remedy will permit compensation to be ordered when it is justified.

Subsequently, in *Seeman v. Liberty Mutual Insurance Co.*, 322 N.W.2d 35 (Iowa 1982), the Court reiterated its conclusion that "a common-law tort action (by the injured third-party) was not, and is not now, recognized for an insurer's bad-faith failure to settle an insurance claim with a party."

The question of recovery for bad faith by the injured party against the tortfeasor's liability carrier was finally directly answered in *Bates v. Allied Mutual Ins. Co.*, 467 N.W.2d 255 (Iowa 1991). Bates had made a claim against Allied's insured for his negligence in causing an auto accident. After the commencement of trial, settlement was ultimately reached for the liability policy limits. After that settlement, Bates pursued a bad faith, unfair trade practice, fraud and intentional infliction case against the insurance carrier and its attorney. The Court reaffirmed that it would not recognize a "bad faith" theory of recovery as it concerns the third-party claims.

PLEASE NOTE that you will be able to find cases in which the injured victim is pursuing a claim against the tortfeasor's insurer. BUT, in those cases, the injured victims is actually pursuing the claim of the insured that has obtained either through the Direct Action Statute of assignment of the insured's rights.

By operation of law, Iowa Code Section 516.1 (the Direct Action Statute) constitutes a part of every insurance policy issued in Iowa. Iowa Code Section 516.1 allows the injured third party to bring an action to enforce the insured's rights under the policy and to pursue any claim the insured might have for extra contractual damages. In other words, the injured third party can bring an action for bad faith directly against the tortfeasor's insurer, as long as the statutory prerequisites are met and the bad faith alleged is between the insurer and insured, rather than from the insurer to the third-party. *Trask v. Iowa Kemper Mutual Insurance Co.*, 248 N.W.2d 97 (Iowa 1976); *Kooyman v. Farm Bureau Mutual Insurance Co.*, 267 N.W.2d 403, 405 (Iowa 1978) (". . . [w]e held Section 516.1 should be construed as statutorily assigning the rights of an insured to any unsatisfied judgment creditor, i.e., the plaintiffs in this case."); *Wierck v. Grinnell Mutual Reinsurance Co.*, 456 N.W.2d 191 (Iowa 1990).

The statutory prerequisites must be strictly met before an action by the injured party against the tortfeasor's insurer will lie. A claim for bad faith under Section 516.1 can only be brought by (1) a judgment creditor (2) who has had an execution on a judgment against the insured returned unsatisfied (3) within one hundred eighty (180) days from entry of the judgment in case no appeal is taken and, in case of appeal, within one hundred eighty (180) days after the judgment is affirmed on appeal. See Iowa Code Sections 516.1, 516.3 (1995).

Direct suit by the injured third-party against the tortfeasor's insurer in such a case must be clearly distinguished from the facts and circumstances alleged in *Long v. McAllister*, *supra*. In *Long v. McAllister*, the injured third-party was seeking to recover based upon the relationship of the insurer to the third-party himself. As noted above, such an action is not cognizable under Iowa law. The third-party may, however, properly pursue an action directly against the tortfeasor's insurer by contractual or statutory assignment, if the alleged wrong for which recovery is sought is based on the insurer's duty to the insured.

3. Insurance Company's Claim of Bad Faith Against Its Insured

Does the obligation of good faith and fair dealing apply to both parties to the insurance contract? Can the insurance company bring a claim of bad faith against the insured?

In *Johnson v. Farm Bureau Mutual Insurance Company*, 533 N.W.2d 203 (Iowa 1995), the insurance company counterclaimed for "reverse" bad faith and abuse of process in an action by an insured brought for breach of contract and bad faith against the liability carrier based upon its refusal to defend and indemnify him against negligence and contribution cross-claims. The Court did agree with Farm Bureau's conclusions regarding coverage -- there was none. However, the Court also concluded that there was no cause of action for "reverse bad faith." In relevant part, this Court stated as follows:

> We decline to adopt a tort of reverse bad faith. Farm Bureau argues that insurers should have a remedy other than abuse of process because abuse of process requires an element of a wrongful or illegal primary purpose. It asserts insurers should not be limited to such a narrow remedy. A motion for rule 80(a) (now Iowa R. Civ. Pro 1.413) sanctions, however, does not require a wrongful motive to remedy the filing of a frivolous claim. We believe sanctions under Iowa Rule of Civil Procedure 80(a) provide an adequate remedy to insurance companies when an insured files a frivolous bad faith claim.

Having lost an opportunity to obtain authority for "reverse bad faith" claims by an insurer against an insured, Farm Bureau has proceeded with the Court's suggestion that the remedy for "bad faith" filing of claims lies in Iowa R. Civ. Pro. 1.413(1). In *Farm Bureau Mutual Insurance Company v. Iowa District Court for Pottawattamie County*, 695 N.W.2d 503, 2005 WL 675 (Iowa App. 2005), the Iowa Court of Appeals found an abuse of discretion by the trial court in NOT awarding penalty pursuant to Iowa R. Civ. Pro. 1.413(1) after the insured filed a bad faith claim again the insurer. The Court of Appeals held that, as the standard was violated, the district court was required to impose some level of sanction and the matter was remanded to the district court for further proceedings to do so.

4. Bad Faith Claims of Injured Employees in Workers' Compensation Setting

a. Injured Worker's Bad Faith Claim Against the Workers' Compensation Insurance Carrier

At first glance, a workers' compensation claimant's action against the employer's insurance carrier for bad faith in the failure to settle his claim or pay benefits due would appear to be barred by the holding in *Long v. McAllister*, 319 N.W.2d 256 (Iowa 1982), as the claimant is a stranger to the insurance contract and the insurer has interests adverse to those of the claimant. Not so fast. While the Iowa Supreme Court was not called upon to resolve the issue in *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35, 41 (Iowa 1982), the Court stated:

> We recognize that due to the nature of workers' compensation insurance a claimant may stand in a position different from that of a third-party claimant under an ordinary liability insurance policy.

No authority was cited; no further explanation was offered. But the hint of what was to come was unmistakable.

In addition, there were three arguments raised by the insurers against the existence of a bad faith

cause of action by an injured worker in the context of a workers' compensation:

1) Exclusivity--the Iowa law provides that the sole remedy for a work-related injury is recovery under the Iowa workers' compensation law;

2) Statutory Pre-Emption--Iowa Code §86.13 already provides for a penalty for unreasonable denial of workers' compensation benefits; and,

3) Social and Economic Policy--the societal and economic impacts of recognition of a tort of bad faith payable to the injured worker.

And, one by one, the arguments fell.

The Iowa Supreme Court next addressed the existence of bad faith in a workers' compensation setting in *Tallman v. Hanssen,* 427 N.W.2d 868 (Iowa 1988). The Court did not specifically determine whether or not it would recognize a bad faith action against the employer's insurer in Iowa, instead limiting its decision to other issues. The Court did, however, address (and reject) one of the three standard arguments against the adoption of such a claim--exclusive remedy. The Court stated:

> It is axiomatic that an employee's rights and remedies arising from an injury suffered in the course of employment are exclusively provided under Iowa Code Chapter 85. *See* Iowa Code section 85.20 (1987). A district court would ordinarily have no subject matter jurisdiction over a claim that an employee is entitled to workers' compensation benefits. But this exclusivity principle is limited to matters surrounding a job-related injury and does not extend to subsequent dealings during which a tort may arise by reason of bad faith on the part of an employer's insurer.

One (exclusivity) down; two to go.

Having apparently abandoned the exclusivity argument against the recognition of such a claim, insurers were left with arguments of statutory preemption (since the Iowa law already provides for penalty in the event of an unreasonable failure to pay workers' compensation benefits) and social and economic policy.

The matter came before the Court again in *Kiner v. Reliance Ins. Co.*, 463 N.W.2d 9 (Iowa 1990). The *Kiner* court noted that *Tallman I* had not reached the issue of the viability of the bad faith claim as it concerns payment of workers' compensation benefits. The defendant in *Kiner*, apparently interpreted *Tallman I* to endorse a bad faith claim and failed to raise the question on appeal.

Thereafter, the development of the law in this area followed a path similar to the winding road followed by the courts on the way to recognition of first-party bad faith claims. The Iowa Supreme Court continued to consider cases without deciding whether a cause of action for bad faith failure to pay workers' compensation benefits exists. For example, in the second trip to the Supreme Court, *Tallman v. Wausau Insurance Cos.*, published in the advance sheet at 469 N.W.2d 706 (Iowa 1991) (*Tallman II*), the Court was again presented an opportunity to decide the issue. In a *Per Curiam*

decision, the Court noted that the issue had not been resolved--and wouldn't be resolved in the case then before it, stating:

> We need not answer the question left unresolved in *Tallman I* and *Kiner* because the record before us furnishes no basis to do so. As aptly noted by the district court, Tallman can sustain no claim of bad-faith failure to pay medical expenses because Wausau dutifully paid all expenses directed by the Industrial Commissioner. The district court properly dismissed Tallman's claim as a matter of law.

Please note that the citation above is from the advance sheet. If you go to the bound volume (yes, REALLY REALLY, some lawyers do still use them) to locate *Tallman II,* you will find the following notation, an entry unique in my legal experience:

> **Editor's Note**: The opinion of the Supreme Court of Iowa in *Tallman v. Wausau Insurance Companies*, published in the advance sheet at this citation, 469 N.W.2d 706, 707, was withdrawn from the bound volume because it is not for publication.

The online sources, however, contain the referenced language.

In any event, finally, in *Boylan v. American Motorists Ins. Co.*, 489 N.W.2d 742 (Iowa 1992), the Iowa Supreme Court directly addressed the question of the existence of the injured workers' claim of bad faith against the employer's workers' compensation insurer. The plaintiff, Robert Boylan, filed a "bad faith tort claim" against his employer's workers' compensation carrier, American Motorists Insurance Company. In essence, he alleged that the defendant "delayed and then terminated [his] workers' compensation weekly benefits and medical benefits, arbitrarily and capriciously, without notice and in bad faith." He further claimed that as a consequence of the acts and omissions of the insurance carrier, the original injuries were aggravated.

The defendant insurance carrier filed a motion to dismiss for failure to state a claim upon which relief could be granted. The motion was granted. The lower court determined that the relationship between a workers' compensation claimant and the employer's insurance company is more analogous to the relationship between a tort victim and a tortfeasor's liability insurance company, a circumstance under which the Court has earlier refused to recognize bad faith tort liability. *See Long v. McAllister*, 319 N.W.2d 256 (Iowa 1982).

Secondly, the district court concluded that the presence of the statutory remedy for unreasonably delaying or terminating workers' compensation benefits was pre-empted by Iowa Code § 86.13. In other words, the district court found both remaining arguments against recognition of the tort to be persuasive.

The Iowa Supreme Court disagreed on both counts.

In noting affirmative obligations provided by the legislature in Section 86.13, the Court held that a

> . . . number of well-reasoned decisions from other jurisdictions have recognized the potential tort liability of workers' compensation insurers for willful or reckless

> disregard of their obligation to pay benefits to injured employees. (Citations omitted). Most of the courts that have refused to recognize the bad-faith tort have based such rejection on exclusive remedy provisions of the workers' compensation statutes in those jurisdictions. (Citations omitted). The Court, in *Tallman v. Hanssen*, 427 N.W.2d 868, 870 (Iowa 1988), recognized that the exclusive remedy provision of our workers' compensation act is applicable only to claims against the employer and does not extend to the employer's compensation carrier.
>
> We conclude that it is unlikely that the legislature intended the penalty provision in Section 86.13 to be the sole remedy for all types of wrongful conduct by carriers with respect to administration of workers' compensation benefits. By its terms, it applies only to delay in commencement or termination of benefits. It contemplates negligent conduct rather than the willful or reckless acts that are required to establish a cause of action under *Dolan*. In addition, no remedy is provided under section 86.13 for delay or failure to pay medical benefits. (Citation omitted).
>
> Penalty provisions for mere delay in payment or improper termination of benefits have been held in several cases not to preclude a common-law action for bad faith. (Citations omitted). The matters herein discussed convince us that recognition of tort liability on the part of workers' compensation insurance carrier guilty of the type of bad faith conduct for which tort liability was recognized in *Dolan* is a logical extension of that decision.

See also *McIlravy v. North River Ins. Co.*, 653 N.W.2d 323 (Iowa 2002).

The barriers were gone. The claim of bad faith by an injured worker against the employer's workers' compensation insurance carrier is cognizable under Iowa law. In fact, bad faith in the workers' compensation setting resulted in one of the largest verdicts for bad faith upheld by the Iowa Supreme Court in recent years.

Thornton v. Am. Interstate Ins. Co., 897 N.W.2d 445 (Iowa 2017) is unusual in several regards. First, and foremost, in this case, the workers' compensation insurance carrier had paid all of the weekly benefits due as they became due. The carrier argued that it therefore could not be found to be acting in bad faith. The injured workers disagreed and based his claim of bad faith on the insurer's refusal to acknowledge that he was permanently, totally disabled and entitled to a commutation, thereby unreasonably delaying his lump-sum payment. The finding of the Court markedly expands the law in this area--and the obligations of the workers' compensation insurer.

On cross motions for summary judgment, the trial court rejected the insurer's position that bad faith could not occur without a denial of payment and found that, as a matter of law, the insurance company had no reasonable basis for denying that the claimant was permanently totally disabled or that a partial commutation was in his best interest. At trial, the jury awarded $284,000 in compensatory damages including past pain and suffering ($125,000), loss of use of money ($14,000), consequential damages for attorney fees in the workers' compensation proceeding ($118,000), and lost home equity ($27,000). In addition, the jury awarded $25 million in punitive damages. The matter was appealed.

The Supreme Court (Justice Waterman) considered the workers' compensation bad faith claim to be in the first-party context; namely, similar to a claim of bad faith denial of health insurance payments, disability payments, underinsured benefits, or property loss. To establish the claim, the plaintiff must show: "(1) that the insurer had no reasonable basis for denying benefits under the policy; and, (2) the insurer knew, or had reason to know, that its denial was without basis." 897 at 461-62. However, in this case, the Court was challenged to identify a term or provision of the obligation of payment of workers' compensation benefits that had been denied or withheld. Can bad faith be proven without a specific break of a policy term?

Courts in other jurisdictions are divided "on whether bad faith can be proven without a specific breach of a policy provision." Some hold that if benefits " 'are fully and promptly paid' there can be no bad faith 'no matter how hostile or egregious the insurer's conduct toward the insured may have been prior to such payment'." In essence, those courts hold that if the insurer's conduct does not affect the parties' contractual rights, there is no bad faith.

In contrast, other courts hold that bad faith is not a " 'tortious breach of contract, but rather a separate and distinct wrong which results from the breach of a duty imposed as a consequence of the relationship established by contract. Therefore, the tort of bad faith allows an insured to recover even if the insurer performs the express covenant to pay claims.' " 897 N.W.2d at 464. In Iowa, prior case law held that to be liable for bad faith, a workers' compensation carrier must have 'denied' the injured worker benefits to which he was entitled. And then, the Court held that "the requisite 'denial' may occur when an insurer unreasonably contests a claimant's PTD status or delays delivery of necessary medical equipment." 897 N.W.2d at 465. It was concluded that this "rationale comports with our long-held view that first-party bad faith arises out of the breach of the affirmative good-faith obligations 'that [our workers' compensation] statutes and administrative regulations place on the insurer.' " 897 N.W.2d at 495 (quoting *Boylan v. Am. Motorists Ins.*, 489 N.W.2d 742 (Iowa 1992).

After a careful review of the facts and the insurer's own tacit recognition that it had no facts to support an argument that the worker was not totally/permanently disabled, the Court concluded that the trial court's summary conclusion that the insured acted in bad faith in that regard was affirmed. The Court further concluded, however, that there were sufficient facts to support the insurer's decision to challenge the requested partial commutation. Relying on the contention that a claim can be reasonably debatable on a point of law, the Court concluded that the insurer's conduct in challenging the entitlement to a partial communication was, indeed, reasonable.

The summary result: The trial court's decision that denial of permanent total disability constituted bad faith was upheld. However, the Court reversed the district court's partial summary judgment that the insurer acted in bad faith for disputing Thornton's petition for commutation and the judgments for actual and punitive damages. The case was remanded for a new trial on the remaining claims for bad faith.

b. Injured Worker's Bad Faith Claim Against the Employer

In general, the employer in a workers' compensation dispute has little/no authority over the decision

to pay claims. Those decisions lie with its insurance carrier. Therefore, it is the insurance carrier, and not the employer, that bears responsibility for mishandling of the workers' compensation claim itself.

However, if the role of the employer changes, so does its responsibility--and its potential liability.

In *Reedy v. White Consolidated Industries, Inc.*, 503 N.W.2d 601 (Iowa 1992), the Iowa Supreme Court was called upon to answer two certified questions from the United States District Court, only the first of which is relevant to our current discussion:

> 1. Is an action against a self-insured employer for bad-faith failure to pay a workers' compensation claim for medical benefits recognized in Iowa?

In response, the Court was directly faced with the exclusive remedy provisions of the workers' compensation law. The hurdle was low, however. The Court succinctly held as follows:

> To be a qualified self-insured employer under the act, it is necessary to voluntarily assume a recognized status under the workers' compensation laws as an insurer. (citation omitted) For purposes of a bad-faith tort claim, we see no distinction between a workers' compensation insurance carrier for an employer and an employer who voluntarily assumes self-insured status under the act. Consequently, we answer the first certified question in the affirmative. 503 N.W.2d at 603.

Self-insured employers should govern their conduct accordingly.

However, it is important to note that there are many other ways an employer can create liability for itself in a workers' compensation setting beyond those benefits payable under Iowa Code Chapters 85 *et seq*. For example, in *Wilson v. IBP, Inc.*, 558 N.W.2d 132 (Iowa 1997), a former employee sued his former employer and the company's nurse for defamation and breach of fiduciary duty. In essence, the employee claimed that the company's nurse made defamatory statements to the physician treating the plaintiff for an on-the-job back injury, falsely indicating that there was videotape showing that the employee was not following prescribed lifestyle restrictions, although the claimant was apparently observed only running errands and working on his car. The court concluded that the "essence of the alleged defamatory statement was that Wilson was faking the severity of his injury and was being untruthful to his doctor, i.e., that he was a liar. It was not, as defendants suggest, that he was working on his car or driving his children to school." 558 N.W.2d at 141. The jury's verdict of $4,000 in compensatory damages and $15 MILLION in punitive damages was reduced by the appellate court to $2 MILLION on appeal; the compensatory award was sustained.

Similarly, in *Phillips v. Swift & Co.*, 137 F. Supp.2d 1126 (S.D. Iowa 2001), the federal district court (Honorable Robert Pratt) was called upon to explore the compensability of a claim for extra-contractual damages against a self-insured employer who purportedly failed to comply with work restrictions imposed on an employee as the result of a work-related injury, thus breaching a fiduciary duty that Swift admitted it had to Phillips.

However, the Iowa Supreme Court has also held that an employer who fails to provide workers' compensation insurance cannot be liable for bad faith denial of workers' compensation benefits. Why? The Court concluded that an entity that is neither an insurer nor a self-insured employer "stands in a much different position." The obligations that arise out of the status of an insurer or one who stands in the position of an insurer are simply non-existent. *See, Bremer v. Wallace*, 728 N.W.2d 803 (Iowa 2007).

B. An Update

There have been cases involving bad faith in the context of insurance coverage since we last met at the General Practice Review. They are summarized below.

1. *B&F Jacobson Lumber & Hardware, L.L.P. v. Acuity*, 2017 Iowa App LEXIS 1256, 912 N.W.2d 500, 2017 WL 6513961 (filed December 17, 2017)

B&F Jacobson Lumber & Hardware, L.L.P. (B&F) appealed from a jury verdict in favor of Acuity, its insurer, on its bad faith claim based upon the adjustment of a property-damage claim arising from tornado damage to two buildings owned by B&F.

Initially, the insurance company inspected the buildings and issued a check to the insured that contained the following language: "Settlement in Full-ACV." B&F cashed the check. Thereafter, it discovered additional damages and worked with a public adjuster to pursue its claim. The insurance company took the position that the claim was already fully and finally settled and no further benefits were due. The insured filed suit almost immediately, asserting claims for breach of contract, unjust enrichment, reasonable expectations, bad faith, and seeking punitive damages. The insured also sought to enforce submission of the damage issue for appraisal pursuant to the portion of the policy that outlined an appraisal process if the parties "disagree on the value of the property or the amount of the loss."

The district court initially granted summary judgment in favor of the insurer. However, on appeal, the Iowa Court of Appeals found that factual issues regarding the notice provision and the bad faith claim precluded summary judgment and the case was remanded to the district court for further proceedings. *B & F Jacobson Lumber & Hardware, L.L.P. v. Acuity*, 852 N.W.2d 20, 2014 WL 1714968, at *1 (Iowa Ct. App. 2014). On appeal, this court concluded questions of fact existed as to a number of issues raised regarding the notice provision and the bad-faith claim, reversed the summary-judgment ruling, and remanded the case back to the district court. 852 N.W.2d 20, Id. at *9-10.

Following remand, the insured again filed a motion to compel an appraisal. It was granted. The appraisal process resulted in a determination that Acuity should pay B&F an additional $83,000 in damages. It did so. Thereafter, only the claim of bad faith remained.

In connection with the bad faith claim, the insured, B&F, sought discovery related to the insurer's post-filing-of-litigation decision to deny the appraisal. The insurer objected, asserting that the communications on that topic were protected by the attorney-client privilege and the trial court agreed.

The parties also disagreed about the admissibility of any facts occurring after the filing of the claim. The insured sought to introduce it; the insurer sought to bar it. Again, the trial court concluded that the insurer's position was appropriate and barred any evidence related to matters occurring after the filing of the litigation.

The matter proceeded to trial and resulted in a defense verdict. B&F appealed, asserting (among other things) that the court should have permitted discovery of the post-filing-of-litigation communications concerning the use of the appraisal process and should not have denied all evidence of post-filing-of-litigation conduct of the insurer. The Court of Appeals agreed and the matter was reversed and remanded for further proceedings and a new trial.

With regard to the discovery of the reasons for denial of the appraisal by the insurance company, Acuity argued that all actions taken by Acuity after the litigation commenced were all on the advice of counsel and therefore privileged and not subject to discovery. In contrast, B&F asserted that the questions asked did not call for the disclosure of attorney-client-protected information. It contended that it was not asking about conversations with counsel, but for specific reasons for Acuity's actions. B&F also argues the information falls outside the umbrella of attorney-client-privilege protection because the information was not intended to be confidential.

The Court of Appeals agreed with B&F, in part because counsel for the insurer had earlier sent a letter to the insured's counsel outlining the reasons for the denial of the appraisal and, as asserted by the insured, the reasons could not reasonably have been expected to remain confidential. In addition, the court implied that the insurance company effectively waived any privilege related to advice of counsel by asserting it relied on advice of counsel in making every post-filing-of-litigation decision. After noting that there was no Iowa authority directly on point, the court favorably cited and relied on *Hearn v. Rhay*, 68 F.R.D. 574, 578-82 (E.D. Wash. 1975) which it found persuasive in addressing implied waiver of the attorney-client privilege.

> We find Acuity placed the communications with its counsel at issue when stating it relied upon counsel's advice in reaching every decision made after the litigation was filed. The court's determination this information is protected by the attorney-client privilege improperly prevented B&F from [*18] obtaining discovery on issues at the heart of the bad-faith claim. See Brandon v. West Bend Mut. Ins. Co., 681 N.W.2d 633, 642 (Iowa 2004) ("[Waiver] may be based not only on words expressing intent to waive, but conduct making it unfair for a client to invoke the privilege.").

Although the Court of Appeals found that the trial court abused its discretion in denying B&F's motion to compel information defendant contended was protected by the attorney/client privilege, the issue was not dispositive of the case because the appellant must also show that there was prejudice resulting from the error. In this case, there was no prejudice unless the trial court was also in error in denying the admissibility of all post-filing-of-litigation conduct. Therefore, the Court of Appeals next addressed that evidentiary issue.

The trial court cited and relied upon *Roesler v. TIG Insurance Co.*, 251 Fed. Appx. 489, 498 (10th Cir. 2007), and *Dakota, Minnesota & Eastern Railroad Corp. v. Acuity*, 2009 SD 69, 771 N.W.2d 623, 634 (S.D. 2009), for the proposition that post-litigation conduct is irrelevant to a bad-faith claim and public policy prevents admissibility of such evidence. In its ruling, the court noted that, thougt "claim review continued after B&F Jacobson filed suit, this early filing may not be used as an end run around the prohibition on the use of post-litigation conduct as evidence of bad faith. Acuity's litigation tactics may not be presented as evidence at trial."

Again, the Court of Appeals noted that there was no clear direction from the Iowa Supreme Court on this issue. However, it acknowledged the Iowa Supreme Court has previously recognized that actions constituting bad faith may arise after the filing of litigation. See *Leuchtenmacher v. Farm Bureau Mut. Ins. Co.*, 460 N.W.2d 858, 861 (Iowa 1990) ("[A] bad-faith claim might well be based on events subsequent to the filing of the suit on a policy and therefore could not be based on the 'same' facts."); see also *Villarreal v. United Fire & Cas. Co.*, 873 N.W.2d 714, 729 (Iowa 2016).

However, the Court of Appeals also noted that there was no clear line on the issue among other jurisdictions. For example, in *Palmer by Diacon v. Farmers Insurance Exchange*, the Supreme Court of Montana noted that "an insurer's duty to deal fairly and not to withhold payment of valid claims does not end when an insured files a complaint against the insurer. Several courts have considered whether evidence of an insurer's conduct during litigation of the underlying suit is admissible in a subsequent bad faith action. After examining the reasoning of courts that have considered the issue, we conclude that the continuing duty of good faith does not necessarily render evidence of an insurer's post-filing conduct admissible. Indeed, courts rarely should allow such evidence and we have adopted a balancing test for those rare circumstances." 261 Mont. 91, 861 P.2d 895, 913-15 (Mont. 1993) (citations omitted). The court advocated in favor of a "balance between deterring improper conduct by the insurer and allowing insurers to defend themselves against spurious claims. . . . When the insurer's post-filing conduct has some relevance, the court must weigh its probative value against the inherently high prejudicial effect of such evidence, keeping in mind the insurer's fundamental right to defend itself."

Because the trial court ruled that ALL evidence after the filing of the petition was inadmissible without any analysis balancing the interests of the parties as provided in Iowa Rule of Evidence 5.403 or even an in camera review of the materials or testimony sought to be introduced, the Court of Appeals analyzed the issues based upon the available information. As B&F argued, the decisions to refuse an appraisal, denial of interest on the second payment, and refusal or delay in paying the deductible amount that had been already accounted for are all adjusting decisions--not litigation tactics or strategies--and should not therefore be barred because they do not prohibit the insurer from effectively defending itself in the pending litigation.

The Court of Appeals concluded that "the probative value of any evidence that Acuity continued to rely in part or in total upon the original payment being a final resolution of the claim due to the language on the check, "settlement in full—ACV," was not substantially outweighed by the danger of unfair prejudice. This basis for denial of the claim existed prior to the initiation of litigation, as well as before any evidence that Acuity had procured counsel, and could not be fairly described as a litigation tactic. Thus, any such evidence would be probative that Acuity

denied the claim for an improper purpose, and would have had no effect on Acuity or its counsel to zealously defend its claim." *28-29. The Court of Appeals similarly concluded that the decision to withhold payment of $5,000 for the deductible was "far removed" from any litigation tactic and therefore is admissible.

And, finally (and interestingly), the Court of Appeals addressed B&F's claim that the district court erred in ruling that B&F may not present evidence as to loss of peace of mind. Because the issue would almost certainly arise at the re-trial, the Court of Appeals addressed it.

The Court of Appeals defined the issues as follows: "The district court determined the damages for loss of peace of mind were not distinguishable from those for emotional distress as B&F asserted. The court found, although partners of a partnership, as individuals, may seek damages for emotional distress, "[t]he rights and damages due to the partner are not available to the partnership itself." Because the partners were not named parties to the suit, the court held B&F may not seek damages for loss of peace of mind or emotional distress." *32.

B&F argued it sought damages for loss of peace of mind, not emotional distress, relying on the following language found in *Dolan v. Aid Insurance Co.*, 431 N.W.2d 790, 792 (Iowa 1988): '"When an insured purchases insurance, she is purchasing more than financial security; she is purchasing 'peace of mind,' and 'therefore, the extra remedy of bad faith is needed to insure she receives the benefit of her bargain.'" 431 N.W.2d at 792 (citation omitted).

The Court of Appeals was not impressed by the purported distinction. It agreed with the trial court's conclusion that "the two ideas are not disparate concepts but part of the same potential damage claim."

2. *DeVolder v. State Farm Mut. Auto Ins. Co.*, 2018 Iowa App. LEXIS 948

This case arises from the disputed value of a diamond ring that was lost while insured for replacement value by State Farm. The ring was originally purchased by the DeVolders, insureds, from Josephs Jewelers (Josephs) for $28,514. That same month, Josephs prepared a "jewelry appraisal report" describing the ring as a "lady's 18K yellow and white gold engagement ring mounting, center set with one round brilliant cut diamond weighing 3.35 cts, Color K, Clarity VS1, GM (GIA Grading Report #12607644), and also prong set with 15 full cut diamonds weighing .75 cts." The report set replacement value of the ring as $39,200. Approximately two years later, the ring was lost and a claim was filed by DeVolders with State Farm.

The State Farm policy provided in relevant part as follows:

> We [State Farm] have the option of repairing or replacing the lost or damaged property. Unless otherwise stated in this policy, covered property values will be determined at the time of loss or damage. We will pay the cost of repair or replacement, but not more than the smallest of the following amounts:
>
> a. The full amount of our cost to repair the property to its condition immediately prior to the loss or damage;

b. The full amount of our cost to replace the item with one substantially identical to the item lost or damaged;

c. Any special limit of liability described in this policy; or,

d. The limit of liability applicable to the property.

Exercising the options defined in the policy, State Farm offered DeVolders another ring from Solomon Brothers Fine Jewelry (Solomon) in Atlanta, Georgia, or Solomon's quoted cost for the ring ($36,985.52), less the $500 deductible. DeVolders rejected both options and proceeded with litigation alleging breach of contract, first-party bad faith, and fraud. State Farm filed for summary judgment on all claims. The district court granted summary judgment in favor of State Farm on all claims and the insureds appealed. Each claim is discussed separately below.

DeVolders argued that State Farm breached the insurance contract by failing to offer a ring that was "substantially identical" to the lost ring or the value of a "substantially identical" ring. The term "substantially identical" was not defined in the policy and the Court of Appeals therefore used the ordinary meaning of the term.

After substantial discussion regarding the valuation of diamonds, the court concluded that there was a genuine issue of material fact as to whether or not the replacement ring offered was "substantially identical."

With regard to the claim for first-party bad faith, the Court of Appeals reasoned that because State Farm had not denied the claim, had located a ring they argue is "substantially identical" that shared many of the same characteristics with the lost ring, and because the insureds had no evidence that the insurer lacked a "reasonable basis to offer the Solomon ring or its cost in satisfaction of their claim," summary judgment for the insurer on the claim of bad faith was upheld. The claim for fraud met the same fate.

It is interesting to note that Judge McDonald dissented. He concluded that there was no genuine issue as to any material fact with regard to the breach of contract claim because the ring offered was "substantially identical" to the one lost under the record made. He found that the insureds had failed to submit any affidavits or other facts admissible in evidence to refute the contention made by State Farm.

C. A Preview of Coming Attractions

Having addressed potential bad faith claims in excess judgment cases, first part cases and workers' compensation matters, against employers and against insurance carriers, by injured plaintiffs and by insurance companies against the insureds themselves, one issue remains conspicuously unresolved: a potential claim against a third-party administrator in the workers' compensation setting. The issue is, however, now before the Iowa Supreme Court on a certified question from the federal district court for the Northern District and is phrased as follows:

> In what circumstances, if any, can an injured employee hold a third-party claims administrator liable for the tort of bad faith for failure to pay workers' compensation benefits?

The certified question arises from a claim of bad faith filed by a workers' compensation claimant, Samuel De Dios, against Indemnity Insurance Company of North America and Broadspire Services, Inc. The case is of sufficient significance that it has generated the filing of an *amici curiae* brief on behalf of the Iowa Defense Counsel Association and the American Insurance Association in support of the third-party administrator.

The arguments are largely predictable:

- The injured worker argues that the third-party administrator is essentially functioning as the insurance company because it is conducting the investigation and adjusting the claim; the third-party administrator argues that the regulations upon which the Iowa Supreme Court relied in adopting the tort of bad faith against workers' compensation carriers (*Boylan v. Am. Motorists Ins. Co.*, 489 N.W.2d 742 (Iowa 1992)) and self-insured employers (*Reedy v. White Consolidated Industries, Inc.*, 503 N.W.2d 601 (Iowa 1992)) are inapplicable to third-party administrators and therefore the rationale for recognition of a bad faith claim is unsupportable.

- The injured worker argues that the use of third-party administrators could essentially avoid the protections inherent in the workers' compensation system and leave injured workers unprotected by the abusive acts of a party that can't be held responsible for its own conduct; the third-party administrator argues that allowance of a claim of bad faith against third-party administrators is completely unnecessary and will result in a waste of judicial resources.

- The injured worker argues that the contract with the third-party administrator could essentially cede the rights and obligations anticipated in the regulations and inherent in the role of an insurer or self-insured but avoid the responsibility commensurate with those duties; the third-party administrator argues that there is no support in the law for imposing liability on the third-party administrator when the law and regulations impose those responsibilities on the self-insured employer and/or insurer and they should be held to be non-delegable. Note the decision of Judge Jarvey in Raymie v. Ins. Co. of State of Pennsylvania, NO. 4:09-CV-00222-JAJ, 2009 WL 8621559 (S.D. Iowa Sept. 29, 2009) wherein the court concluded that the workers' compensation carrier or self-insured employer "is responsible for the acts of its agents conducted within the scope of that agency relationship." Id. at *3.

- The use of punitive damages to punish and prevent future abuses is disconnected if they can't be assessed against the responsible party; the current structure already provides adequate compensation.

Stay tuned for more. It's going to be an interesting year.

III. APPRAISALS

Many property insurance policies contain language similar or identical to the following:

> If we (the insurer) and you (the insured) disagree on the amount of loss, either may make written demand for an appraisal of the loss. In this event, each party will select a competent and impartial appraiser after receiving a written request from the other, and will advise the other party of the name of such appraiser within 20 days. The two appraisers will select an umpire. If appraisers cannot agree, either may request that selection be made by a judge of a court having jurisdiction. The appraisers will state separately the value of property and the amount of loss. If they fail to agree, they will submit their differences to the umpire. A decision agreed to by any two will be binding. Each party will:
>
> a. Pay its chosen appraiser; and,
>
> b. Bear the other expenses of the appraisal and umpire equally.
>
> If there is an appraisal, we will still retain our right to deny the claim.

The impact of that language was addressed by the Iowa Supreme Court in *Walnut Creek Townhome Ass'n v. Depositors Ins. Co.,* 913 N.W.2d 80 (Iowa 2018).

The facts of *Walnut Creek* are rather complex and succinctly articulated by the Supreme Court:

> Walnut Creek Townhome Association (Walnut Creek or the Association) is a residential common interest community in Urbandale. The thirty-six multifamily buildings at Walnut Creek were built between 2004 and 2006. Walnut Creek is governed by a board of directors. In 2011, the board began investigating the need to replace the shingles on the roofs installed during the original construction. The type of shingle—New Horizon manufactured by CertainTeed—was regarded by roofing professionals to be defective.
>
> Marcus Harbert, a professional roofer for Hedberg & Son Roofing, evaluated the life expectancy of the roofs in the spring or summer of 2011. He inspected the roofs of three buildings. Harbert observed "[c]racking, crazing of appliques, [and] significant granule loss throughout the whole shingle itself." CertainTeed shingles carry a twenty-five-year warranty, but Harbert recommended to Mike Gooding, Hedberg's residential salesperson, that the shingles be replaced within five years. Gooding relayed this information to the Association's board. Minutes of the board meetings in 2011 and 2012 show the board was preparing to replace the roofs.
>
> On August 8, 2012, a severe wind and hailstorm hit Walnut Creek. One resident described the hail as "pea size" and "dime size" and noted that it covered his entire deck. Within a week after the storm, Harbert inspected the roofs at Walnut Creek again, this time for hail damage. He concluded the hail impacts were not significant enough "to warrant calling for an insurance claim." However, Harbert

recommended to Gooding that Walnut Creek follow through with the CertainTeed warranty claim.

In September, Walnut Creek asked Nicholas Waterman, a roofing renovator with GreenGuard Construction, to inspect the roofs for hail damage. Waterman found between eight to twelve hits per ten-by-ten-foot square and concluded that "[t]he roofing definitely had hail damage." Waterman testified that his standard practice was to ignore hits to the applique because damage to this area is "not accepted in the insurance-related field." He acknowledged that he will sometimes examine an area twice as large as the usual ten-by-ten-foot square to make up for the applique area that is ignored.

….

Walnut Creek submitted an insurance claim to Depositors, alleging that the August 8 storm caused damage to the roofs, gutters, siding, soffits, and air conditioning units and that the policy covered such damage. Depositors retained Haag Engineering to conduct a hail damage inspection. Two engineers—Robert Danielson and Richard Herzog—inspected the roofs on December 12 to 14. They prepared a report dated January 18, 2013. In the report, Danielson noted that there were nine hail events in the Urbandale area between 2006 and September 2012. The report concluded, "There was no hail-caused damage to shingles on the Walnut Creek Townhome Association property roofs."

Timothy Barthelemy, a public adjuster, assessed the buildings for Walnut Creek in 2013. Barthelemy observed nine to eleven hits per ten-by-ten-foot square. Barthelemy concluded that the hail caused damage to the buildings. Barthelemy inspected the roofs with a representative of Haag Engineering and Jason Johnson, the adjuster for Depositors.

On February 13, Depositors sent Walnut Creek a reservation-of-rights letter, noting its "investigation reveal[ed] no hail damage to the composition shingle roof covering of the subject [**8] buildings" at Walnut Creek. Depositors denied most of Walnut Creek's claim but payed Walnut Creek $124,656.79 for hail damage to the "soft metals" (such as the gutters, downspouts, and fascia).

Walnut Creek exercised its right to an appraisal under the parties' insurance policy.

The appraisal signed by Walnut Creek and the umpire concluded that the amount of the loss from the hail and windstorm that occurred on or about August 8, 2012 was $1,467,830.

At trial, Walnut Creek sought a declaratory judgment enforcing the appraisal award in the full amount. Depositors claimed that the roof damage was due to multiple concurrent causes excluded from coverage by the policy's “anti-concurrent clause” provision and that the air conditioning units included in the appraisal award were not covered because they were not owned by the insured. Depositors claimed the appraisal award is neither binding nor conclusive,

and alternatively, if coverage existed, any liability should be reduced by the amount of any warranty negotiated with CertainTeed, the manufacturer of the defective shingles.

The trial court concluded that it was not bound by the causation conclusion of the appraisal and entered judgment for Depositors. The matter was appealed and assigned to the Court of Appeals. The Court of Appeals reversed and held that the trial court should be bound by the award as signed by two of the appraisers. The Iowa Supreme Court granted further review.

In essence, Depositors argued (and the trial court found) that the causation determination of the appraisers was not binding on the court and that the appraisers could not determine coverage. The Iowa Supreme Court disagreed on the first argument, but agreed with Depositors on the second.

In essence, the Court concluded that factual causation issues may be decided through the appraisal process, but that the court alone can ascertain coverage under the terms of the policy. That is particularly relevant in the particular case because of the anti-concurrent cause that essentially provides that, if a loss is caused by two different causes, one covered and one not, there is no coverage available. In addressing resolution of that issue, the Court stated as follows:

> Coverage issues are for the court. Depositors relies on the anti-concurrent cause provision and the exclusions for defective materials and deterioration. Depositors argues the policy does not cover roof damage caused by both hail and deterioration from defective shingles. See *Travelers Prop. Cas. Co. of Am. v. Brookwood, LLC*, 283 F. Supp. 3d 1153, 1161-63 (N.D. Ala. 2017) (applying exclusions for faulty workmanship and inadequate maintenance to defeat coverage claim for storm water damage from leaking roof). Anti-concurrent cause provisions are enforceable under Iowa law. *Amish Connection, Inc. v. State Farm Fire & Cas. Co.*, 861 N.W.2d 230, 241 (Iowa 2015). "Anti-concurrent cause language addresses multiple concurrent or sequential causes of the same loss. It does not apply if the perils at work caused different damage or different losses. These would not be concurrent causes." 5 New Appleman on Insurance Law Library Edition § 44.04[1], at 44-28 (Marc J. Shrake ed., 2017).
>
> After its bench trial, the district court found that "the defective and deteriorating shingles are at the core of [Walnut Creek's] roof damage." But the court also found no hail damage to the shingles, contrary to the appraisal award. A new trial is required because the district court applied the wrong legal standard when it disregarded the appraisers' causation determination on hail damage. In the retrial, the court shall accept the appraisal award as to the hail damage loss, and then determine the amount, if any, Depositors owes under the policy after adjudicating the coverage defenses. We express no opinion on the merits of those defenses.

And it's back to the trial court for resolution.

IV. COVERAGE

A. *City of W. Liberty v. Employers Mut. Cas. Co.*, 2018 Iowa App. LEXIS 221

Sometimes the legal insignificance of a case is outweighed by its entertainment value – if one can successfully ignore the untimely demise of one of God's creatures. This case arises from property damages suffered in an electrical power substation owned by the City of West Liberty ("West Liberty") and insured by Employers Mut. Cas. Co. ("EMC"). The circumstances leading to the property loss was succinctly and cleverly described by the court as follows:

> … the squirrel was climbing on equipment when, as the district court found, "the squirrel found itself in a rather shocking situation when it came into contact simultaneously with a cable clamp energized at 7200 volts and the grounded steel frame which supported the cable attached to the clamp." An electrical arc was generated when the squirrel completed the circuit. The arcing lasted thirty to forty-five seconds, causing substantial damage to the City's property and short-circuiting the squirrel's life. The City and EMC agree the squirrel created the conductive path that resulted in an electrical arc that caused substantial damage to equipment at the City's electrical substation.

The policy in question provided in relevant part as follows:

> 2. "We" do not pay for loss or damage that is caused by or results from one or more of the following excluded causes or events:
>
> . . . .
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> g. Electrical Currents — "We" do not pay for loss caused by arcing or by electrical currents other than lightning. But if arcing or electrical currents other than lightning result in fire, "we" cover the loss or damage caused by that fire.

EMC denied coverage as damage from "electrical currents" was excluded. EMC argued that the squirrel did not damage anything; the current did.

The Iowa Court of Appeals agreed, noting that "but for" the electrical arcing, there would have been no damage.

B. *Struebing v. Addison Ins. Co.*, 2017 Iowa App. LEXIS 1224

One loss or two? That is the question.

The insured, Struebing, brought suit against Addison Insurance Company ("Addison") claiming property damage by fire and subsequent property damage by rain constituted two separate losses.

The sequence of events is not in question. On April 7, 2013, a fire occurred in the upper level of the insured building and firefighters cut a hole in the roof to extinguish the flames. Temporary repairs were made to the roof and replacement of the entire roof had been recommended. The insurer's adjuster recommended that the property owner hold off on replacing the roof until the

damages were fully assessed. Unfortunately, a few weeks later torrential rains pummeled the area and the entire building suffered water damage.

Addison subsequently concluded that the fire caused a total loss. An appraisal was obtained to ascertain the value of the building prior to the fire and Addison paid the appraised amount. The insurer did, however, deny the insured's effort to receive a separate payment for the water damage as it argued that both the fire and the subsequent water damage amounted to a single covered cause of loss.

The Court of Appeals concluded that the water damage was part and parcel of the fire loss and affirmed the decision of the district court in that regard.

C. *E. Iowa Plastics, Inc. v. Hartford Cas. Ins. Co.*, 2018 Iowa App. LEXIS 633

The underground fire suppression system became disconnected from the underground water service line in the East Iowa Plastics ("EIP") building and the property flooded. Repair required that the floor and an office above the line be excavated, the pipes reconnected, a portion of the concrete floor re-poured where the floor was excavated. Hartford paidfor those repairs. However, EIP claims additional damages to repair another portion of the concrete floor which settled a few inches because the soil underneath the floor compacted after the water leakage. The insurance policy contains an exclusion for damage caused by earth movement, including settling as a result of water underneath the ground surface and Hartford denied coverage for the additional damage.

The insurer filed a motion for summary judgment on the coverage issue, supporting the motion with deposition testimony of numerous persons involved in the construction and repair of the building. EIP resisted the motion, disputed the exact nature of the pipe's failure, that the policy was ambiguous and that the policy provided coverage for the collapse or explosion of a building. After hearing, the district court found "the settlement of the concrete slab was due to the soils under the concrete slab floor shifting, eroding and/or compacting because water from the underground service line saturated the underlying soils. The alleged damages are excluded per the policy."

Based upon the record before the court and the obligations of one resisting a motion for summary judgment to generate a genuine issue of material fact, the Court of Appeals affirmed.