THE FIRST PARTY DILEMMA: BAD FAITH OR BAD BUSINESS?*

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I. Introduction

Insurance is big business. In 1983, the insurance industry collected nearly 400 billion dollars in insurance premiums[1] — roughly one-fifth of the total disposable income of all Americans.[2] Over two and one-half billion dollars of this total was collected from Iowans on life and casualty policies alone,[3] making insurance one of Iowa's largest industries.

Des Moines itself is among the top ten insurance meccas in the country.[4] With over seventy home offices located in the capital city,[5] and another thousand-plus offices scattered across the state,[6] it is apropos that Iowa

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1. Life Insurance Fact Book, p. 56 (1984)(Assuming that collections on life and health policies only account for half of all insurance premium collections).

2. Survey of Current Businesses; National Revised Estimates of the National Income and Product Accounts, S-1 (July 1984).

3. Ins. Dep't of Iowa, Ann. Rep; Bus. for 1983, pp. 63, 176 (Dec. 31, 1983).

4. World Book Encyclopedia, Vol. 10, p. 239 (1983).

5. Ins. Dep't of Iowa, Ann. Rep; Bus. for 1983, at 36, 176. Figures for 1983 revealed 38 life and 58 casualty insurance companies with Iowa domicile. *Id.*

6. Ins. Dep't of Iowa, Ann. Rep; Bus. for 1984, p. 5 (Dec. 31, 1984). Figures for 1984

courts are fast becoming battlefields for bad faith insurance suits. For years the war has raged as to whether an independent tort action should be recognized for an insurer's bad faith failure to settle first-party claims.[7]

On one side are the insureds, who, without the extra ammunition of punitive damages via a bad faith tort action, claim to be defenseless against insurers' bad faith denials of benefits.[8] On the other are the insurers, which claim that the traditional contract remedy of compensatory damages provides adequate protection for insureds.[9] Prisoners of war in this battle are practitioners, who, without a definitive word from either the Iowa Supreme Court or the Iowa Legislature, are left lawless in the pursuit or defense of first-party bad faith claims.

This article examines strategic arguments for both sides involved in first-party bad faith claims. In addition, relevant Iowa decisions are analyzed to see what, if anything, they have added to the status of the bad faith tort in first-party claims. Finally, this article discusses what "bad faith" will mean if the tort is not adopted in Iowa.

II. Background

A. *First-Party Coverage*

It is important to distinguish first-party from third-party insurance coverage to understand why the adoption of the tort of bad faith in third-party claims does not go hand-in-hand with the adoption of the tort of bad faith in first-party claims.[10] First-party coverage refers to insurance contracts whereby an insurer agrees to pay policy benefits to the insured directly.[11] Third-party coverage, on the other hand, refers to insurance contracts wherein the insurer has agreed to indemnify an insured against potential liability to third-persons.[12] The distinction lies in who the insurer agrees to pay; under first-party coverage the insurer agrees to pay the insured directly, while under third-party coverage the insurer agrees to pay a third-party to whom the insured may become liable.[13] First-party arrangements include coverage for: health, life, disability, accident, property damage, title, fire and medical payments, and any other types of policies providing for direct payments to the insured.[14]

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revealed 595 casualty and 517 life insurance companies were doing business in Iowa. *Id.*

7. *See* Amsden v. Grinnell Mut. Reinsurance Co., 203 N.W.2d 252, 254-55 (Iowa 1972).

8. *See infra* notes 38-47 and accompanying text.

9. *See infra* notes 48-61 and accompanying text.

10. *See infra* notes 35-37 and accompanying text.

11. W. Shernoff, S. Cage, H. Levine, Insurance Bad Faith Litigation, § 5.01 at 5-3 (1984)(hereinafter referred to as *Shernoff*).

12. *Id.*

13. *See id.*

14. *Id.*

B. *Insurer's Fiduciary Relationship With Its Insured*

The ontology of the tort of bad faith is a hybrid of the notion of a fiduciary relationship between an insurer and its insured and the concept of a duty of good-faith and fair dealing.[15] Traditionally, courts refused to find a fiduciary relationship between insurer and insured due to a lack of sufficient level of trust to create such a relationship.[16] Rather, the relationship between the parties to a contract of insurance was likened more to one of debtor and creditor.[17]

Superseding this traditional contract approach is the modern judicial notion of an "implied covenant of good faith and fair dealing, violation of which may give rise to a tort cause of action."[18] A premise of this modern approach recognizes that the relationship between the insurer and insured is of a fiduciary nature.[19] The California Supreme Court was first to embrace this notion that the insurer is a fiduciary to its insured in *Egan v. Mutual of Omaha Insurance Co.*,[20] as a justification for imposing punitive damages in a bad faith suit.[21] In formulating its policy framework and decisional basis, the court noted that insurers are endowed with a public trust which places them in a quasi-public role unlike that of other commercial enterprises:[22]

> As a supplier of a public service . . . the obligations of insurers go beyond meeting reasonable expectations of coverage. *The obligations of good-faith and fair dealing encompass qualities of decency and humanity inherent in responsibilities of a fiduciary.* Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonate [sic] with that trust.[23]

Other jurisdictions also have held, under certain circumstances, that the insurer may be recognized as a fiduciary to its insured.[24] But, the finding that a fiduciary duty exists often is determined not by the presence of an insurer-insured relationship, but instead is dependent upon whether the insurer has retained an exclusive right to conduct the defense of third-party claims against its insured.[25] In other words, the fiduciary duty found in cases imposing tort liability for bad faith failure to settle third-party claims will not

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15. *See id.* § 1.05 at 1-10.
16. *Id.* at 1-10, 1-11.
17. 3 Couch, Encyclopedia of Insurance Law § 23.11 (2d ed. 1960).
18. *Shernoff*, *supra* note 11, §1.05 at 1-11.
19. *Id.*
20. 24 Cal. 3d 809, 598 P.2d 452, 157 Cal. Rptr. 482, (1979), *cert. denied*, 445 U.S. 912, (1980).
21. *Id.* at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487.
22. *Shernoff*, *supra* note 11, §1.05 at 1-12, n.8.
23. 24 Cal. 3d at 820, 598 P.2d at 457, 157 Cal. Rptr. at 487 (quoting Goodman & Seaton, *Forward: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court*, 62 Calif. L. Rev. 309, 346-47 (1974).
24. *See*, *Shernoff*, *supra* note 11, § 1.05 at 1-12 n.8.
25. *Id.*

always be extended to first-party situations where an insurer refuses to pay policy benefits to the insured; such conduct may only be adjudged a breach of contract.[26]

Support for the notion that an insurer should owe fiduciary duties to its insureds can be found in Shernoff's argument that insurance is purchased because people anticipate a need for assistance if certain contingencies occur:

> They specifically want to secure an insurer's obligation to pay in certain circumstances. In a sense, the premiums that insurers receive [are] not entirely for their own benefit, but rather for the insured's benefit. Indeed, insurers are usually required by state law to set up reserve accounts for the payment of claims. Hence, by the inherent nature of the services to be provided, insureds place great trust and confidence in their insurance coverage and their insurers. In a practical sense, the insurer occupies a position comparable to that of a trustee for the benefit of its insureds. This is the very essence of a fiduciary obligation.[27]

The counter argument is simply that the relationship in first-party situations is adversarial rather than fiduciary:

> In the [first-party] insurance situation, the relationship between insurer and insured is for many purposes at arms length. The insurer has no clearly defined duty of investigation . . . . The two parties are on opposite sides of the issue rather than being partners on the same side as in the [third-party] insurance situation.[28]

III. Bad Faith

A. Development of the Tort of Bad Faith

The implied-in-law covenant of good faith and fair dealing provides that "neither party will do anything that will injure the rights of the other party to receive the benefits of the agreement."[29] Historically, this duty was imposed in cases involving parties to contracts which contained conditions of satisfaction.[30] Courts first imposed the duty of good faith and fair dealing on insurers in cases involving a liability insurer's refusal to settle within policy limits a third-party's claim against the insured; the theory was that the fiduciary duty created by the right to conduct the defense also created a duty to act in good faith.[31]

Because the insurer often exposed the insured to an unfair risk of ex-

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26. *Id.* at 1-13.
27. *Id.*
28. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d 633, 635 (Iowa 1984).
29. *Shernoff*, *supra* note 11, § 2.01 at 2-1 to 2-2 (citing Brown v. Superior Court, 34 Cal. 2d 559, 569, 212 P.2d 878, 881 (1949)).
30. *Shernoff*, *supra* note 11, § 1.07(1) at 1-22.
31. *See Id.* at 1-24, n.10.

cess liability when it refused to settle third-party actions, a number of jurisdictions developed the rule that when a liability insurer improperly refused to settle such actions, it could be held liable for the total amount of any judgment subsequently entered against an insured, including any sums in excess of policy limits.[32] Though some courts based the insurer's liability on negligence and others on bad faith, the results were basically the same: an insurer would be liable for any excess judgment if it breached the duty of good faith and fair dealing owed to its insured by unreasonably failing to settle a third-party action within policy limits.[33] Consequently, courts which characterized the insured's claim for relief as one sounding in tort broadened the range of available compensatory damages and other additional items of recovery to include punitive damages and damages for emotional distress, which previously were unavailable remedies in actions founded upon breach of contract alone.[34]

Since courts first applied this new tort to cases involving an insurer's methods in handling third-party claims against the insured, many have split over its applicability to an insurer's unreasonable refusal to honor direct claims of its own insured.[35] Courts imposing the duty of good faith and fair dealing on the insurer in first-party situations hold that violation of this duty subjects the insurer to liability in tort,[36] while courts finding insufficient basis for extending the fiduciary relationship existent in third-party situations to first-party situations have declined to impose tort liability for an insurer's refusal to pay such claims.[37]

B. *Arguments for the First-Party Tort of Bad Faith*

The following reasons are frequently cited for adoption of the first-party bad faith tort:

> 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;"[38]
> 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;"[39]

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32. *Id.* at 1-24.
33. *Id.* at 1-24 to 1-25.
34. *Id.* 1-25.
35. *Id.*
36. *See generally* Spencer v. Aetna Life & Casualty Ins. Co., 227 Kan. 914, 611 P.2d 149 (1980) and authorities cited therein.
37. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d at 635.
38. Spencer v. Aetna Life & Casualty Ins. Co., 227 Kan. at —, 611 P.2d at 152 (citing Note, *The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims An Emerging Trend*, 45 FORDHAM L. REV. 164, 166 (1972)).
39. *Id.* at —, 611 P.2d at 152 (citing Craft v. Economy Fire & Casualty Co., 572 F.2d 565, 569 (7th Cir. 1978); and, Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co., 34 Conn.

> 3. "Insurance contracts are contracts of adhesion;"[40]
> 4. The bad faith tort "is justified because of the nature of the insurance industry, which is imbued with the public interest;"[41]
> 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;"[42]
> 6. "The recognition of the bad faith tort in third-party situations justifies its recognition in first-party situations;"[43] 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."[44]

The primary arguments for the adoption of the first-party bad faith tort generally center around "the unequal bargaining position of the insured and insurer and the public interest nature of the insurance industry."[45] In addition, it has been noted that "[t]he tort of bad faith has grown out of an appreciation of the fact that an insurance contract is not an ordinary agreement and that principles of contract law are totally inadequate in protecting the consumer from the wrongful denial of insurance claims."[46] Finally, it has

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Supp. 46, _, 375 A.2d 428, 230 (1977)).

40. *Id.* at _, 611 P.2d at 152 (citing D'Ambrosio v. Pennsylvania Nat'l. Mut. Casualty Inc. Co., 262 Pa. Super. Ct. 331, _, 396 A.2d 780, 785 (1978)).

41. *Id.* at _, 611 P.2d at 152 (citing Eckenrode v. Life of America Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972); and, Grand Sheet Metal Prods. Co. v. Protection Mut Ins. Co., 34 Conn. Supp. at _, 375 A.2d at 430).

42. *Id.* at _, 611 P.2d at 152 (citing Grand Sheet Metal Prods. Co. v. Protection Mut. Ins. Co., 34 Conn. Supp. at _, 375 A.2d at 430).

43. *Id.* at _, 611 P.2d at 152 (citing Escambia Treating Co. v. Aetna Casualty & Sur. Co., 421 F. Supp. 1367, 1370 (N.D. Fla. 1976); and, Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 688, 271 N.W.2d 368, 375 (1978)). *But cf.* Prikl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d at 635.

44. Spencer v. Aetna Life & Casualty Ins. Co., 227 Kan. at _, 611 P.2d at 152 (citing Eckenrode v. Life of America Ins. Co., 470 F.2d at 5, and D'Ambrosio v. Pennsylvania Nat'l. Mut. Casualty Ins. Co., 262 Pa. Super. at _, 392 A.2d at 786).

45. *Id.* at _, 611 P.2d at 152.

46. *Shernoff, supra* note 11, §1.01 at 1-2. *See generally*: Craft v. Economy Fire & Casualty Co., 572 F.2d 565 (7th Cir. 1978)(Indiana law); Eckenrode v. Life of America Ins. Co., 470 F.2d 1 (7th Cir. 1972)(Illinois law); Phillips v. Aetna Life Ins. Co., 473 F. Supp. 984 (D. Vt. 1979)(Vermont law); Robertsen v. State Farm Mut. Auto Ins. Co., 464 F. Supp. 876 (D.S.C. 1979)(South Carolina law); Escambia Treating Co. v. Aetna Casualty & Sur. Co., 421 F. Supp. 1367 (N.D. Fla. 1976)(Florida law); Corwin Chrysler-Plymouth v. Westchester Fire, 279 N.W.2d 638 (N.D. 1979); Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 271 N.W.2d 368 (1978); Christian v. American Home Assurance Co., 577 P.2d 899 (Okla. 1978); MFA Mut. Ins. Co. v. Flint, 574 S.W.2d 718 (Tenn. 1978); Grand Sheet Metal v. Protection Mut. Ins., 34 Conn. Supp. 46, 375 A.2d 428 (1977); Diamon v. Pennsylvania Mut. Fire Ins. Co., 247 Pa. Super. 534, 372 A.2d 1218 (1977); Vernon Fire & Casualty Ins. Co. v. Sharp, 264 Ind. 599, 349 N.E.2d 173 (1976); United States Fidelity v. Peterson, 91 Nev. 617, 540 P.2d 1070 (1975); Ledingham v. Blue Cross, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976); United Servs. Auto. Ass'n v. Werley, 526 P.2d 28 (Alaska 1974); Amsden

been asserted that through the use of contemporary American tort law desirable social goals may be accomplished, to-wit — the imposition of a duty on insurers to deal fairly and in good faith with policyholders — providing an impetus to deter dilatory, unconscionable and unfair claims practices.[47]

C. *Arguments Against the First-Party Bad Faith Tort*

The following reasons are frequently cited for not adopting the first-party bad faith tort:

> 1. "The rationale behind a bad faith claim in a third-party situation is not applicable to first-party situations;"[48]
> 2. "The 'peace of mind' argument does not justify" the application of tort principles "in insurance cases because every contract is entered into for peace of mind;"[49]
> 3. The insurance industry is like any other commercial enterprise and is not "imbued with a public interest to justify the recognition of the bad faith tort;"[50]
> 4. Insurance contracts are not contracts of adhesion because they have the approval of both parties;[51]
> 5. Many states have statutory penalties against "companies which fail without good cause to settle claims with their insureds" and "these legislative remedies are exclusive, thus eliminating the need for other remedies;"[52]
> 6. "Traditional compensatory damages for breach of contract are adequate and the additional remedy of" the "bad faith tort is unnecessary;"[53] and
> 7. The torts of outrage, intentional infliction of emotional distress, fraud and the tort of bad faith provide "remedies for the same wrongs and they are in fact mixed concepts used somewhat interchangeably."[54]

Arguments opposing recognition of an independent bad faith tort action in first-party situations usually distinguish between first-party and third-party

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v. Grinnell Mut. Reinsurance Co., 203 N.W.2d 252 (Iowa 1972); Kirk v. Safeco Ins. Co., 273 N.E.2d 919 (Ohio 1970); and Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220 (Me. 1978).

47. *Shernoff*, *supra* note 11, § 1.01 at 1-2 to 1-3.

48. Spencer v. Aetna Life & Casualty Ins. Co., 227 Kan. at _, 611 P.2d at 153 (citing Farris v. United States Fidelity and Guar. Co., 284 Or. 453, 460, 587 P.2d 1015, 1022 (1980)). *See also* Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d at 635.

49. Spencer v. Aetna Life & Casualty Ins. Co., 227 Kan. at _, 611 P.2d at 153 (citing Farris v. United States Fidelity & Guar. Co., 284 Or. at _, 587 P.2d at 1022).

50. *Id.* at _, 611 P.2d at 153 (citing Farris v. United States Fidelity & Guar. Co., 284 Or. at _, 587 P.2d at 1022).

51. *Id.* at _, 611 P.2d at 153 (citing A.A.A. Pool Serv. & Supply, Inc. v. Aetna Casualty & Sur. Co., 121 R.I. 96, 395 A.2d 724, 726 (1978)).

52. *Id.* at _, 611 P.2d at 153.

53. *Id.* at _, 611 P.2d at 153.

54. *See, e.g.*, Lavoie v. Aetna Life & Cas. Co., Inc., 374 So. 2d 312 (Ala. 1979)(Jones, J., concurring).

situations, and stress the fact that in first-party claims, the insurer is not in a position to expose the insured to a judgment in excess of policy limits through its refusal to settle a claim, nor is the insurer in exclusive control of the defense.[55] Although an insurer must make a good faith attempt to settle claims,[56] the insured and insurer in a first-party relationship have an adversary relationship rather than a fiduciary relationship,[57] and indeed, the insurer "may require the insured to present adequate proof of loss before paying [a] claim."[58] As compelling an argument can be made that courts, including the Iowa Supreme Court,[59] which already recognize and have applied the tort of intentional infliction of emotional distress in first-party insurance cases, have eliminated any need for the bad faith tort remedy,[60] and/or that legislative adoption of the Model Insurance Act precludes recognition of the tort of bad faith.[61]

IV. Iowa Law

A. *Recognized Theories of Liability*

To date, Iowa recognizes two torts which may serve as the gravamen of a complaint involving breach of an insurance contract.[62] The first involves an insurer's bad faith representation of the insured against a third-party claim.[63] The second, which involves first-party claims, is the tort of intentional infliction of emotional distress.[64] The latter allows an insured to recover against its insurer for injuries resulting from "outrageous bullying tactics in settling claims,"[65] including an insurer's threat to withhold or actually withholding payments "maliciously and without probable cause . . . by depriving [the insured] of the benefits of the policy."[66] Although some courts have held that the tort of intentional infliction of emotional distress can coexist with the tort of first-party bad faith in an insured's action

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55. Wilson v. Colonial Penn. Life Ins. Co., 454 F. Supp. 1208 (D. Minn. 1978)(applying Minnesota law); A.A.A. Pool Serv. & Supply, Inc. v. Aetna Casualty & Sur. Co., 121 R.I. 96, 395 A.2d 724 (1978); Farris v. United States Fidelity and Guar. Co., 284 Or. 453, 587 P.2d 1014 (1978); Lawton v. Great Southwest Fire Ins. Co., 118 N.H. 607, 392 A.2d 576 (1978); Debold v. Mutual of Omaha, 56 Ill. App. 3d 111, 371 N.E.2d 373 (1978); Craig v. Iowa Kemper Mut. Ins. Co., 565 S.W.2d 716 (Mo. Ct. App. 1978)(suggesting only that Missouri law did not support bad faith tort); MacDonald v. Penn Mut. Life Ins. Co., 276 So. 2d 232 (Fla. Dist. Ct. App. 1973).

56. *See supra* notes 29-37 and accompanying text.

57. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d at 635.

58. *Id.*

59. *See* Amsden v. Grinnell Mut. Reinsurance Co., 203 N.W.2d 252 (Iowa 1972).

60. *See supra* notes 38-63 and accompanying text.

61. *See infra* notes 63-73 and accompanying text; *see also* Iowa Code § 507B (1985).

62. Higgins v. Blue Cross, 319 N.W.2d 232, 235 (Iowa 1982).

63. *Id.*

64. *Id.*

65. Amsden v. Grinnell Mut. Reinsurance Co., 203 N.W.2d 252, 254 (Iowa 1972).

66. *Id.*

against its insurer arising from the breach of the insurance contract,[67] the Iowa court has yet to address this issue.[68]

In addition, the Iowa Supreme Court has declined to recognize the right of a tort victim to bring a common law action against the tortfeasor's insurer for bad faith in settling the victim's claim.[69] But, in the recent case of *Loudon v. State Farm Mutual Auto Insurance Co.*,[70] the Iowa Court of Appeals affirmed an excess judgment in a bad faith action brought by a tort victim against the tortfeasor's insurer pursuant to an assignment to the victim by the tortfeasor of his bad faith claim against his insurer.[71] Thus, although a direct tort cause of action by an injured third-party against an insured's malfeasant insurer has been rejected in Iowa, *Loudon* suggests that an assignment to the injured third-party of an insured's bad faith claim against the insurer may provide a way to avoid such a prohibition.

B. *First-Party Bad Faith in Iowa*

The Iowa Supreme Court has yet to decide whether the tort of an insurer's bad faith refusal to pay a valid first-party claim will be recognized in Iowa. The court has determined, however, that the adopted Iowa version of the Model Insurance Act,[72] specifically the section prohibiting unfair claims practices, does not create a private cause of action in individuals when an insurer acts in bad faith in violation of the statute.[73] Not surprisingly, the court's indecision as to whether this tort should be recognized has resulted in at least four appeals on the issue in the past few years.[74] The remainder of this article examines recent Iowa decisions to see what, if any, light they shed on recognition of the first-party bad faith tort in Iowa.

In 1982, in the cases of *M-Z Enterprises, Inc. v. Hawkeye-Security Insurance Co.*,[75] and *Higgins v. Blue Cross of Western Iowa and South Dakota*,[76] the Iowa Supreme Court discussed the first-party bad faith tort in dicta, but found it unnecessary to answer the question of its endorsability due to what the court found to be insufficient evidentiary grounds.[77] The first-party tort action was pleaded in both cases, submitted to the juries in both cases, and in both cases the plaintiff-insureds were awarded punitive

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67. *See e.g.*, Fletcher v. Western Nat'l Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970).

68. *See infra* notes 73-107 and accompanying text.

69. Long v. McAllister, 319 N.W.2d 256, 261-62 (Iowa 1982).

70. 360 N.W.2d 575 (Iowa Ct. App. 1984).

71. *Id.*

72. *See supra* note 61. Iowa adopted the Model Act in IOWA CODE Chapter 507B (1985).

73. The Act specifically prohibits unfair claim practices in "not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims . . . ." *Id.*

74. *See infra* notes 75-106 and accompanying text.

75. 318 N.W.2d 408 (Iowa 1982).

76. 319 N.W.2d 232 (Iowa 1982).

77. *See* 318 N.W.2d at 414-15; 319 N.W.2d at 236.

damages.[78] The tort award was then appealed by the defendant-insurers.[79]

In neither opinion did the Iowa Supreme Court specifically endorse or specifically reject the tort.[80] Rather, its skeletal discussions of the tort in the two opinions were very similar and focused more upon what a plaintiff must show in Wisconsin to succeed on a bad faith claim than whether such a claim is cognizable as a cause of action in Iowa.[81] Accordingly, the court cited the Wisconsin two-prong test as determinative of first-party bad faith.[82] Under that test, a plaintiff must first "demonstrate the absence of a reasonable basis for the insurer's denial of policy benefits;" second, the plaintiff must demonstrate the "insurer's knowledge or reckless disregard of the lack of reasonable basis for denying the claim."[83] Applying this test to the facts of both cases, the court determined that, because the plaintiffs' claims had been "fairly debatable"[84] in both instances, neither plaintiff could meet the first of the two tests: namely, showing the absence of a reasonable basis for denying insurance benefits.[85] The court concluded in both cases, therefore, that it was improper to instruct the juries on the first-party bad faith tort as a matter of law, notwithstanding the fact that the court was applying Wisconsin and not Iowa law.[86]

A year later, in the case of *Brown Township Mutual Insurance Association v. Kress*,[87] the Iowa Supreme Court stated that it had "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," citing *M-Z Enterprises* and *Higgins*.[88] In *Kress*, a fire insurer sought declaratory relief to define its policy liability to its insured.[89] The insured counterclaimed for additional amounts allegedly due under the policy, and for consequential and punitive damages and attorneys' fees.[90] The district court ruled in favor of the insured on the coverage issue, but denied the additional claims for consequential and punitive damages and attorneys' fees.[91]

On appeal, the insured argued that he was entitled to these additional claims on account of the insurer's refusal and delay in paying his claim. The insured asserted that he was entitled to additional damages for: "(1) current

78. *See* 318 N.W.2d at 410; 319 N.W.2d at 233.
79. *See* 318 N.W.2d at 410; 319 N.W.2d at 233.
80. *See* 318 N.W.2d at 414-15; 319 N.W.2d at 236.
81. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
82. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
83. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
84. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
85. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
86. *See* 318 N.W.2d at 415; 319 N.W.2d at 236.
87. 330 N.W.2d 291 (Iowa 1983).
88. *Id.* at 298.
89. *Id.* at 292.
90. *Id.* at 293.
91. *Id.*

replacement costs of personal property, (2) loss of other personal property and also real estate, (3) loss of business fees, (4) attorneys' fees for defending this declaratory judgment action, and (5) punitive damages on account of bad faith."[92] Thus, the issue was whether the insurer "was liable for damages incurred as a result of its refusal to pay the claim and to do so promptly."[93] In refusing to award punitive damages, the Iowa Supreme Court noted that this case did not involve a third-party claim and that the court has previously and consistently "declined to recognize a separate tort action based on allegations of an insurer's bad faith failure to settle a claim with its insured."[94] In failing to find an independent tort action in this case, the Supreme Court had to decide the issue of damages on the breach of insurance contract action.

Although noting that other jurisdictions allow consequential and punitive damages for an insurer's willful failure to pay claims, the Iowa Supreme Court nonetheless applied "the general measure of damages in an action for breach of a contract to pay a sum of money," and limited the insured's recovery for such breach to the amount due under the policy plus interest.[95]

Finally, in *Pirkl v. Northwestern Mutual Insurance Association*,[96] the Iowa Supreme Court conceded the need to clarify whether it recognizes the first-party bad faith tort:fcqa]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.[97]

Instead of clarifying the matter, the court confused it. In retracting its statement in *Kress* rejecting the first-party bad faith tort,[98] and by releasing its previous reliance on Wisconsin law[99] in the *M-Z* and *Higgins* cases,[100] the court secured its indecisive stance:

> If the issue were simply a theoretical one of whether the nature of this type of claim is one which should properly 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 casu-

92. *Id.* at 298.
93. *Id.*
94. *Id.*
95. *Id.* at 298-300.
96. 348 N.W.2d 633 (Iowa 1984).
97. *Id.* at 635.
98. Brown v. Township Mut. Ins. Ass'n v. Kress, 330 N.W.2d at 298.
99. 318 N.W.2d at 415.
100. 319 N.W.2d at 436.

alty loss claim by an insurer for other than legitimate reasons.[101]

In *Pirkl*, sixty-nine feeder pigs had been stolen from the insured's farm, and he had filed a claim against his insurer for indemnification.[102] The insurer denied the claim since there was no "substantial proof" that the loss was due to theft.[103] The insured then filed an action for compensatory and punitive damages for the insurer's bad faith failure to honor the claim.[104] The jury awarded both compensatory and punitive damages, but the district court granted the insurer's motion for judgment notwithstanding the verdict as to the punitive damage award while upholding only the award of compensatory damages.[105] Both parties appealed.

In finding that the facts in *Pirkl* did not support a finding of "positive misconduct of a malicious, illegal or immoral nature," and that "not all acts constituting bad faith will support an award of punitive damages," the Iowa Supreme Court affirmed the district court's denial of the punitive damage award and hence, the bad faith claim as well.[106] In dicta, however, the court noted there were instances which would support a claim for punitive damages in addition to recovery of a loss which should have been paid under an insurance policy, and that "the nature of the [defendant's] conduct is more significant than the legal label attached to the conduct."[107]

Although the court could have denied the insurer's first-party bad faith tort on the basis that it was "fairly debatable," as it had done in *Kress*, *M-Z* and *Higgins*, it decided instead to retreat from that analysis and focus for the first time on the distinctions between insurer and insured in first-party and third-party claims.[108] Given this recognition of the diverse duties of an insurer in first-party and third-party claims, the court needed only to state that under both situations bad faith is intolerable and actionable, or, that because of these recognized differences, first-party and third-party claims should be treated separately. The court's failure to avail itself of the opportunity presented in *Pirkl* to clearly decide the issue can only perpetuate further appeals of first-party bad faith claims in order to bring this issue back to the court. In addition, the next petitioner will undoubtedly urge the court to clarify the *Pirkl* clarification.

V. Conclusion

As the Iowa insurance industry grows, so grow Iowans' demands for good faith and fair dealing in first-party insurance claims. Likewise, as the

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101. Pirkl v. Northwestern Mut. Ins. Ass'n, 348 N.W.2d at 636.
102. *Id.* at 633-34.
103. *Id.* at 634.
104. *Id.*
105. *Id.*
106. *See id.* at 634-36.
107. *Id.* at 636.
108. *See id.* at 635.

Iowa Supreme Court's indecision in this area continues, so continues the debate over recognition of the first-party bad faith tort.

Perhaps the recognition of this tort is not an insured's only protection against "outrageous bullying tactics" by an insurer's bad faith failure to pay a valid first-party claim; as *Pirkl* acknowledges, there are "instances that will support a claim for punitive damages" in such situations. Without further clarification, however, of what circumstances will justify such an award, the first-party bad faith tort remains the best protection of the insured in a first-party claim. Indeed, the issue is not simply a theoretical one and it demands more than the court's inclinations to achieve final resolution, and finally put an end to the war.