THE TORT OF BAD FAITH ARISING FROM WORKERS' COMPENSATION MATTERS—A RUMBLING VOLCANO

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I. INTRODUCTION

The Iowa Supreme Court in *Dolan v. AID Insurance Co.*[1] recognized the tort of bad faith in the first party claim setting. This article discusses the logical extension of that cause of action to arbitrary conduct by workers' compensation insurance carriers in the handling of claims brought by injured workers.

The tort of bad faith was first recognized in third party claim settings. In these cases, the injured person, who is not a party to the insurance contract, sues the tortfeasor's insurance company. For example, in *Hilker v. Western Automobile Insurance Co.*[2] an insured asserted that his insurance company committed bad faith in failing to adequately investigate and thus to settle within policy limits, resulting in an excess judgment against the insured.[3] The evidence showed that the insurance company knew that the injured party had been taken to the hospital by an eyewitness to the accident.[4] The eyewitness had evidence that the insured was negligent.[5] Despite

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1. Dolan v. AID Ins. Co., 431 N.W.2d 790 (Iowa 1988). For other jurisdictions that have adopted the tort of bad faith in the first party context, see *id.* at 791 n.1.

2. Hilker v. Western Automobile Ins. Co., 204 Wis. 1, 231 N.W. 257 (1930), *aff'd on rehearing*, 204 Wis. 1, 235 N.W. 413 (1931).

3. *Id.* at ____, 231 N.W. at 258.

4. *Id.* at ____, 231 N.W. at 260.

5. *Id.*

this knowledge, the insurance company made no effort to contact this witness or other potential witnesses who ultimately testified against the insured at trial.[6] An excess judgment was entered against the insured after the insurance company refused to accept an offer within policy limits.[7] The court, in recognizing a cause of action in bad faith, implied a duty analogous to that of a fiduciary in evaluating and settling claims brought against its insured.[8] The action was not based upon breach of contract but upon an implied duty of good faith.[9] The Iowa Supreme Court has long recognized such a cause of action in third party cases.[10]

Since *Hilker* the California courts have led the way in extending the cause of action to first party situations. In *Gruenberg v. Aetna Insurance Co.*[11] the California Supreme Court held that an implied duty of good faith and fair dealing also existed with respect to a claim by the insured.[12] The court stated that "in every insurance contract there is an implied covenant of good faith and fair dealing."[13] This duty exists both when the company is attending to the claims of the insured and when attending to the claims of third persons against the insured.[14] Therefore, the insurer is subject to tort liability for withholding payment of an insured's claim unreasonably and in bad faith.[15]

The established elements of a cause of action in bad faith were first enunciated in *Anderson v. Continental Insurance Co.*[16] as follows: (1) "the

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6. *Id.*
7. *Id.*
8. *Id.* at ____, 231 N.W. at 259.
9. *Id.* at ____, 231 N.W. at 258.
10. *See, e.g.*, Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30 (Iowa 1982).
11. Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973). *See also* Silberg v. California Life Ins. Co., 11 Cal. 3d 452, 521 P.2d 1103, 113 Cal. Rptr. 711 (1974).
12. Gruenberg v. Aetna Ins. Co., 9 Cal. 3d at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.
13. *Id.* at 575, 510 P.2d at 1038, 108 Cal. Rptr. at 486.
14. *Id.*
15. *Id.*
16. Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978). *See also* Kranzush v. Badger State Mut. Casualty Co., 103 Wis. 2d 56, ____, 307 N.W.2d 256, 261-62 (1981). In *Kranzush* the court explained the rationales in *Anderson* as follows:

> Even this cursory overview suggests the significantly greater impact of an insurer's bad faith in a workers' compensation case than in a tort case. For the tort victim, the failure to settle with the tort-feasor is but the first skirmish; the principal battle is yet to come. But where an injured worker cannot obtain compensation benefits, his alternatives are far more limited. His ability to bring an action against the insurer for bad faith under the principles set forth in *Anderson* [85 Wis.2d 675, 271 N.W.2d 368 (1978)] is some assurance that his exclusive remedy will not be denied through the intentional wrongdoings of the insurer.
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> Furthermore, owing to the design of the workers' compensation laws, the injured employee and the insurance carrier occupy relative positions which are analogous to the insurer-insured relationship at the heart of the Anderson tort. Where a work-

absence of a reasonable basis for denial of policy benefits"[17]; and (2) "the knowledge or reckless disregard of a reasonable basis for a denial."[18] The Wisconsin Supreme Court stated in *Anderson* that the absence of a reasonable basis can be inferred and imputed to an insurance company in certain situations: "where there is a reckless disregard of a lack of a reasonable basis for denial" or where "a reckless indifference to facts or proofs submitted by the insured" exists.[19] Claims which are fairly debatable, however, can be challenged by the insurance company, and the insurer is only liable "where it has intentionally denied (or failed to process or pay) a claim without a reasonable basis."[20] The court stated that its recognition of the tort's intentional nature and the objective basis of the test would minimize extortionate lawsuits.[21] The court concluded that bad faith cannot be found where the insurer exercises ordinary care in investigating "the facts and law and concludes on a reasonable basis that the claim is at least debatable."[22]

The elements of recovery set forth in *Anderson* were adopted by the Iowa Supreme Court in *Dolan*. The rationale of *Anderson*, however, was not accepted *in toto*. In fact, the Iowa Supreme Court had criticized the *Anderson* rationale in an earlier case. In *Pirkl v. Northwestern Mutual Insurance Association*[23] the Iowa court was not persuaded that the rationale recognizing the duty of an insurer to exercise good faith in the settlement of third party claims was equally applicable to first party claims for a property loss against the insured's own casualty insurer.[24] The court differentiated the relationship between the insurance company and its insured in the two situations. In a third party situation, a fiduciary duty exists "which places an affirmative duty on the insurer to investigate the claim" and take other action necessary to further the best interests of the insured.[25] This differs from a first party situation in which the relationship between the insured and the

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> related injury occurs, liability is imposed upon the employer (sec. 102.03(1), Stats.), the statutory recovery is the employee's sole remedy (sec. 102.03(2)), and the employer or the insurer must pay (sec. 102.22 and 102.31). Under these legislatively imposed conditions, it is reasonable for the employee to expect fair dealing from the insurer, and it is not unreasonable to impose upon the insurer that duty.

Id. at ____, 307 N.W.2d 261-62. The court, however, refused to extend these principles to a tort victim who sought to bring an action for bad faith directly against the tortfeasor's insurance carrier. *Id.* at ____, 307 N.W.2d at 265. *Accord* Long v. McAllister, 319 N.W.2d 256 (Iowa 1982).

17. Anderson v. Continental Ins. Co., 85 Wis. 2d at ____, 271 N.W.2d at 377.
18. *Id.* at ____, 271 N.W.2d at 378.
19. *Id.* at ____, 271 N.W.2d at 377.
20. *Id.*
21. *Id.*
22. *Id.*
23. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d 633 (Iowa 1984).
24. *Id.* at 635.
25. *Id.*

insurance company is at arms length.[26] The insured and the insurer are opposed on the issue involved, unlike the liability situation, in which the insurer and the insured are on the same side.[27]

In *Dolan* the court continued to resist the acceptance of a fiduciary relationship in the first party situation.[28] Instead, the justification for adopting the cause of action was premised upon "the inherently unequal bargaining power between the insurer and insured, 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."[29]

The extension of the tort of bad faith to an injured worker who is arbitrarily denied benefits by a workers' compensation carrier is logically mandated by the same policy consideration underlying the first party claim situation. The difference lies in the fact that an injured worker is not a party to the insurance contract.

II. Relationship Between Injured Worker and Insurance Carrier

As between the insured and the insurance carrier, the duty of good faith and fair dealing is easily recognized. The workers' compensation claimant, however, is not a party to the insurance contract. The insurance carrier and claimant have adverse interests. The duty of the insurance carrier is to investigate and then to settle, pay, or defend claims under the state workers' compensation acts.[30] This obligation runs to the insured: the employer. The various workers' compensation statutes contemplate the denial of benefits and provide remedies to the injured employee by providing a forum for the resolution of such disputes, and in many cases, penalty provisions designed to provide a remedy for unreasonable conduct on the part of the insurance carrier. For example, in Texas a carrier is subject to a fifteen percent penalty if the carrier fails to pay benefits or file a notice of controversion within twenty days of receiving notice of the claim.[31] Further, a twelve percent penalty plus attorney fees may be imposed as a sanction against a carrier who fails to promptly pay the proceeds of a settlement.[32]

As a consequence many courts have refused to permit bad faith actions arising from a workers' compensation setting on the ground that such claims are barred by the exclusive remedy provisions of the various state workers' compensation acts.[33] The exclusive remedy provision of the Iowa Workers'

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26. *Id.*
27. *Id.*
28. Dolan v. AID Ins. Co., 431 N.W.2d at 794.
29. *Id.*
30. Workers' Compensation and Employers' Liability Insurance Policy, Part One, effective April 1, 1984.
31. Tex. Rev. Civ. Stat. Ann. art. 8306, § 18(a) (Vernon 1988).
32. Tex. Ins. Code Ann. art. 3.62-1 (Vernon 1988).
33. *See, e.g.*, Robertson v. Travelers Ins. Co., 95 Ill. 2d 441, 448 (1983)(claim for vexatious

Compensation Act provides:

> The rights and remedies provided in this chapter, chapter 85A or chapter 85B for an employee on account of injury, occupational disease or occupational hearing loss for which benefits under this chapter, chapter 85A or chapter 85B are recoverable, shall be the exclusive and only rights and remedies of such employee, the employee's dependents, or next of kin, at common law or otherwise, on account of such injury, occupational disease, or occupational hearing loss against:
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> 1. the employee's employer . . . .[34]

This provision protects the employer from common law liability arising from injuries which are covered by the Iowa Workers' Compensation Act. Courts have held that workers' compensation acts are not intended to cover actions of insurance carriers that are not intimately related to the original injury.

For example, in *Coleman v. American Universal Insurance Co.*,[35] an injured employee alleged that his compensation payments were arbitrarily cut off on several occasions despite the validity of his claim. In reversing a summary judgment in favor of the insurance carrier, the court held that "where a workers' compensation insurer acts in bad faith in the settlement or payment of compensation benefits, a separate tort is committed that is not within the purview of the exclusivity provisions of the workers' compensation law."[36] Thus, "the separate tort of bad faith may be alleged and proved in the courts."[37] The court noted that the exclusive remedy provisions of the Wisconsin workers' compensation statute would not bar the action since the action was not based upon the original work-related injury, but on "intentional acts of the insurer and its agents while investigating and paying the claim."[38] This case has limited application in the State of Wisconsin since the legislature has enacted a penalty statute with respect to the suspension, termination, or failure to make payments under the act, and further provides that the statute is the exclusive remedy by the employee

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delay and alleged outrageous conduct held to be within the penalty provision of the Illinois Workmen's Compensation Act and such remedy was exclusive); Gonzales v. United States Fidelity & Guar. Co., 99 N.M. 432, 659 P.2d 318 (1983)(claim for wrongful termination of benefits denied on the basis that the Workmen's Compensation Act provided an adequate remedy: the right to file a claim); Dickson v. Mountain States Mut. Casualty Co., 98 N.M. 479, 650 P.2d 1 (1982)(dismissal of claim based on a bad faith refusal to pay medical expenses upheld).

34. Iowa Code § 85.2 (1989).

35. Coleman v. American Universal Ins. Co., 86 Wis. 2d 615, 273 N.W.2d 220 (1979) *superseded by statute as stated in* Jadofsky v. Iowa Kemper Ins. Co., 120 Wis. 2d 494, 355 N.W.2d 550 (Ct. App. 1984). *See also* Hollman v. Liberty Mut. Ins. Co., 712 F.2d 1259 (8th Cir. 1983)(bad faith tort independent of industrial injury); Hayes v. Aetna Fire Underwriters, 187 Mont. 148, 609 P.2d 257 (1980) (intentional tort does not arise out of original employment relationship).

36. Coleman v. American Universal Ins. Co., 86 Wis. 2d at ____, 273 N.W.2d at 221.

37. *Id.*

38. *Id.* at ____, 273 N.W. 2d at 223.

against the employer or insurance carrier.[39]

Nevertheless, the case illustrates the clear distinction which can be made between the original injury and subsequent acts of claims handling. In *Tallman v. Hanssen*[40] the Iowa Supreme Court refused to determine the question of whether or not a valid tort claim had been asserted by the allegation that an insurance carrier had intentionally refused to pay medical bills. The court did state that:

> 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.*[41]

The court then quoted a case in which the South Dakota Supreme Court held that the exclusivity provision of the Wisconsin Workers' Compensation Act did not bar an action by an employee against an insurance carrier for the commission of an intentional tort, since the independent tort was not compensable under the Act.[42]

In addition, the Iowa Supreme Court has never placed the insurance carrier under the umbrella of Iowa Code section 85.20. The statute itself refers only to the "employer" and the court has treated insurance carriers as third parties, rather than as alter egos of the employer.[43]

III. Impact of Penalty Provisions

Section 86.13 of the Iowa Code provides a penalty provision with re-

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39. Schachtner v. Department of Industry, 144 Wis. 2d 1, ____, 422 N.W.2d 906, 909 (Ct. App. 1988). Wis. Stat. § 102.18(1)(bp) (1983-84) provides:

> The department may include a penalty in its final award to an employee if it determines that the employer's suspension of, termination of or injury resulted from malice or bad faith. This penalty is the exclusive remedy against an employer or insurance carrier for malice or bad faith. The department may award an amount which it considers just, not to exceed the lesser of 200% of total compensation due or $15,000. The department may assess the penalty against the employer, the insurance carrier or both. Neither the employer nor the insurance carrier is liable to reimburse the other for the penalty amount. The department may, by rule, define actions which demonstrate malice or bad faith.

40. Tallman v. Hanssen, 427 N.W.2d 868 (Iowa 1988).

41. *Id.* at 870 (emphasis added)(citing Fabricius v. Montgomery Elevator, 254 Iowa 1319, 1329, 121 N.W.2d 362, 366 (1963)(action allowed against insurance company based on negligent inspection)).

42. Matter of Certification of Question of Law, 399 N.W.2d 320, 322 (S.D. 1987).

43. Fabricius v. Montgomery Elevator Co., 254 Iowa 1319, 121 N.W.2d 361 (1963).

spect to the delay or denial of weekly benefits.[44] The penalty is limited to a maximum of fifty percent of the amount of benefits that are delayed or denied, but does not apply to claims for medical expenses.[45]

This provision clearly applies to insurance carriers by reference to earlier paragraphs in that section as well as the fact that in most cases insurance carriers have control over the payment of benefits.[46] In *Coleman*, it was argued that the statutory penalty provision extant in the Wisconsin Workers' Compensation Act at the time, barred a common law action for delay in paying benefits.[47] The court in *Coleman* rejected this argument and held that a cause of action for bad faith failure to honor or pay a claim was not precluded by the penalty provision for delayed workers' compensation payments.[48] The court reasoned that the penalty provision would be applicable to an unexcused delay in payment even if no bad faith was shown.[49] Two other cases which had reached a similar result were cited. In those cases, the courts had held that "the statutory penalty for inexcusably late payment [did] not bar additional remedies for an intentional wrong going beyond the mere late payment."[50] One court concluded that although the statutory penalty applied to both intentional and negligent failure to make compensation payments, the provision was not the exclusive remedy where the wrong was intentional.[51]

Texas courts have also upheld bad faith actions notwithstanding statutory provisions. In *Aranda v. Insurance Co. of North America*[52] the court held that a worker's compensation claim against a carrier for breach of the duty of good faith and fair dealing or intentional misconduct in the process-

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44. IOWA CODE § 86.13 (1982) provides, in part:
If a delay in commencement or termination of benefits occurs without reasonable or probable cause or excuse, the industrial commissioner shall award benefits in addition to those benefits payable under this chapter, or chapter 85, 85A, or 85B, up to fifty percent of the amount of benefits that were unreasonably delayed or denied.

45. Klein v. Furnas Elec. Co., 384 N.W.2d 370, 375 (Iowa 1986).

46. IOWA CODE § 86.13 (1982) provides, in pertinent part:
If an employer or *insurance carrier* pays weekly compensation benefits to an employee, the employer or *insurance carrier* shall file with the industrial commissioner on forms prescribed by the industrial commissioner a notice of the commencement of the payments . . . . If an employer or *insurance carrier* fails to file the notice . . . . (emphasis added).

47. Coleman v. American Universal Ins. Co., 86 Wis. 2d at ____, 273 N.W.2d at 221. *See* WIS. STAT. § 102.221(1) (1989)(statutory penalty provision).

48. Coleman v. American Universal Ins. Co., 86 Wis. 2d at ____, 273 N.W.2d at 224.

49. *Id.*

50. *Id.* (citing Martin v. Travelers Ins. Co., 497 F.2d 329 (1st Cir. 1974); Stafford v. Westchester, 526 P.2d 37 (Alaska 1984)).

51. *Id.* (citing Stafford v. Westchester, 526 P.2d at 43). *But see* Bowen v. Aetna Life & Casualty Co., 512 So. 2d 248 (Fla. Dist. Ct. App. 1987); Robertson v. Travelers Ins. Co., 95 Ill. 2d 441, 448 N.E.2d 866 (1983); Gonzales v. United States Fidelity & Guar. Co., 99 N.M. 432, 659 P.2d 318 (Ct. App. 1983).

52. Aranda v. Insurance Co. of North Am., 748 S.W.2d 550 (Tex. 1988).

ing of claims was not precluded by the exclusivity provision or the penalty provisions of the Workers' Compensation Act.[53] Similarly, in *Izaguirre v. Texas Employers' Insurance Association*,[54] the court, in holding that the penalties provided in the Workers' Compensation Act were not the exclusive remedies for any wrongful denials or delays of payments, stated that " 'a special relationship arises out of the parties' unequal bargaining power and the nature of the insurance contracts which would allow unscrupulous insurers to take advantage of their insured's misfortunes in bargaining for settlement or resolution of claims.' "[55] The court went on to state that the statutory regulation and existing statutory penalties were not adequate to equalize bargaining power between workers and insurers in settling claims.[56]

The penalty provision set out in section 86.13 of the Iowa Workers' Compensation Act is restricted to the "delay in commencement or termination of benefits . . . without reasonable or probable cause or excuse . . . ."[57] Because the statute applies only to weekly benefits and there is no clear legislative intent to bar a common law action for bad faith, it is unlikely that the Iowa Supreme Court will hold that this provision is exclusive.

IV. Bad Faith as an Intentional Tort

An equally persuasive reason for allowing a common law action in the face of an exclusive remedy or penalty provision is the fact that such provisions are generally not considered to bar intentional torts. Courts from most jurisdictions have permitted injured workers to bring common law actions against workers' compensation insurance carriers on the basis of intentional torts despite exclusive remedy provisions.[58] A traditional remedy against an insurance carrier which is not premised upon the relationship between the insurance carrier and the insured is the tort of intentional infliction of mental distress.[59]

An action that reaches the status of an intentional tort is simply not within the purview of exclusive remedy provisions that are designed to insulate the employer against common law liability for the ordinary hazards of

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53. *Id.* at 215.

54. Izaguirre v. Texas Employers' Ins. Ass'n, 749 S.W.2d 550 (Tex. Ct. App. 1988).

55. *Id.* at 554 (quoting Aranda v. Insurance Co. of North Am., 748 S.W.2d 210, 212 (1988); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987)).

56. *Id.* at 554-55. *But see* Bowen v. Aetna Life & Casualty Co., 512 So. 2d 248 (Fla. Dist. Ct. App. 1987); Robertson v. Travelers Ins. Co., 95 Ill. 2d 441, 448 N.E.2d 866 (1983); Gonzales v. United States Fidelity & Guar. Co., 99 N.M. 432, 659 P.2d 318 (Ct. App. 1983).

57. Iowa Code § 86.13 (1989).

58. *See, e.g.*, Bowen v. Aetna Life & Casualty Co., 512 So. 2d 248 (Fla. 1987)(exclusive remedy provisions upheld with respect to an action based on bad faith and negligent infliction of emotional distress, but common law action based on intentional infliction of mental distress permitted).

59. Restatement (Second) of Torts § 46 (1965). *See also* Amsden v. Grinnell Mut. Reinsurance Co., 203 N.W.2d 252 (Iowa 1972).

employment. This is even more apparent when the intentional tort occurs independent from the original injury, such as, in the case of actions by insurance carriers in delaying or denying benefits.[60]

The Iowa Supreme Court recognized the intentional tort exception to the exclusive remedy doctrine in *Harned v. Farmland Foods, Inc.*[61] The court in *Harned* held that the claim of an injured employee who had been denied chiropractic care was a matter to be determined by the Industrial Commissioner[62] and that the claim did not form the basis for an intentional tort.[63] The court did, however, allude to the fact that the exclusive remedy doctrine would not protect an insurance carrier from intentional torts.[64] The same exception was noted in *Tallman*.[65]

The importance of *Harned* and *Tallman* is that the Iowa Supreme Court has recognized the distinction between the original injury and subsequent dealings that may form the basis for an intentional tort. The court in *Dolan* characterized the tort of bad faith as intentional, stating, "This test [*Anderson*] creates an objective standard and makes clear the intentional nature of the tort."[66]

The intentional nature of the bad faith tort as recognized in *Dolan* would seem to set this action apart from the requirements for recovering a penalty under section 86.13 of the Iowa Code, which requires only proof of unreasonable conduct.

V. Policy Reasons for Denying Bad Faith Actions

Despite the legal distinctions which have previously been set out in support of permitting bad faith actions in the workers' compensation setting, there are sound policy reasons for denying such claims. The court in *Noe v. Traveler's Insurance Co.*[67] recognized that "if delay in medical service attributable to a carrier would give rise to independent third party court actions, the system of workmen's compensation could be subjected to a process of partial disintegration."[68] The court further stated, "[t]he uniform

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60. *See, e.g.*, Hayes v. Aetna Fire Underwriters, 187 Mont. 148, 609 P.2d 257 (1980); Kuney v. PMA Ins. Co., 379 Pa. Super. 598, 550 A.2d 1009 (1988); Matter of Certification of a Question of Law, 399 N.W.2d 320 (S.D. 1987); Izaguirre v. Texas Employers' Ins. Ass'n, 749 S.W.2d 550 (Tex. Civ. App. 1988); Coleman v. American Ins. Co., 86 Wis. 2d at 616, 273 N.W.2d at 221. *See also* Deeter v. Safeway Stores, Inc., 50 Wash. App. 67, 747 P.2d 1103 (1987)(upholds same principle but finds the facts of the case insufficient to support a claim of outrageous conduct).

61. Harned v. Farmland Foods, Inc., 331 N.W.2d 98 (Iowa 1983).

62. *Id.* at 101.

63. *Id.* at 99.

64. *Id.*

65. Tallman v. Hanssen, 427 N.W.2d 868, 870 (Iowa 1988).

66. Dolan v. AID Ins. Co., 431 N.W.2d at 794.

67. Noe v. Traveler's Ins. Co., 172 Cal. App. 2d 731, 342 P.2d 976 (1959).

68. *Id.* at ____, 342 P.2d at 979.

and exclusive application of the law would become honeycombed with independent and conflicting rulings of the courts. The objective of the Legislature and the whole pattern of workmen's compensation could thereby be partially nullified."[69]

There is certainly fear among employers and insurance carriers that bad faith common law actions will become a form of extortion, or at least, evade a legislative scheme which was designed to resolve workers' compensation matters at the administrative level. The Iowa Supreme Court must use caution and permit the action only where there is clear evidence of intentional conduct, as opposed to negligent handling of claims.

Proposed Uniform Jury Instruction 1410.1 provides, in part:

> INSURANCE BAD FAITH—FIRST PARTY CLAIMS.
> The plaintiff must prove all of the following propositions:
> 1. The defendant denied plaintiff's claim.
> 2. There was no reasonable basis for denying the claim.
> 3. The defendant knew there was not reasonable basis for denying the claim or acted in reckless disregard of whether there was any reasonable basis for denying the claim.
> 4. The denial was a proximate cause of damage to the plaintiff.
> 5. The amount of damage.
> If the plaintiff has failed to prove any of these provisions, the plaintiff is not entitled to damages. If the plaintiff has proven all of these propositions, the plaintiff is entitled to damages in some amount.[70]

This language is taken directly out of *Dolan*. In contrast, the Texas Court of Appeals only requires proof "that the carrier knew or should have known that there was not a reasonable basis for denying the claim or delaying payment of the claim."[71] This is clearly a negligence standard.

So long as the Iowa Supreme Court restricts bad faith actions to extreme conduct by insurance carriers—conduct which is clearly intentional—the action should serve to curtail abuses without disrupting the statutory scheme of workers' compensation.

VI. Punitive Damages

In *Dolan* the court held that punitive damages may be appropriate in bad faith actions as defined in an earlier Iowa case.[72] In *Pirkl v. Northwestern Mutual Insurance Association*[73] the Iowa Supreme Court held that punitive damages "are recoverable in situations involving 'positive misconduct

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69. *Id.* at ____, 342 P.2d at 979-80.

70. The instruction further provides that "[If an affirmative defense is submitted, delete the second sentence and insert the following: If the plaintiff has proven all of these propositions, then you will consider the defense of _____ as explained in Instruction No. _____.]"

71. Fuentes v. Texas Employers' Ins. Ass'n, 757 S.W.2d 31, 33 (Tex. Ct. App. 1988).

72. Dolan v. Aid Ins. Co., 431 N.W.2d at 794.

73. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d 633 (Iowa 1984).

of a malicious, illegal, or an immoral nature.' "[74]

The Iowa legislature, however, has now enacted specific legislation covering punitive damages. Section 668A.1 of the Iowa Code provides, in pertinent part:

> Punitive or Exemplary Damages
> 1. In a trial of a claim involving the request for punitive or exemplary damages, the court shall instruct the jury to answer special interrogatories or, if there is no jury, shall make findings, indicating all of the following:
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> a. Whether, by a preponderance of clear, convincing, and satisfactory evidence, the conduct of the defendant from which the claim arose constituted willful and wanton disregard for the rights or safety of another.
>
> b. Whether the conduct of the defendant was directed specifically at the claimant, or at the person from which the claimant's claim is derived.
>
> 2. An award for punitive or exemplary damages shall not be made unless the answer or finding pursuant to subsection 1, paragraph "a", is affirmative. If such answer or finding is affirmative, the jury, or court if there is no jury, shall fix the amount of punitive or exemplary damages to be awarded . . . .[75]

According to this statute, the recovery of punitive damages requires proof of "willful and wanton disregard for the rights or safety of another." If the test of *Dolan* is satisfied, it is likely that the issue of punitive damages will be submitted for consideration by the jury since the tests are quite similar.

Punitive damage awards in cases involving target defendants such as insurance carriers tend to be excessive and therefore there is legitimate concern about the impact of such awards on the insurance industry and ultimately employers.

VII. Access to the Claim File

Under Rule 122 of the Iowa Rules of Civil Procedure and Rule 26 of the Federal Rules of Civil Procedure, matters prepared in anticipation of litigation are generally protected against discovery unless there is a showing of substantial need or undue hardship.[76] The courts, however, have generally permitted broad discovery in bad faith actions.

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74. *Id.* at 636 (quoting Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30, 34 (Iowa 1982)). *See also* Pogge v. Fullerton Lumber Co., 277 N.W.2d 916 (Iowa 1979).

75. Iowa Code § 668A.1 (1989).

76. Iowa R. Civ. P. 122(c) provides:

> Trial Preparation: materials. Subject to the provisions of subdivision "d" of this rule, a party may obtain discovery of documents and tangible things otherwise discoverable . . . only upon a showing that the party seeking discovery has substantial need of the materials in the preparation of his case and that he is unable without undue hardship to obtain the substantial equivalent of the materials by other means.

Federal Rule of Civil Procedure 26(c) is essentially identical.

In *Ashmead v. Harris*[77] the Iowa Supreme Court held that a routine investigation by a liability carrier is conducted in anticipation of litigation and that therefore a showing of substantial need was required to obtain the materials.[78] The person seeking the material in that case was a plaintiff who had brought an action against the liability insurance carrier's insured.[79] The court declined to decide the test that should be used when the litigation is with the insured.[80]

If the insured worker is to show an absence of a reasonable basis for denying benefits as well as knowledge of that fact on the part of the insurer, it appears that she must obtain access to the claim file. Portions may not satisfy the test of relevancy or be barred due to the attorney-client privilege, but for the most part the claim file should be discoverable due to the ability to show substantial need. Even materials normally protected by the attorney-client privilege may be discoverable if central to a party's claim or defense.[81]

VIII. Conclusion

The Iowa Supreme Court in *Dolan* cited the following reasons for the adoption of first party bad faith actions:

> 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 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"; and
> 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."[82]

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77. Ashmead v. Harris, 336 N.W.2d 197 (Iowa 1983).
78. *Id.* at 201.
79. *Id.* at 198.
80. *Id.* at 201.
81. Brown v. Superior Court, 137 Ariz. 327, 670 P.2d 725 (1983).
82. Dolan v. AID Ins. Co., 431 N.W.2d at 791-92 (quoting Phelan, *The First Party Dilemma: Bad Faith or Bad Business?*, 34 Drake L. Rev. 1031, 1035-36 (1985-86)).

Although the court ultimately relied on unequal bargaining powers between the insurer and insured as the basis for its holding, the bulk of the reasons are applicable to their workers' compensation setting. The workers' compensation policy is designed to provide statutory benefits to injured workers. There is an expectation that the claims will be administered fairly and that all benefits provided by law will be paid when due. The vulnerability of an injured worker at this time is at least equal to that of first party claimants.

It is important to injured workers that benefits be denied only when a claim is fairly debatable. Arbitrary denials not only result in hardship to the injured, but often shift responsibility to the public welfare sector. The extension to injured workers of the right to bring a common law bad faith action under proper circumstances should not threaten the vast majority of insurance carriers. Arbitrary denials are the exception, and not the rule.