A JURISPRUDENTIAL SURVEY OF BAD FAITH CLAIMS IN THE WORKERS' COMPENSATION CONTEXT AND A CALL FOR A UNIFIED STATUTORY REMEDY

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The article advocates for an exclusive unified remedial approach to insurer bad faith claims in the worker's compensation context as opposed to a mixed statutory and common law approach. The article considers the various jurisprudential positions on common law bad faith causes of action. The article then details the legislative response to the bad-faith cause of action, with a focus on legislation designed to make the Worker's Compensation Act the exclusive remedy for bad faith misconduct by insurers. The judicial response to this legislation is also highlighted. The article then focuses on legislative attempts to impose penalties on insurers as a deterrent to insurer misconduct. Lastly, the article proposes in detail a unified approach utilizing an administrative adjudicatory system that benefits from knowledgeable and experience triers of fact. The article proposes keeping the current statutory framework in place but with an escalating scale of penalties for insurer misconduct that would be coupled with a requirement that insurers keep records of complaints filed against them, as well as penalties assessed against them, for improper claims handling. The penalties would then be escalated according to an insurer's penalty experience rating.

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The issue of whether a specific Workers' Compensation Act precludes common-law tort actions for an insurer's bad faith conduct in mishandling a claim for benefits has arisen in many American

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jurisdictions.[1] The issue has been resolved in different ways; the results depend upon the particular facts alleged, the elements of the tort of common-law bad faith within the jurisdiction, and the exclusivity and penalty provisions of the relevant Workers' Compensation Act. The courts are almost equally divided on this issue. There has been minimal scholarly commentary analyzing the competing legal viewpoints which populate the debate regarding the proper forum for resolving unfair claim handling committed in the workers' compensation context.

A large number of courts have held that common-law bad faith actions are barred by the exclusivity provisions[2] of a particular Workers' Compensation Act.[3] Still other courts have recognized actions for conduct

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[1] One court has observed that the tort of workers' compensation bad faith arises when an insurance company or a self-insured employer intentionally fails to process or pay a claim without a reasonable basis for such action and the carrier either knows or it is being unreasonable or fails to conduct an investigation adequate to determine whether its conduct was reasonable. *See* Rowland v. Great States Ins. Co., 20 P.3d 1158, 1166 n.5 (Ariz. Ct. App. 2001).

[2] The exclusive remedy provisions of the Workers' Compensation Acts are designed to balance the interests of both employers and employees. On the one hand the employer assumes liability for "accidental" injuries to employees regardless of fault and, on the other hand, the employer is relieved of the possibility of large damage verdicts which may jeopardize the future of the employer's business. *See* Gunter v. Mersereau, 491 P.2d 1205, 1206-07 (Or. Ct. App. 1971) (motivating philosophy behind workmen's compensation acts is that loss arising from accidents in industry should be distributed between employer and consumer as cost of production); Woolsey v. Panhandle Refinery Co., 116 S.W.2d 675, 676 (Tex. 1938) (workers' compensation objective is to do away with issues of negligence, unavoidable accident, and contributory negligence, and to fix amount recoverable free from uncertainty). Generally, under the exclusivity provisions of the Act employees are not barred from bringing actions for intentional torts against their employer, but if the employee elects to pursue a claim under the Act the employee may waive his cause of action for the intentional tort. *See, e.g.*, Reed Tool Co. v. Copelin, 610 S.W.2d 736, 739 (Tex. 1980) (intentional tort action waived by proceeding under Act from injuries derived in course of employment); H.L. Hutton & Co. v. District Court of Kay County, 398 P.2d 530, 534 (Okla. 1965) (election of remedy waives other claims).

[3] *See, e.g.*, Garvin v. Shewbart, 442 So. 2d 80 (Ala. 1983) (provision for circuit court action provides remedy for negligent or bad faith failure to pay medical expenses); Stafford v. Westchester Fire Ins. Co. of New York, Inc., 526 P.2d 37 (Alaska 1974), *overruled by* Cooper v. Argonaut Ins. Cos., 556 P.2d 525 (Alaska 1976) (20 percent penalty for late payment of benefit installments provides

constituting bad faith although the tort was not characterized as such.[4] As an example, a plurality of jurisdictions that have precluded a bad faith cause of action have nevertheless recognized that certain other common-law tort actions, particularly actions for intentional infliction of emotional distress,[5] can be maintained against a workers' compensation insurer.[6]

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remedy for negligent or bad faith delay); Sandoval v. Salt River Project Agric. Impr. & Power Dist., 571 P.2d 706 (Ariz. Ct. App. 1977) (Act provides procedures in event of failure to provide benefits); Cervantes v. Great American Ins. Co., 140 Cal. App. 3d 763, 189 Cal. Rptr. 761 (1983) (10 percent penalty for unreasonable delay in payment is exclusive remedy for willful and intentional, as well as negligent delay); Old Republic Ins. Co. v. Whitworth, 442 So. 2d 1078 (Fla. Ct. App. 1983) (penalty and attorney fee provisions are exclusive remedies for bad faith); Robertson v. Travelers Ins. Co., 448 N.E.2d 866 (Ill. 1983) (50 percent penalty for unreasonable or vexatious delay remedies insurer's malicious deception or outrageous conduct); Harned v. Farmland Foods, Inc., 331 N.W.2d 98 (Iowa 1983) (statutory procedure for resolving dispute over treatment constitutes exclusive remedy); Hormann v. New Hampshire Ins. Co., 689 P.2d 837 (Kan. 1984) (8 percent interest when carrier refuses to pay without just cause or excuse is remedy for intentional refusals); Paradissis v. Royal Indem. Co., 507 S.W.2d 526 (Tex. 1974) (self-help and administrative procedures provide sole relief for insurer's negligence).

[4] *See, e.g.*, Martin v. Travelers Ins. Co., 497 F.2d 329 (1st Cir. 1974); Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220 (Me. 1978); Broaddus v. Ferndale Fastener Division, 269 N.W.2d 689 (Mich. Ct. App. 1978).

[5] The standard of proof for an intentional tort in the workers' compensation context can be very difficult to satisfy. As an example, a tort claim against a workers' compensation insurer alleging a bad faith failure to pay an insurance claim is barred by the exclusivity provisions of Alabama's Workers' Compensation Act. Stewart v. Matthews Indus., Inc., 644 So. 2d 915 (Ala. 1994) (citing ALA. CODE §§ 25-5-11, -52, -53 (1975); Farley v. CNA Ins. Co., 576 So. 2d 158 (Ala. 1991); *Garvin*, 442 So. 2d at 80; Oliver v. Liberty Mut. Ins. Co., 548 So. 2d 1025 (Ala. 1989); Nabors v. St. Paul Ins. Co., 489 So. 2d 573 (Ala. 1986); Moore v. Liberty Mut. Ins. Co., 468 So. 2d 122 (Ala. 1985); Waldon v. Hartford Ins. Group, 435 So. 2d 1271 (Ala. 1983). Although the Alabama Supreme Court has held that a claim alleging bad faith failure to pay an insurance claim –in the context of a workers' compensation claim –is barred by the exclusivity provisions of the Act, the court has also recognized that the tort of outrageous conduct or intentional infliction of emotional distress can occur in a workers' compensation setting. *See, e.g.*, *Farley*, 576 So. 2d at 158; *Garvin*, 442 So. 2d at 80. The Court in *Garvin v. Shewbart* observed:

> The [Workers' Compensation] Act is designed to compensate those who are injured on the job and provides immunity from common law suits for those employers and carriers who come within the Act. A suit seeking recovery under the tort of outrageous conduct does not seek compensation [or] medical benefits for the original on-the-job injury. The connection with the physical injury that gave rise to the original workmen's compensation claim is tenuous. *The conduct giving rise to the tort of outrageous conduct in the context of this kind of case can be more accurately characterized as mental assault than as failure to pay compensation or medical benefits even though it may arise in a failure to pay context.* Conduct constituting the tort of outrageous conduct cannot reasonably be considered to be within the scope of the Act. When the employer or carrier's conduct crosses the line between mere failure to pay and intent to cause severe emotional distress, the cloak of immunity is removed.

Garvin, 442 So. 2d at 83 (emphasis added).

Under Alabama law, the tort of outrageous conduct or intentional infliction of emotional distress involves "extreme and outrageous conduct" by one who "intentionally or recklessly causes severe emotional distress to another." American Road Service Co. v. Inmon, 394 So. 2d 361, 365 (Ala. 1980). In order to present a case of outrageous conduct, the plaintiff must show that the conduct was "so outrageous in character and so extreme in degree as to go beyond all possible bounds of decency, and to be regarded as atrocious and utterly intolerable in a civilized society." *Id.*; *see also* Bearden v. Equifax Services, 455 So. 2d 836 (Ala. 1984); Strickland v. Birmingham Bldg. & Remodeling, 449 So. 2d 1242 (Ala. 1984); Cates v. Taylor, 428 So. 2d 637 (Ala. 1983).

The severe emotional distress required for the tort of outrage requires the following:

> The emotional distress . . . must be so severe that no reasonable person could be expected to endure it. Any recovery must be reasonable and justified under the circumstances, liability ensuing only when the conduct is extreme. By extreme we refer to conduct so outrageous in character and so extreme in degree as to go beyond all possible bounds of decency, and to be regarded as atrocious and utterly intolerable in a civilized society.

Am. Road Serv. Co., 394 So. 2d at 365 (citations omitted).

Some courts recognize tort actions for bad faith outside of the relevant Workers Compensation Act.[7] Other jurisdictions have held that statutory penalty provisions, although available, do not constitute exclusive remedies for insurer bad faith.[8]

This article will explore the utility of a modified statutory approach to unfair claim handling practices in the workers' compensation context. Part I of the article surveys the competing jurisprudential viewpoints on whether to allow a common-law bad faith cause of action. The debate among these courts center upon the legislative intent regarding the scope of a particular Workers' Compensation Act exclusivity provision. A small number of courts have straddled the issue and determined that their state's Workers' Compensation Act provided only partial immunity through exclusivity for most routine delays in payment of compensation benefits alleged to have been withheld in bad faith while permitting a common law bad faith tort action where egregious and willful misconduct is involved. A few courts have adopted a breach of contract theory regarding bad faith misconduct in the workers' compensation context. Each of these competing theories is surveyed in Part I.

Part II of the article briefly discusses legislative intervention following judicial recognition of a common-law bad faith tort action. Legislative intervention, overturning the judicial recognition of the tort, has met with mixed success.

Part III of the article discusses statutory penalties and deterrents. There is wide variation of severity and scope in state workers'

The outrageous conduct must be established by clear and convincing evidence. *Farley*, 576 So. 2d 158.

[6] *See Garvin*, 442 So. 2d at 80; *Stafford*, 526 P.2d at 37*; Sandoval*, 571 P.2d at 706 (tortious conduct as breaking and entering not immunized); Unruh v. Truck Ins. Exch., 498 P.2d 1063 (Cal. 1972); Sullivan v. Liberty Mut. Ins. Co.*,* 367 So. 2d 658 (Fla. Dist. Ct. App. 1979) (statute provides exceptions for intentional assault and automobile accidents); Robertson v. Travelers Ins. Co., 448 N.E.2d 866 (Ill. 1983) (penalty might not be exclusive remedy in Unruh-like facts); Paradissis v. Royal Indem. Co., 507 S.W.2d 526 (Tex. 1974) (willful torts such as fraud or outrageous conduct not within exclusivity bar of Texas Act).

[7] *See, e.g.*, Hollman v. Liberty Mut. Ins. Co., 712 F.2d 1259 (8th Cir. 1983) (under South Dakota law); Hayes v. Aetna Fire Underwriters, 609 P.2d 257 (Mont. 1980); Coleman v. Am. Universal Ins. Co., 273 N.W.2d 220 (Wis. 1979).

[8] *See, e.g.*, Martin v. Travelers Ins. Co., 497 F.2d 329 (1st Cir. 1974) (20 percent penalty for late payment not exclusive remedy); Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220 (Me. 1978) (similar ruling).

compensation penalty statutory remedies. Courts have reached mixed conclusions on whether a particular state's penalty provision provides adequate deterrence to prevent insurer misconduct.

Part IV of the article analyzes the statutory unification of bad faith remedies through increased penalties and the maintenance of exclusivity. It is the thesis of this article that an exclusive unified remedial approach to insurer bad faith is preferable to a combination of statutory and common-law remedies. An effective unified remedial approach would utilize the administrative apparatus in current use which benefits from a knowledgeable trier of fact. The current statutory approach would be supplemented with a significant penalty system coupled with measures to require the annual record-keeping of penalty experience rating. Statistics regarding findings of misconduct could be used to assess greater penalties and would permit insurance company executives to understand the true cost of improper claim handling practices.

I. JURISDICTIONAL SURVEY ON WHETHER TO ALLOW OR REJECT COMMON-LAW BAD FAITH IN THE WORKERS' COMPENSATION CONTEXT.

Courts are almost evenly divided over the issue of whether a workers' compensation insurer may invoke the employer's immunity from suit in the workers' compensation context against charges that the insurer committed bad faith in its handling of an employee's compensation claim.[9] Set forth below are the four principle viewpoints on this issue.

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[9] The following courts held that the workers' compensation insurer is entitled to immunity: Alabama (*Stewart*, 644 So. 2d at 915; Oliver v. Liberty Mut. Ins. Co., 548 So. 2d 1025 (Ala. 1989)); Arkansas (Liberty Mut. Ins. Co. v. Coleman, 852 S.W.2d 816 (Ark. 1993); Johnson v. Houston Gen. Ins. Co., 536 S.W.2d 121 (Ark. 1976)); California (Goetz v. Aetna Cas. & Sur. Co., 710 F.2d 561 (9th Cir. 1983) (interpreting California law); Stoddard v. Western Employer's Ins. Co., 245 Cal. Rptr. 820 (Cal. Ct. App. 1988)); Connecticut (DeOliveira v. Liberty Mut. Ins. Co., 870 A.2d 1066 (Conn. 2005)); District of Columbia (Hall v. C&P Telephone Co., 793 F.2d 1354 (D.C. Cir. 1986), *reh'g denied*, 809 F.2d 924 (D.C. Cir. 1987)); Georgia (Bright v. Nimmo, 320 S.E.2d 365 (Ga. 1984); Aetna Cas. & Sur. Co. v. Davis, 320 S.E.2d 368, 370 (Ga. 1984)); Idaho (Van Tine v. Idaho State Ins. Fund, 889 P.2d 717 (Idaho 1994)); Illinois (Robertson v. Travelers Ins. Co., 448 N.E.2d 866 (Ill. 1983); Perfection Carpet, Inc. v. State Farm Fire and Cas. Co., 630 N.E.2d 1152 (Ill. App. Ct. 1994)); Indiana (Stump v. Commercial Union, 601 N.E.2d 327 (Ind. 1992); Borgman v. State Farm Ins. Co., 713 N.E.2d 851 (Ind. Ct. App.

1999)); Kentucky (Coker v. Daniel Const. Co., 664 F. Supp. 1079 (W.D. Ky. 1987), *aff'd*, 848 F.2d 189 (6th Cir. 1988); Zurich Ins. Co. v. Mitchell, 712 S.W.2d 340 (Ky. 1986); General Acc. Ins. Co. v. Blank, 873 S.W.2d 580 (Ky. Ct. App. 1993)); Louisiana (Bergeron v. North American Underwriters, Inc., 549 So. 2d 315 (La. 1989); Banes v. American Mut. Liab. Ins. Co., 544 So. 2d 700 (La. Ct. App. 1989)); Massachusetts (Kelly v. Raytheon, Inc., 563 N.E.2d 1372 (Mass. App. Ct. 1990); Boduch v. Aetna Life & Cas. Co., 528 N.E.2d 1182 (Mass. App. Ct. 1988)); Minnesota (Denisen v. Milwaukee Mut. Ins. Co., 360 N.W.2d 448 (Minn. Ct. App. 1985)); Missouri (Young v. U. S. Fid. & Guar. Co., 588 S.W.2d 46 (Mo. Ct. App. 1979)); Nebraska (Ihm v. Crawford & Co., 580 N.W.2d 115 (Neb. 1998)); New Mexico (Chavez v. Kennecott Copper Corp., 547 F.2d 541 (10th Cir. 1977); Cruz v. Liberty Mut. Ins. Co., 889 P.2d 1223 (N.M. 1995)); New York (Burlew v. Am. Mut. Ins. Co., 472 N.E.2d 682 (N.Y. 1984)); Pennsylvania (Winterberg v. Transp. Ins. Co., 72 F.3d 318 (3rd Cir. 1995); Fry v. Atl. States Ins. Co., 700 A.2d 974 (Pa. Super. Ct. 1997)); Rhode Island (Cianci v. Nationwide Ins. Co., 659 A.2d 662 (R.I. 1995)); South Carolina (Cook v. Mack's Transfer & Storage, 352 S.E.2d 296 (S.C. Ct. App. 1986)); Utah (Savage v. Educators Ins. Co., 908 P.2d 862 (Utah 1995); Gunderson v. May Dept. Stores Co., 955 P.2d 346 (Utah Ct. App. 1998)); Washington (Wolf v. Scott Wetzel Services, Inc., 782 P.2d 203 (Wash. 1989)).

The following courts allowed common-law bad faith claims against workers' compensation insurers: Arizona (Hayes v. Cont'l Ins. Co., 872 P.2d 668 (Ariz. 1994); Franks v. U. S. Fid. & Guar. Co., 718 P.2d 193 (Ariz. Ct. App. 1985)); Colorado (Travelers Ins. Co. v. Savio, 706 P.2d 1258 (Colo. 1985)); Connecticut (Carpentino v. Transport Ins. Co., 609 F. Supp. 556 (D. Conn. 1985), *but see DeOliveira*, 870 A.2d 1066 (where the court held that bad faith actions are not available, except under the intentional act exception to exclusivity)); Delaware (Correa v. Pa. Mfrs. Ass'n Ins. Co., 618 F. Supp. 915 (D. Del. 1985); Pierce v. Int'l Ins. Co. of Ill., 671 A.2d 1361 (Del. 1996)); Hawaii (Hough v. Pacific Ins. Co., Ltd., 927 P.2d 858 (Haw. 1996)); Iowa (Reedy v. White Consol. Indus., Inc., 503 N.W.2d 601 (Iowa 1993); Boylan v. American Motorists Ins. Co., 489 N.W.2d 742 (Iowa 1992), *reh'g denied*, (Oct. 23, 1992)); Minnesota (Kaluza v. Home Ins. Co., 403 N.W.2d 230 (Minn. 1987), *but see* Hastings v. Fireman's Fund Ins. Cos., 404 N.W.2d 374 (Minn. Ct. App. 1987)); Mississippi (S. Farm Bureau Cas. Ins. Co. v. Holland, 469 So. 2d 55 (Miss. 1984)); Montana (Brewington v. Employers Fire Ins. Co., 992 P.2d 237 (Mont. 1999); Spadaro v. Midland Claims Service, Inc., 740 P.2d 1105 (Mont. 1987); Birkenbuel v. Montana State Comp. Ins. Fund, 687 P.2d 700 (Mont. 1984)); Nevada (Falline v. GNLV Corp., 823 P.2d 888 (Nev. 1991)); North Carolina (Johnson v. First Union Corp., 496 S.E.2d 1 (N.C. Ct. App. 1998), *on reh'g*, 505 S.E.2d 808 (N.C. Ct. App. 1998)); Ohio (Balyint v. Ark. Best Freight System, Inc., 480 N.E.2d 417 (Ohio 1985)); Oklahoma (Sizemore v. Cont'l Cas. Co., 142 P.3d 47 (Okla. 2006)); South Dakota (*Hollman,* 712 F.2d 1259,

The following principles regarding liability for delayed payment can be gleaned from the decisions in those jurisdictions which have rejected a common-law tort of bad faith. First, without significant analysis, courts have found that their state's exclusive remedy statute forecloses a common-law bad faith tort. Second, a cause of action generally will not arise from delayed payment of a workers' compensation claim unless the insurer or self-insured employer has committed offenses greater than mere delay of payment. Third, the existence of a penalty for late payment of claims generally indicates that the legislature intended to expand a statute's exclusive remedy provision to bar bad faith claims arising from delayed payment.[10] Fourth, even where the statutory penalties do not adequately

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aff'd, 752 F.2d 311 (8th Cir. 1985)); Texas (Aranda v. Ins. Co. of North America, 748 S.W.2d 210 (Tex. 1988), *aff'd*, 833 S.W.2d 209 (Tex. Ct. App. 1992), *reh'g denied*, (June 18, 1992); Aetna Cas. and Sur. Co. v. Marshall, 724 S.W.2d 770 (Tex. 1987); Escajeda v. Cigna Ins. Co. of Texas, 934 S.W.2d 402 (Tex. Ct. App. 1996)); Wisconsin (*Coleman*, 273 N.W.2d 220; Messner v. Briggs & Stratton Corp., 353 N.W.2d 363 (Wis. Ct. App. 1984)).

[10] Some courts have concluded that the exclusivity principle is manifest through the penalty award provisions in the Workers' Compensation Act. *See, e.g.*, Cain v. Nat'l Union Life Ins. Co., 718 S.W.2d 444, 444 (Ark. 1986) (rejecting workers' compensation claim for late payment because statutes provide remedies for late payment); Hormann v. N. H. Ins. Co., 689 P.2d 837, 840 (Kan. 1984) (denying independent claim for tortious behavior because statute providing penalties provided exclusive remedy); *Kelly*, 563 N.E.2d at 1374-75 (dismissing claim for intentional and negligent infliction of emotional distress for failure to compensate because workers' compensation laws provided exclusive remedy of statutory penalties); Wood v. Union Elec. Co., 786 S.W.2d 613, 614 (Mo. Ct. App. 1990) (denying claim for recovery of work-related medical expenses because penalty provision provided exclusive remedy); Dunlevy v. Kemper Ins. Grp., 532 A.2d 754, 756 (N.J. Super. Ct. App. Div. 1987) (holding that penalty in statute for failure to pay compensation benefits provided sole remedy); *Messner*, 353 N.W.2d at 368 (dismissing claim for bad faith denial of workers' compensation because penalty provision provided exclusive remedy). *See also* Michael A. Rosenhouse, Annotation, *Tort Liability of Worker's Compensation Insurer for Wrongful Delay or Refusal to Make Payments Due*, 8 A.L.R. 4th 902 (1981).

In *Dunlevy*, the Court held that New Jersey's Workers' Compensation Act provided the exclusive remedy for an insurance company's intentional conduct in failing to provide benefits. The Court observed that the New Jersey Legislature recognized the need to impose sanctions when the party responsible for providing benefits unreasonably or negligently failed to do so. It provided the specific remedy of penalties in N.J. STAT. ANN. § 34:15-28.1. Had the New Jersey

compensate the employee for damages caused by late payments, the imposition of a penalty reveals a legislative intent to preempt common-law causes of action.[11]

One commentator has observed: "[w]hether one views the workers' compensation system as a well-oiled, humming engine of adequate

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lawmakers intended common-law redress also to be available for intentional conduct in failing to provide benefits, the Court found that the Legislature could have readily done so in the manner of N.J. STAT. ANN.§ 34:15-8. In essence, the Court found the specific nature of New Jersey's remedial legislation for failure of an employer to pay required benefits as its rationale for sustaining the exclusivity in face of common-law actions for redress.

In Flick v. PMA Ins. Co., 928 A.2d 54 (N.J. Super. App. Div. 2007), the Court reaffirmed its prior ruling that New Jersey's Workers' Compensation Act's exclusive remedy provisions foreclosed a common-law tort action for bad faith. The Court observed that the New Jersey Legislature specifically envisioned that there would be situations in which an employer or its insurance carrier would "unreasonably or negligently delay" providing compensation to an injured worker entitled to compensation benefits. N.J. STAT. ANN. § 34:15-28.1 imposes a 25% penalty on amounts due plus any reasonable legal fees incurred as a result of such delays or refusals.

[11] A few jurisdictions have allowed bad faith claims despite the existence of statutory penalties. In general, these jurisdictions have based their conclusions on two factors: the failure of the relevant statutes to identify specific penalties for bad faith or injurious delay of payment, and a failure to provide penalties to adequately compensate employees for the real harm suffered as a result of delayed payments. *See, e.g.*, *Gibson*, 387 A.2d at 220; *Aranda*, 748 S.W.2d at 210; *Coleman*, 273 N.W.2d at 220.

In *Travelers Ins. Co. v. Savio*, 706 P.2d 1258 (Colo. 1985), Travelers argued that the penalty provisions in the Workers' Compensation Act provided claimants with a remedy for an insurer's misconduct. *See* 3 COLO. REV. STAT. § 8-44-106 (1973). The Act provides that "[i]f any insurance carrier intentionally, knowingly, or willfully violates any of the provisions of articles 40 to 54 of this title, the commissioner of insurance, on the request of the director, shall suspend or revoke the license or authority of such carrier to do a compensation business in this state." *Id.* The Court noted that while such conduct on the part of the insurer was risky for any insurer to engage in, the statute did not provide any remedy for the individual injured thereby. *Savio*, 706 P.2d at 1266. Citing other penalty provisions, (*see* 3 COLO. REV. STAT. §§ 8-53-124, 8-53-126, 8-53-127, 8-53-129 (1973) (repealed by Laws 1990, H.B.90-1160, § 77, eff. July 1, 1990)), while they serve to deter conduct which violates the Workers' Compensation Act, the penalty statutes did not provide any direct remedy to employees who may claim injuries from the same conduct which is proscribed by the penalty provisions.

compensation, or a conglomerate of discordant parts meting out rough justice, the exclusivity principle, which mandates workers' compensation as the virtual sole means of compensation for work-related injuries, serves as the system's cornerstone."[12]

A. THE EXCLUSIVE REMEDY BAR

Some commentators have adopted an inflexible view of the exclusive remedy principle. These commentators hold that "the exclusive remedy principle mandates, which the compensation system holds, sway over all workers' compensation-related causes of action, whether they relate to the injury, or sound in tort or contract law."[13] This is reflected in Professor Larson's rejection of a bad faith tort in his renowned treatise:

> It seems clear that a compensation claimant cannot transform a simple delay in payments into an actionable tort by merely invoking the magic words "fraudulent, deceitful and intentional" or "intentional infliction of emotional distress" or "outrageous conduct." [sic] in his complaint. The temptation to shatter the exclusiveness principle by reaching for the tort weapon whenever there is a delay in payments or a termination of treatment is all too obvious, and awareness of this possibility has undoubtedly been one reason for the reluctance of courts to recognize this tort except in cases of egregious cruelty or venality.[14]

"The exclusivity principle is the great fence that seeks to enclose all work-related tort-like injuries. The overriding fear is that the exclusivity principle will begin to disintegrate, with each new application of judicial gloss forcing the law to 'become honeycombed with independent and conflicting rulings of the courts.'"[15] Were this to occur, the objective of the

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[12] Joel E. Fenton, *The Tort of Bad Faith in Iowa Workers' Compensation Law*, 45 DRAKE L. REV. 839, 847 (1997).

[13] *Id.* at 848.

[14] *Id.* at 848 (citing 6 ARTHUR LARSON, WORKERS' COMPENSATION LAW § 68.34(c), at 13-229 to 13-230 (1997)).

[15] Fenton, *supra* note 12, at 848 (citing Noe v. Travelers Ins. Co., 342 P.2d 976, 979 (Cal. Dist. Ct. App. 1959).

Legislature in enacting Workers' Compensation Acts and the whole pattern of workers' compensation could thereby be partially nullified.[16]

One California court has observed:

> In these days of ever shrinking judicial resources, the plaintiff's bar would be well advised to heed these rules [re exclusive jurisdiction of the WCAB] and to concentrate its energy on securing swift and simple compensation for the injured employee in the forum which has exclusive jurisdiction over the claims. Its continual efforts to make end-runs around the exclusivity provisions of the workers' compensation system would be more appropriately addressed to the Legislature . . . .[17]

The jurisprudence of Kentucky, Connecticut, Rhode Island, Louisiana, Pennsylvania and Massachusetts provide good examples of state jurisdictions where the courts have held that the exclusivity provisions of the state's Workers' Compensation Act bar a common-law tort of bad faith because the insurer is immunized.

Kentucky's exclusive remedy statute in the Workers' Compensation Act is set forth in KY. REV. STAT. § 342.690(1). The Kentucky exclusive remedy statute grants immunity for liability arising from common-law and statutory claims, meaning those claims which could not be pursued in the courts of the Kentucky Commonwealth.[18] The Kentucky Supreme Court has observed that the grant of exclusive immunity was part of the bargain provided by the Act whereby employers are made strictly liable to their employees for compensation for work-related injuries. The Kentucky Supreme Court has held that the statute continues by specifically extending the immunity to the employer's workers' compensation insurance carrier:

> The exemption from liability given an employer by this section shall also extend to such employer's carrier and to all employees, officers or directors of such employer or

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[16] Noe v. Travelers Ins. Co., 342 P.2d 976, 980 (Cal. Dist. Ct. App. 1959).

[17] Caplan v. Fireman's Fund Ins. Co., 220 Cal. Rptr. 549, 550 (Cal. Ct. App. 1985) (citing United States Borax & Chem. Corp. v. Superior Court, 213 Cal. Rptr. 155, 158 (Cal. Ct. App. 1985)).

[18] Ky. Emp'rs Mut. Ins. v. Coleman, 236 S.W.3d 9, 13 (Ky. 2007).

> carrier, provided that the exemption from liability given an employee, officer or director or an employer or carrier shall not apply in any case where the injury or death is proximately caused by the willful and unprovoked physical aggression of such employee, officer or director.[19]

The effect of KY. REV. STAT. § 342.690(1) is to shield a covered employer *and its insurer* from any other liability to a covered employee for damages arising out of a work-related injury.[20] The Kentucky courts have found that the immunity granted by the statute is "[e]xtensive, ranging from disputes over the payment of injuries of the employee to allegations of tortious conduct related to dealing with the workers' compensation claim itself."[21]

In *DeOliveira v. Liberty Mut. Ins. Co*., the Connecticut Supreme Court held that Connecticut would not recognize a common-law cause of

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[19] *Coleman*, 236 S.W.3d at 13.

[20] *Coleman*, 236 S.W.3d at 13 (emphasis added); Travelers Indem. Co. v. Reker, 100 S.W.3d 756, 760 (Ky. 2003). *See also* Zurich Ins. Co. v. Mitchell, 712 S.W.2d 340, 341 (Ky. 1986) ("[T]he Workers' Compensation Act provides an exclusive remedy and consequently bars an employee's tort action for separate damages due to the untimely payment of benefits."); *Reker*, S.W.3d at 759 (reaffirming this principle rejecting a civil lawsuit alleging bad faith in the workers' compensation context for a violation of Kentucky's Unfair Claims Settlement Practices Act, KY. REV. STAT. § 304.12-230, as being barred by the exclusive remedy provision of the workers' compensation statute); *Reker*, S.W.3d at 762 (reasoning that the Workers' Compensation Act provided administrative remedies for a delay in payment or failure to pay: "[T]he the statutory scheme of the Workers' Compensation Act . . . provides[s] civil remedies for an employee who is injured by an employer's 'bad faith' refusal to settle or to make payments when due.") (alteration in the original); KY. REV. STAT. § 342.040(1) (West 2008) (allowing for the imposition of interest at the rate of 18% upon an ALJ finding that a "[D]enial, delay, or termination in payment of income benefit was without reasonable foundation.").

[21] *Coleman*, 236 S.W.3d at 14; Gen. Acc. Ins. Co. v. Blank, 873 S.W.2d 580, 582-83 (Ky. Ct. App. 1993) (holding that the Act precludes suit against the carrier for alleged violation of the Consumer Protection Act and the UCSPA); Zurich Ins. Co. v. Mitchell, 712 S.W.2d 340, 341 (Ky. 1986) (holding that the Act precludes a civil action against the insurance carrier for failure to pay medical expenses under either a common law "bad faith" theory or under the tort of outrage theory); Brown Badgett, Inc. v. Calloway, 675 S.W.2d 389 (Ky. 1984).

action for bad faith handling of a workers' compensation claim.[22] Central to the Court's ruling was the conclusion that the statutory penalties within Connecticut's Workers' Compensation Act demonstrated a legislative intent to confine the available remedies to those provided by the relevant penalty statutes.

The Court began its analysis of the issue by addressing the exclusivity provision in Connecticut's Workers' Compensation Act.[23] Connecticut's Act provided a number of statutory penalties against insurers for improper delay in providing benefits.[24] The Legislature had vested in the Commission the jurisdiction to hear employee complaints and award interest, attorney's fees, and penalties for improper claim handling.[25] A $500 penalty for "undue" delay in adjusting a claim is provided for within the Connecticut Act, together with provisions for the awarding of attorney's fees and interest to the claimant if it was determined that the insurer unreasonably contested liability or delayed payment.[26] The Act also provided a 20% penalty when an insurer failed to make timely payments pursuant to an award or voluntary agreement.[27] The Court in *DeOliveira* found that the existence of the statutory penalty provisions revealed both a legislative awareness of the serious problems injured workers faced when insurers acted in bad faith, and a legislative solution to those problems "In other words, by providing remedies for such conduct, the legislature evinced its intention to bar a tort action for the same conduct proscribed and penalized under the act."[28] The Court found that a recognition of a bad faith cause of action would "usurp" the legislative function.[29] The Court noted that Connecticut's Workers' Compensation Act, which was carefully balanced between rights and remedies, limited but also guaranteed that benefits would be timely paid without regard to fault.

The Court in *DeOliveira* bolstered its legislative intent analysis by examining the Workers' Compensation Act's legislative history. The Court focused on legislative testimony between 1979 through 1993 (when the Act

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[22] DeOliveira v. Liberty Mut. Ins. Co., 870 A.2d 1066, 1070-71 (Conn. 2005).

[23] *Id.* at 1071 (citing CONN. GEN. STAT. ANN. § 31-284(a) (West 1961)).

[24] CONN. GEN. STAT. ANN. §§ 31-288(b), 31-295 (West 1961).

[25] CONN. GEN. STAT. ANN. § 31-300 (West 1961).

[26] *See* CONN. GEN. STAT. ANN. §§ 31-288(b), 31-295(c), 31-300 (West 1961).

[27] *DeOliveira*, 870 A.2d at 1072 (citing CONN. GEN. STAT. ANN. § 31-303 (West 1961)).

[28] *Id.* at 1073.

[29] *Id.* at 1074.

underwent major revisions) which described the "horrific circumstances" that resulted from bad faith claims handling as evidence that the legislature was fully aware of those type of problems and that the solution they fashioned through the adoption of various statutory penalty provisions was the legislature's response to the problem. The Court concluded that "[t]he legislature clearly was aware of the scope and nature of this problem and presumably crafted the remedies that it deemed fit."[30] Based upon this legislative history, the Court in *DeOliveira* found that bad faith claims handling was clearly a "[r]isk contemplated by the compensation bargain" and therefore fell within the Act's exclusive remedy provisions.[31] The Court also found that the various statutory penalties for undue or unreasonable delay were "[b]road enough to encompass the bad faith processing of a workers' compensation claim,[32] thus preempting a judicially created common-law cause of action.[33]

In *Cianci v. Nationwide Ins. Co.*,[34] the Supreme Court of Rhode Island held that the exclusivity provisions of Rhode Island's Worker's Compensation Act applied to any suit against an employer's workers' compensation insurer.[35] The Court held that the Worker's Compensation Act provided an efficient mechanism permitting employees and the insurer to resolve disputes relating to work-related injuries and medical payments in a timely manner.[36] An employee covered under the Act has no common-law right of action against the insurer because the Act expressly addressed such claims and thus immunized the insurer from liability.

Under Louisiana law, no civil common-law cause of action for an insurer's arbitrary refusal to pay medical expenses in an accident covered

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[30] *Id.* at 1073-74.

[31] *Id.* at 1076.

[32] *Id.* at 1077.

[33] *Contra* Boylan v. American Motorists Ins. Co., 489 N.W.2d 742, 744 (Iowa 1992) ("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 . . . ."). *See also id.* at 744 (referencing other Iowa Supreme Court decisions holding that statutory penalties did not exclude independent bad faith actions); Gibson v. ITT Hartford Ins. Co., 621 N.W.2d 388, 396-97 (Iowa 2001).

[34] Cianci v. Nationwide Ins. Co., 659 A.2d 662, 688 (R.I. 1995).

[35] *Contra* Lopes v. G.T.E. Products Corp., 560 A.2d 949, 951 (R.I. 1989) (holding that there was no intentional tort exception to the exclusivity provisions of the Act); Coakley v. Aetna Bridge Co., 572 A.2d 295, 296 (R.I. 1990) (holding the same).

[36] *Cianci*, 659 A.2d at 669.

by workers' compensation is allowed.[37] The sole remedy for arbitrary failure to pay workers' compensation benefits is the recovery of penalties and attorney's fees under LSA-R.S. § 23:1201.2.[38] The crucial inquiry is whether the insurer had an articulable and objective reason to deny benefits at the time it took action.[39] In order to reasonably controvert a claim, the insurer must have some valid reason or evidence upon which to base the denial of benefits.[40]

Under LSA-R.S. § 23:1032, an employee's exclusive remedy against his employer for injuries suffered in the course and scope of his employment lies within the Louisiana Workers' Compensation Act. The Louisiana courts have held that the exclusivity statute manifested the following legislative intent: "The rights and remedies herein granted . . . shall be exclusive of all other rights and remedies of such employee . . . against his employer[.]"[41] The statute provides an exception for employees injured as a result of an "intentional act" on the part of their employers.[42] In order to constitute an intentional act within the meaning of LSA-R.S. § 23:1032, the employer must have consciously desired the physical result of

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[37] Bergeron v. North Am. Underwriters, Inc., 549 So. 2d 315 (La. 1989).

[38] *Id.* at 315; *see also* LA. REV. STAT. ANN. § 23:1201(F) (1989) (stating that under Louisiana's workers' compensation statutes, penalties and attorney's fees are recoverable if the employer or insurer fails to commence payments of benefits timely or to pay continued installments or medical benefits timely, unless the claim is reasonably controverted); Jackson v. Wal-Mart Stores, Inc., 868 So. 2d 813, 820 (La. Ct. App. 2004) (holding Louisiana's penalty and attorney's fees statute is designed to discourage indifference and undesirable conduct by insurers and are essentially penal in nature); Cooper v. St. Tammany Parish School Bd., 862 So. 2d 1001, 1008-10 (La. Ct. App. 2003) (holding that although the Worker's Compensation Act is to be liberally construed under Louisiana law in regards to benefits, penal statutes generally are to be strictly construed in Louisiana).

[39] McLin v. Indus. Specialty Contractors, Inc., 851 So. 2d 1135, 1144 (La. 2003).

[40] Brown v. Texas-LA Cartage, 721 So. 2d 885, 890 (La. 1998).

[41] Banes v. Am. Mut. Liab. Ins. Co., 544 So. 2d 700, 704 (La. Ct. App. 1989).

[42] LA. REV. STAT. ANN. § 23:1032.A.(1)(a) (1995) (Louisiana's exclusivity statute). *But see* LA. REV. STAT. ANN. § 23:1032.B (1995) ("Nothing in this Chapter shall affect the liability of the employer, or any officer, director, stockholder, partner, or employee of such employer or principal to a fine or penalty under any other statue or the liability, civil or criminal, *resulting from an intentional act*." (emphasis added)).

his act or have known that that result was substantially certain to follow from his conduct.[43]

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[43] Yousufali v. Southland Corp., 467 So. 2d 191, 193 (La. Ct. App. 1985); Courtney v. BASF Wyandotte Corp., 385 So. 2d 391, 392-93 (La. Ct. App. 1980) (stating under Louisiana law, "intentional acts" is to be interpreted as the equivalent of intentional torts. Thus the only statutory exception to worker's compensation as a remedy is for intentional torts); *Banes*, 544 So. 2d at 705 (stating Louisiana courts have held that the Legislature has expressly concerned itself not only with assuring compensation to the injured workers, but with policing the procedures under which the claims are made and paid); *id.* at 705 (holding LSA-R.S. §§ 23:1201(E) and 23:1201.2 [now codified in LSA-R.S. § 23:1201 (F), (I), (J)] provide that penalties and attorney's fees are awarded to a claimant who is denied worker's compensation coverage when such denial is arbitrary, capricious and without probable cause) (alteration in the original); Mott v. River Parish Maint., Inc., 432 So. 2d 827, 832 (La. 1983) (holding a violation of the statutes alone are not per se an intentional act that would result in the employers tort liability even if injuries sustained by the employee because of the violation); Physicians and Surgeons Hosp. v. Leone, 399 So. 2d 806, 807-08 (La. Ct. App. 1981) (holding damages for emotional and mental anguish arising from an insurer's failure to pay an employee's medical benefits is covered by the exclusivity remedy of the Workers' Compensation Act penalties. Thus, a worker's compensation insurer of the employer is immune from a tort proceeding). *See also* LA. REV. STAT. ANN. § 23:1032.B (1995) (Louisiana's exclusivity statute permitting a civil cause of action for civil or criminal intentional acts). In *Boudoin v. Bradley*, 549 So. 2d 1265 (La. Ct. App. 1989), the Court considered whether an employee could maintain an action in tort for intentional infliction of emotion distress against the employer's workers' compensation insurer. It was alleged that the employee's benefits were termination by the insurer in order to place the employee in a position of having to financially accept the insurer's settlement offer even though the offer was unreasonably low. The Court found that to recover damages for the intentional infliction of mental distress, the employee was required to prove that the insurer damages for the intentional infliction of mental distress, the employer was required to prove that the insurer either actively desired to bring about mental anguish or realized to a virtual certainty that it would occur. The Court noted that recovery in such cases had generally been limited to instances of outrageous conduct. Steadman v. South Central Bell Tel. Co., 362 So. 2d 1144, 1145-46 (La. Ct. App. 1978). By "outrageous" it is meant conduct "so extreme in degree, as to go beyond all possible bounds of decency, and to be regarded as atrocious, and utterly intolerable in a civilized community." Having recognized this standard, the Court in *Boudoin* noted that the Workers' Compensation Act provisions for penalties and attorney's fees were part of the legislative compromise which governed the rights of employees and employers in work-related accidents.

In *Kuney v. PMA Ins. Co.*, the Pennsylvania Supreme Court addressed a claim for damages arising from an insurer's bad faith failure to pay workers' compensation benefits.[44] The Court utilized the following rationale to hold that Pennsylvania's Workers' Compensation Act provided the claimant's sole remedy:

> Reduced to its essence, the appellee's claim is that the insurance company wrongfully delayed his receipt of compensation benefits. This is clearly a matter pertaining to a workers' compensation claim and must therefore be adjudicated within the framework of the statute, which, as

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To allow recovery in tort against a compensation insurer under a standard less than that articulated by the Louisiana Court in *Steadman* would upset the balance struck by this compromise by permitting tort damages where the legislature has determined that an administrative penalty is the plaintiff's appropriate remedy. *Boudoin*, 549 So. 2d at 1267. The Court in *Boudoin* cited with approval Professor Larson's treatise on workers' compensation law:

> It seems clear that a compensation claimant cannot transform a simple delay in payments into an actionable tort by merely invoking the magical words "'fraudulent, deceitful and intentional" or "intentional infliction of emotional distress" or "outrageous" conduct in his complaint. The temptation to shatter the exclusiveness principle by reaching for the tort weapon whenever there is a delay in payments or a termination of treatment is all too obvious, and awareness of this possibility has undoubtedly been one reason for the reluctance of courts to recognize this tort *except in cases of egregious cruelty or venality*.
>
> One final factor may be noted that has figured in many of these cases: *the presence in the statute of an administrative penalty for the very conduct on which the tort suit is based*. A majority of the courts have taken the view that this evidences a legislative intent that the remedy for delay in payments, even vexatious delay, shall remain in the system in the form of some kind of penalty.

Id. at 1268 (emphasis added) (citing 2A LARSON, WORKMEN'S COMPENSATION LAW § 68.34(c) (1987), at 13-145).

[44] Kuney v. PMA Ins. Co., 578 A.2d 1285, 1286-87 (Pa. 1990).

> stated above, has specific remedies for such a grievance. . . . It is fruitless to argue that the appellee has nevertheless failed to receive full indemnification for the injury he suffered through the insurance company's allegedly fraudulent handling of his claim. Benefits payable under the Workmen's Compensation Act are normally the limit of a worker's recovery even though compensatory damages in a tort action might be much higher. . . . We have long recognized that the adequacy of [workers'] compensation [awards] is solely a matter for the legislature.[45]

Similarly, in *Kelly v. Raytheon, Inc.*, the insurer refused to pay a workers' compensation award until the trial court issued a contempt order.[46] The Massachusetts Court of Appeals held that, however egregious the insurer's delay of payment, its obvious bad faith "adds nothing of substance to the claim that the delay was not justified."[47] Thus, the Court reasoned that: "the exclusivity provisions of [the Massachusetts workers' compensation statute], in conjunction with the . . . penalties for delayed payments, reveal a legislative intent that the remedies [for delayed payment] should remain within the system and should be exclusive of all other common law and statutory remedies. . . . [T]he touchstone of [this] claim is the delay in the payment of benefits, and . . . [even] the extraordinary duration and intensity of the dispute between the parties is inadequate to overcome the plain legislative scheme."[48]

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[45] *Id.* at 1287. In *Cook v. Mack's Transfer & Storage*, 352 S.E.2d 296, 299 (S.C. Ct. App. 1986), the Court observed: "The Act itself provides for speedy adjudication of all controversies over the processing of an injured worker's claim for benefits. If the dispute concerns an alleged wrongful denial of statutory benefits, the Commission has exclusive jurisdiction to adjudicate the controversy. Whether the denial is willful, in bad faith, negligent, or the result of a good faith difference is immaterial to the question of the Commission's exclusive jurisdiction." The Court in *Cook* held that because a remedy existed under South Carolina statute, the injured worker had no right to bring a common-law action in the courts.

[46] 563 N.E.2d 1372, 1373 (Mass. App. Ct. 1990).

[47] *Id.* at 1374.

[48] *Id.* at 1374-75.

B. COMMON-LAW BAD FAITH ALLOWED

A central viewpoint of those courts which have allowed a common-law tort of bad faith in the workers' compensation context is that a cause of action that reaches the status of an intentional tort is not within the purview of the exclusive remedy provisions of their state's Act because the exclusive remedy provisions are only designed to insulate the employer against common-law liability for the ordinary hazards of employment. A "bad faith" workers' compensation claim requires the insurer to indulge in intentional misconduct which places it outside the framework of a state's workers' compensation system. Thus, the insurance company, by its own conduct, abandons the defense that a claimant's exclusive remedies arise under the workers' compensation framework when the insurer commits bad faith.

A bad faith cause of action is a fault-based tort and does not arise under workers' compensation laws even when the state's workers' compensation framework provides the basic relationship between the parties for the action.[49] These courts have concluded that a bad faith claim does not arise under their state's workers' compensation law merely because an independent fault-based tort occurs in that context. The courts of Iowa, Hawaii and South Dakota provide examples of this approach.

In *Boylan v. American Motorists Ins. Co*., the Iowa Supreme Court recognized a bad faith cause of action by an employee against the insurance carrier in delaying or failing to pay compensation benefits.[50] The lawsuit brought by the employee alleged that American Motorists Insurance Company delayed and then terminated weekly wage and medical benefits in bad faith causing an aggravation of the employee's work-related injuries.[51] The trial court analogized the claim brought by the employee to third-party bad faith suits which Iowa courts did not recognize and, therefore, dismissed the claim.[52] However, the Iowa Supreme Court reversed. Referring to Iowa's Workers' Compensation Act, where penalties may be assessed when benefits are unreasonably delayed or denied, the Iowa Supreme Court declared that the Act mandated an obligation to furnish medical and hospital supplies to an injured employee as well as to

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[49] Spearman v. Exxon Coal USA, Inc., 16 F.3d 722, 725 (7th Cir. 1994).
[50] 489 N.W.2d 742, 742 (Iowa 1992).
[51] *Id.*
[52] *Id.*

provide temporary disability or healing period benefits.[53] The Court found that these statutory obligations ran from the insurance company to the employee directly making the employee's claim analogous to a first party bad faith lawsuit, which Iowa did recognize.[54] In so holding, the *Boylan* Court recognized that an implied contract existed between the workers' compensation insurer and the injured employee.[55]

The Court in *Boylan* disregarded the penalty provision under Iowa statute for the insurer's wrongful conduct in the administration of benefits.[56] The Court in *Boylan* concluded that it was "unlikely that the legislature intended the penalty provision in [IOWA CODE] section 86.13 to be the sole remedy for all types of wrongful conduct by carriers with respect to administration of workers' compensation benefits."[57] The Court reached this conclusion for the following reasons: (1) looking at the terms of the penalty provision, "it provides applies only to delay in commencement or termination of benefits;"[58] (2) the penalty provision did not contemplate the "willful or reckless acts" necessary for a bad faith cause of action, but only negligent conduct;[59] (3) the penalty provision did not provide a remedy "for delay or failure to pay medical benefits;"[60] and (4) other jurisdictions had held that a common-law bad faith action was not

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[53] *Id.* at 743.

[54] Iowa first recognized first party bad faith in *Dolan v. AID Ins. Co.,* 431 N.W.2d 790, 790 (Iowa 1988). However, in *Long v. McAllister*, 319 N.W.2d 256, 262 (Iowa 1982), the Iowa Supreme Court refused to recognize a bad faith cause of action permitting a third-party to recover against the tortfeasor's liability insurer for failing to settle a liability claim against the insured.

[55] 489 N.W.2d at 743. The *Dolan* Court also emphasized that a contractual relationship existed between the insurer and insured. 431 N.W.2d at 794. The insurer in *Dolan* was found to have a duty to act in the best interest of the insured because of its insurance contract with the insured. *Id.* Applying this duty to the facts of *Boylan*, the Supreme Court found that American Motorists Ins. Co., whose contract was with the employer, had a duty to act in good faith to the employee who was not a party to the insurance contract. 489 N.W.2d at 744.

[56] *See* IOWA CODE § 86.13 (1991); *Boylan,* 489 N.W.2d at 744.

[57] *Boylan,* 489 N.W.2d at 744.

[58] *Id.*

[59] *Id.*

[60] *Id.*

precluded by "[p]enalty provisions for mere delay in payment or improper termination of benefits."[61]

The Hawaii courts permit a cause of action for insurer bad faith in the workers' compensation context.[62] In *Hough v. Pacific Ins. Co., Ltd.,* the Court held "[b]y its plain language, HRS § 386-5, and indeed, the entire workers' compensation scheme, applies only to 'work injuries.'"[63] In *Hough* the plaintiff filed a claim for, *inter alia*, bad faith and intentional and negligent infliction of emotional distress against his previous employer's workers' compensation insurer for injuries allegedly incurred in the handling of his claim for benefits. The Court ruled that "[b]ecause Hough's common-law tort claims do not 'arise under' HRS Chapter 386, the director of labor and industrial relations does not have original jurisdiction under HRS § 386-73." [64] Additionally, the Court found that the relevant statutory language under Hawaii's Workers' Compensation Act did not reasonably envision emotional and physical suffering allegedly

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[61] *Id.* The *Boylan* Court's interpretation of legislative intent is questionable. The Court's reasoning that IOWA CODE § 86.13 applied only to delay in commencement or termination of benefits and not to delays at other times would appear to frustrate the purpose of § 86.13. Just as the Court concluded that "it [was] unlikely that the Legislature intended the penalty provision . . . to be the sole remedy" for delays in payment, it is equally unlikely that the Iowa Legislature intended to award penalties only for damages in commencement or termination of benefits. *Id.* There is no rational basis to make the distinction between the two types of payments and the court did not attempt to make such a distinction. The Court's conclusion that the penalty provision did not provide a remedy "for delay or failure to pay medical benefits" is also flawed because section 86.13 does apply to delay or termination of benefits inasmuch as it does not list specific benefits. *See* IOWA CODE § 86.13 (1991); *Boylan*, 489 N.W.2d at 744. Section 86.13 is broad enough to provide a penalty for all types of benefits allowable under the Workers' Compensation Act. Finally, the Court's reasoning that the penalty provision "contemplates negligent conduct rather than the willful or reckless acts" required for a bad faith action can be questioned. *Boylan*, 489 N.W.2d at 744. Certainly the fact that the Iowa Legislature adopted a penalty of "fifty percent of the amount of benefits that were unreasonably delayed or denied" was a substantial penalty to deter wrongful conduct. IOWA CODE § 86.13 (1991). Moreover, if the Iowa Legislature had intended to allow a common-law cause of action, the Legislature could have statutorily provided for a bad faith cause of action.

[62] Hough v. Pac. Ins. Co., Ltd., 927 P.2d 858, 869-70 (1996). Hawaii's exclusivity statute is HAW. REV. STAT. § 386-5 (1993).

[63] *Hough*, 927 P.2d at 865.

[64] *Id.* at 867.

caused by an insurer's outrageous and intentional denial of medical benefits and disability payments as an injury arising out of and in the course of employment.[65]

The South Dakota courts have recognized a cause of action for bad faith in the workers' compensation context. The South Dakota courts follow a two-prong test in cases of alleged bad faith failure to pay by a workers' compensation carrier:

> [F]or proof of bad faith, there must be an absence of a reasonable basis for denial of policy benefits and the knowledge or reckless disregard [of the lack] of a reasonable basis for denial, implicit in that test is our conclusion that the knowledge of the lack of a reasonable basis may be inferred and imputed to an insurance company where there is a reckless disregard of a lack of a reasonable basis for denial or a reckless indifference to facts or to proofs submitted by the insured.
>
> Under these tests of the tort of bad faith, an insurance company, however, may challenge claims which are fairly debatable and will be found liable only where it has intentionally denied (or failed to process or pay) a claim without a reasonable basis.[66]

In *Hein v. Acuity*, the South Dakota Supreme Court discussed the unique contours of a bad faith cause of action in the workers' compensation context:

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[65] *Id.* at 866. *See also* Catron v. Tokio Marine Mgmt., Inc., 978 P.2d 845, 849-50 (1999). Under Hawaii law, a bad faith cause of action against a workers' compensation insurer is originally cognizable in court and does not fall within the original jurisdiction of the director under HAW. REV. STAT. §386. Jou v. Nat'l Interstate Ins. Co. of Hawaii, 157 P.3d 561, 567 (Haw. Ct. App. 2007). A workers' compensation insurance carrier has a duty to act in good faith in dealing with workers' compensation claimants, and a breach of this duty gives rise to a cause of action in tort for insurer bad faith. Wittig v. Allianz, 145 P.3d 738, 743 (Haw. Ct. App. 2006); *See also Hough,* 927 P.2d at 869-70. A reasonableness standard governs bad faith claims in Hawaii. Best Place, Inc. v. Penn Am. Ins. Co., 920 P.2d 334, 347 (Haw. 1996).

[66] Walz v. Fireman's Fund Ins. Co., 556 N.W.2d 68, 70 (S.D. 1996) (citing Champion v. U.S. Fid. & Guar. Co., 399 N.W.2d 320, 324 (S.D. 1987)).

> Customarily, bad faith litigation can be classified as either first- or third-party bad faith. Third-party bad faith is traditionally based on principles of negligence and arises when an insurer wrongfully refuses to settle a case brought against its insured by a third-party. Third-party bad faith exists when an insurer breaches its duty to give equal consideration to the interests of its insured when making a decision to settle a case.
>
> First-party bad faith, on the other hand, is an intentional tort and typically occurs when an insurance company consciously engages in wrongdoing during its processing or paying of policy benefits to its insured. In these cases, the parties are adversaries, and therefore, an insurer is permitted to challenge claims that are fairly debatable. However, a frivolous or unfounded refusal to comply with a duty under an insurance contract constitutes bad faith.
>
> Wrongful conduct toward an employee claimant by the employer's insurer in a workers' compensation case does not fit the traditional definition of either first- or third-party bad faith. A bad faith claim related to workers' compensation is not based on an insurer's refusal to settle its own insured's suit as in third-party cases, but exists when an insurer breaches its duty to deal in good faith and fairly when processing a workers' compensation claim. And, unlike first-party bad faith, the claimant, not the insured employer, brings the action against the insurer. Nonetheless, it is within the first-party bad faith context that multiple jurisdictions, including South Dakota, recognize a bad faith cause of action based on an insurer's conduct in a workers' compensation case. . . .
>
> [T]here exists a key difference between bad faith in a workers' compensation action and bad faith in a traditional first-party insured-insurer relationship. In workers' compensation cases, the claimant is not the insured. In true first-party claims, there exists a contractual relationship, whereby the insurer has accepted a premium from its insured to provide coverage. Under those circumstances,

> we recognized . . . that bad faith can extend to situations beyond mere denial of policy benefits.
>
> Nonetheless, in a dispute between a workers' compensation claimant and the employer's insurer, no contractual relationship exists. . . . Bad faith arising out of workers' compensation proceedings does not have the necessary attribute of a traditional first-party bad faith claim, i.e., a contractual relationship.[67]

A bad faith action cannot proceed once the South Dakota Department of Labor has determined that the plaintiff was not entitled to benefits.[68] Thus, claimants must exhaust administrative remedies.

C. PARTIAL IMMUNITY

A few courts have found that their state's workers' compensation statutes grant immunity to insurers for routine bad faith delay claims but allow a common-law tort action where extreme misconduct is involved.[69] This approach has been utilized by the courts in Alaska[70] and Florida.[71] As an example, in *Stafford v. Westchester Fire Ins. Co. of New York, Inc.*, the Alaska Supreme Court held that ALASKA STAT. § 23.30.155 was enacted

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[67] Hein v. Acuity, 731 N.W.2d 231, 235-36 (S.D. 2007) (internal citations omitted).

[68] Zuke v. Presentation Sisters, Inc., 589 N.W.2d 925, 930 (S.D. 1999) (citing Jordan v. Union Ins. Co., 771 F. Supp. 1031 (D. S.D. 1991)).

[69] *See, e.g.*, McCutchen v. Liberty Mut. Ins. Co., 699 F. Supp. 701, 711 (N.D. Ind. 1988) (holding insurer's mockery of claimant while repeatedly refusing to pay psychiatric treatment claims rose to the level of a separate tort committed during claim settlement and was not barred by workers' compensation statute); Cont'l Cas. Ins. Co. v. McDonald, 567 So. 2d 1208, 1219 (Ala. 1990) (stating delay of payment cannot give rise to tort actions unless delay is "so outrageous in character and so extreme in degree as to go beyond all possible bounds of decency, and to be regarded as utterly intolerable in a civilized society"); Young v. Hartford Accident & Indem. Co., 492 A.2d 1270, 1279 (Md. 1985) (holding claimant's stated cause of action when she alleged insurance carrier forced her to submit to psychiatric exam for sole purpose of making her abandon her claim or commit suicide).

[70] Stafford v. Westchester Fire Ins. Co. of N.Y., 526 P.2d 37, 43-44 (Alaska 1974).

[71] Aguilera v. Inservices, Inc., 905 So. 2d 84, 95 (Fla. 2005).

by Alaska's Legislature to cover situations where the employer or insurer negligently, or willfully, failed to make timely compensation payments to claimants.[72] However, the Court held that ALASKA STAT. § 23.30.155, Alaska's penalty statute, was not intended to operate as the exclusive remedy for all intentional wrongdoings.[73] In those circumstances where there has been tortious conduct that goes beyond the bounds of untimely payments, the Court in *Stafford* held that exclusive immunity from suit provided by the Alaska Workers' Compensation Act is lost.[74]

The Court in *Stafford* observed that normally an insurer must investigate claims in order that the compensation scheme of payments for actual injuries will be properly administered. However, intentional torts committed in connection with the investigation of claims and payments thereof are not protected.[75] In *Stafford,* the claimant alleged that Westchester did more than delay in making benefit payments; claimant asserted that Westchester intentionally and maliciously misled him about his right to compensation and discouraged him from exercising his rights, resulting in emotional injury. The Court in *Stafford* held that these types of allegations, if proven, could form the basis of an independent bad faith tort action.

The Court in *Stafford* adopted the rationale of the California Supreme Court in *Unruh v. Truck Ins. Exch.*[76] The Alaska Supreme Court's observation of the *Unruh* decision was that the *Unruh* Court had reasoned that the insurer obtained immunity by being the alter ego of the employer, and that exclusive immunity was lost when the insurer exceeded its proper role in the process. The *Unruh* Court had concluded that the insurer's committing of intentional torts, placed the insurer outside the role of being the alter ego of the employer, and became a "person other than the

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[72] *Stafford*, 526 P.2d at 43.

[73] *Id.* ALASKA STAT. § 23.30.155(e) (1962) is one of several provisions in the Alaska Workers' Compensation Act that directly penalizes employers for failure to comply with the Act's requirements. The statute provides for a civil penalty up to $1,000 for failure to file reports. ALASKA STAT. § 23.50.155(e) (1962). Under ALASKA STAT. § 23.30.155(f) (1962), a 25% penalty on unpaid awards payable under the terms of an award. The Commission can also award attorney's fees to claimants. *See* ALASKA STAT. § 23.30.145 (1962). The employer faces felony liability for failure to pay compensation due. *See* ALASKA STAT. § 23.30.255 (1962).

[74] *Stafford*, 526 P.2d at 43.

[75] *Id.* at 43-44.

[76] *Id.* at 43 (adopting Unruh v. Truck Ins. Exch., 498 P.2d 1063 (Cal. 1972)).

employer" against whom the employee is entitled to bring a civil action for damages. The *Unruh* Court refused to allow tort recovery for negligent acts by the insurer reasoning that the system of workers' compensation would be subjected to a process of partial disintegration as a result. However, the *Unruh* Court found that permitting suits for intentional torts would subserve the laudable objectives of the compensation scheme, while encouraging the insurer to fulfill its proper role in that scheme.[77]

In *Aguilera v. Inservices, Inc.*, the Florida Court recognized that minor delays in payment, and conduct amounting to simple bad faith in claim handling procedures of the employee's compensation claim are protected by immunity.[78] The Court stated that mere delay of payments or simple bad faith in handling workers' compensation claims are not actionable torts, and that employees are not permitted to transform such simple delays into actionable torts cognizable by the courts.[79] However, where the conduct of the insurer goes beyond a simple claim of delay or termination of benefits and alleges harm caused subsequent to and distinct from the original workplace injury, the Court found that Florida's Workers' Compensation Act did not permit compensation insurance carriers to cloak themselves with blanket immunity in circumstances where the carrier has not merely breached the duty to timely pay benefits, or acted negligently, but has actually committed an intentional tort upon an employee. The Court stated:

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[77] *Id.* at 42-43 (citing Unruh v. Truck Ins. Exch., 498 P.2d 1063, 1073) (Cal. 1972)).

[78] Aguilera v. Inservices, Inc., 905 So. 2d 84, 91 (Fla. 2005).

[79] *Id. See also* Sheraton Key Largo v. Roca, 710 So. 2d 1016, 1017 (Fla. Dist. Ct. App. 1998) (stating an employee cannot avoid the exclusivity of the workers' compensation law and transform a mere delay in payments into an actionable tort simply by calling that delay outrageous, fraudulent, deceitful, or an intentional infliction of emotional distress); Assoc. Indus. of Fla. Prop. & Cas. Trust v. Smith, 633 So. 2d 543, 544 (Fla. Dist. Ct. App. 1994) ("Because Florida's compensation law contains mechanisms to insure timely payment and provides an array of sanctions which may be imposed when a carrier wrongfully withholds payment, the remedy under the act is exclusive."); Old Republic Ins. Co. v. Whitworth, 442 So. 2d 1078, 1079 (Fla. Dist. Ct. App. 1983) (determining that while the employee alleged a bad faith refusal to timely compensate him for his disabilities, the complaint did not allege that the insurance carrier intentionally harmed the employee).

> The workers' compensation system was never designed or structured to be used by employers or insurance carriers as a sword to strike out and cause harm to individual employees during the claim process and then provide a shield from responsibility for an employee's valid intentional tort claim for that conduct through immunity flowing under the law. Most certainly, the workers' compensation system was never intended to function as a substitute for an employee's right to seek relief in a common law intentional tort action against an employer or insurance carrier, but was only intended to provide employers and insurance carriers with immunity for negligent workplace conduct which produced workplace injury. Minor delays in payments, and conduct amounting to simple bad faith in claim handling procedures of the employee's compensation claim have been captured within the immunity.[80]

The Court in *Aguilera* held that an insurance carrier that utilizes the process of administering benefits to intentionally injure a worker is not afforded immunity.[81]

D. BREACH OF CONTRACT THEORY

The courts in Delaware[82] and Utah[83] have found that their state's Workers' Compensation Act did not bar a cause of action brought *in contract* against the claimant's workers' compensation insurer. As an example, in *Pierce v. Int'l Ins. Co. of Illinois*, the Delaware Supreme Court ruled that Delaware's Workers' Compensation Act did not bar a cause of action in contract brought by claimants against a workers' compensation insurance carrier alleging bad faith delay in payment of claims.[84] According to the Court in *Pierce*, the claimant is limited to contract remedies which include breach, consequential and punitive damages.[85]

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[80] *Aguilera*, 905 So. 2d at 91.
[81] *Id.* at 98.
[82] Pierce v. Int'l Ins. Co. of Ill., 671 A.2d 1361 (Del. 1996).
[83] Savage v. Educators Ins. Co., 908 P.2d 862 (Utah 1995).
[84] *Pierce*, 671 A.2d at 1362.
[85] *Id.* at 1367.

However, damages for emotional distress do not arise from the breach of the duty of good faith and fair dealing when the insurer allegedly acts in bad faith by delaying payment of claims.[86]

The Utah Supreme Court in *Savage v. Educators Ins. Co.* concluded that injured workers cannot pursue a tort action for bad faith.[87] This was predicated upon the jurisprudence of Utah which had previously held that a breach of the implied contractual covenant of good faith and fair dealing did not give rise to a tort claim because the claim was actionable only as a contractual breach.[88] Because injured claimants do not have a contractual relationship with the workers' compensation insurer, the Court in *Savage* held that no cause of action exists between the injured employee claimant and the workers' compensation insurer for breach of the covenant of good faith and fair dealing.[89] To support this conclusion, the Court in *Savage* recognized that a cause of action in favor of employees against an insurer for the manner in which it adjusted a workers' compensation claim was inconsistent with the workers' compensation scheme and, in fact,

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[86] *Id.*

[87] *Savage*, 908 P.2d 862, 866.

[88] *Id.*

[89] *Id.* The relationship between a workers' compensation insurer and an injured employee is different from the relationship between an insurance company and a normal third-party. However, some courts examining the relationship have concluded that it involves the same level of intimacy as does the relationship between an insurer and a first-party insured. *See, e.g.*, Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1272 (Colo. 1985) (holding that covered employee stands in the same position as an insured in a private insurance contract). The roots of this relationship are grounded in the purpose of workers' compensation statutes, which is to provide speedy, equitable relief to injured employees. *See* State Tax Comm'n v. Indus. Comm'n, 685 P.2d 1051, 1053 (Utah 1984). Under worker's compensation statutes, employees relinquish their common-law claims against their employers in return for the promise that employers and their workers' compensation insurers will fairly compensate them for injuries sustained in the course of employment. From the time of injury, employees in most areas rely on workers' compensation insurers for protection from the severe financial adversity associated with disabling injuries. This reliance, combined with the exclusive control workers' compensation insurers exercise over the processing of claims creates a considerable disparity in bargaining power. Thus, injured employees are particularly vulnerable to delaying tactics and other bad faith acts by workers' compensation insurers. *See* Scott Wetzel Servs., Inc. v. Johnson, 821 P.2d 804, 810 (Colo. 1991).

could do substantial harm to the workers' compensation system as a whole. The Court observed:

> [B]eyond the legalistic objection to appellant's position, we must point out that if delay in medical service attributable to a carrier could give rise to independent third party court actions, the system of workmen's compensation could be subjected to a process of partial disintegration. In the practical operation of the plan, minor delays in getting medical service, such as for a few days or even a few hours, caused by a carrier, could become the bases of independent suits, and these could be many and manifold indeed. The uniform 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.[90]

The Court in *Savage* observed that Utah's workers' compensation system contemplated situations where a claim for medical benefits was denied by a workers' compensation insurer.[91] Under the Workers' Compensation Act, an employee who disagreed with the denial of benefits could apply for a hearing with the Industrial Commission.[92] Therefore, the Court found that the workers' compensation system provided an efficient and definite remedy to employees who disagreed with the decision of a workers' compensation insurer.[93] The Court observed that both the Legislature and the Commission provided penalties to be imposed where an insurer or employer delayed payment without good cause.[94]

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[90] *Savage*, 908 P.2d at 867 (citing with approval the Florida Court of Appeals in Sullivan v. Liberty Mut. Ins. Co., 367 So. 2d 658, 660-61 (Fla. Dist. Ct. App. 1979)); *see also* Noe v. Travelers Ins. Co., 342 P.2d 976, 979-80 (Cal. Dist. Ct. App. 1959).

[91] *Savage*, 908 P.2d at 867.

[92] *Id.*

[93] *Id.*

[94] *Id.*

II. LEGISLATIVE INTERVENTION AFTER JUDICIAL RECOGNITION OF A COMMON-LAW BAD FAITH TORT.

In a few instances, the state legislatures have reacted to their state's judicial adoption of a common-law bad faith tort in the workers' compensation context by passing legislation to strengthen the exclusivity provision of the Workers' Compensation Act to include bad faith misconduct. These corrective legislative attempts have experienced mixed success.

The seminal case for extending bad faith tort responsibility to workers' compensation claimants is the Wisconsin Supreme Court's decision in *Coleman v. American Universal Ins. Co.*[95] The Wisconsin Supreme Court in *Coleman* reasoned that a bad faith action predicated upon the settlement practices of the workers' compensation insurer was an "independent" claim for injuries that was not covered by the Wisconsin Workers' Compensation Act.[96] The Court rejected the insurer's contention that the Workers' Compensation Act provided the claimant's sole remedy reasoning that the available compensation remedy is exclusive, "only if the injury falls within the coverage of the Act."[97] The injury asserted by Coleman, according to the Court, was "distinct in time and place" from the original industrial injury and, as such, it did not fall within the purview of Wisconsin's Workers' Compensation Act.[98] Therefore, the Court concluded, the exclusivity provision of the Act was not a bar to a claim grounded on tort principles. In finding that Coleman's injury was separate and distinct from the original injury suffered in the course of employment, and not merely an aggravation or extension of the original injury, the Court in *Coleman* quoted Professor Larson to illustrate its finding:

> It is true that but for the original injury the investigation would never have been undertaken and the second injury would not have occurred. But must we go on to say that the carrier acquires complete tort immunity ever after for anything its agents do to carry out their investigation? Suppose the agent had decided to burglarize the claimant's house to get needed evidence. Suppose claimant died of

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[95] Coleman v. Am. Universal Ins. Co., 273 N.W.2d 220, 221 (Wis. 1979).
[96] *Id.*
[97] *Id.* at 222.
[98] *Id.* at 223.

> fright on seeing the burglar. Is the compensation act the exclusive remedy, merely because the activity involved, which was the collecting of evidence, was in the mainstream of the agent's duties?
>
> Again, suppose a claimant has a compensable broken toe, and is being tailed by a photographer. Claimant sees him in the bushes, a scuffle ensues, and claimant receives a skull fracture as a result of a blow from the camera. Is this skull fracture nothing but an aggravation of the broken toe?[99]

The Court in *Coleman* focused upon the Compensation Act's penalty provision, finding that it did not foreclose an action for the tort of bad faith. The Court found that the penalty provision was designed to avoid litigation by promoting the automatic payment of benefits where there was no justification for delay.[100] In instances where the insurer inexcusably delayed payment due to its own mismanagement or deficient administration, the penalty provision was applicable.[101] However, the Court based its decision, allowing for a bad faith cause of action, on the public policy consideration of providing a remedy in instances where the penalty provision may be wholly inadequate.[102] "The inexcusable-delay provision . . . does not contemplate that the intentional tort of bad faith can be expiated merely by payments augmented in the amount of 10 percent."[103] Where insureds have been harmed to the extent that the remedies available in the penalty provision are inadequate, the insured can bring an action for the tort of bad faith.[104]

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[99] *Id.* at 223-24 (quoting 2A ARTHUR LARSON, WORKMEN'S COMPENSATION LAW, § 65.00, at 13-36 to 13-37 (1978)).

[100] *Coleman*, 273 N.W.2d at 224 (interpreting WIS. STAT. ANN. § 102.22(1) (West 1977) allowing for increase of compensation award of 10% as penalty for inexcusable delay of payments).

[101] *Id.*

[102] *Id.*

[103] *Id.*

[104] *Id.* (citing Martin v. Travelers Ins. Co., 497 F.2d 329, 331 (1st Cir. 1974) (federal Longshoremen's and Harbor Workers' Compensation Act does not prohibit separate tort action for insurer's bad faith conduct outside bounds of Act); Stafford v. Westchester Fire Ins. Co. of N.Y., 526 P.2d 37, 43 (Alaska 1974) (penalty provision of Alaska's Workers' Compensation Act no bar to recovery of intentional bad faith torts of insurer committed in processing worker's claim)).

The Wisconsin Legislature successfully overturned the *Coleman* decision in 1981 when it replaced the old penalty provision of the Workers' Compensation Act with a new penalty provision giving an exclusive remedy for an insurer's bad faith conduct.[105]

In *Stump v. Commercial Union,* 601 N.E.2d 327 (Ind. 1992), the Indiana Supreme Court permitted workers to sue workers' compensation insurers for bad faith.[106] The Court observed that Indiana's statutes granted a right to injured employees to assert actions for damages against persons other than the employer or a fellow employee.[107] The Indiana courts had consistently held the exclusive remedy provisions do not apply to bar the right of an employee to assert actions against third-parties.[108] Under Indiana law, the exclusive remedy provisions precluded separate actions for employee injuries only when the injury or death (a) occurred by accident, (b) arose out of employment, and (c) arose in the course of employment.[109] Actions for employee injuries or death not meeting each of these prerequisites were not excluded and could be pursued in the courts.[110] The Indiana courts observed:

> The relationship of the compensation insurance carrier to the employer should not afford it special immunity. Various entities may also be involved in assisting employers in fulfilling their obligations under the worker's compensation laws. Ambulance services, physicians, hospitals, pharmacies, medical device manufacturers, and others may participate in providing medical and rehabilitative care covered by worker's compensation. We find no adequate justification to absolve worker's compensation insurance carriers and other such third parties of their responsibilities in the event of additional

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[105] *See* WIS. STAT. ANN. § 102.18(3)(bp) (West Supp. 1984) (providing exclusive remedy for employers or insurers' bad faith conduct through lesser of 200% of compensation due or $15,000).

[106] Stump v. Commercial Union, 601 N.E.2d 327 (Ind. 1992).

[107] *Id.* at 330 (citing IND. CODE § 22-3-2-13 (1992)).

[108] Stump v. Commercial Union, 601 N.E.2d 327, 330 (Ind. 1992); Rosander v. Copco Steel & Eng'g Co., 429 N.E.2d 990, 991 (Ind. Ct. App. 1982).

[109] Evans v. Yankeetown Dock Corp., 491 N.E.2d 969, 973 (Ind. 1986).

[110] *Id.*

> injuries or harm proximately caused by their actionable conduct.[111]

After the *Stump* decision, the Indiana Legislature enacted IND. CODE § 22-3-4-12.1(a), the so-called bad faith statute, which became effective in July 1997. The statute provides as follows:

> The worker's compensation board, upon hearing a claim for benefits, has the exclusive jurisdiction to determine whether the employer, the employer's worker's compensation administrator, or the worker's compensation insurance carrier has acted with a lack of diligence, in bad faith, or has committed an independent tort in adjusting or settling the claim for compensation.[112]

Based upon the statutory language, the Compensation Board has exclusive jurisdiction in bad faith situations.[113]

In *Borgman v. State Farm Ins. Co.*, the constitutionality of Indiana's workers' compensation bad faith statute was challenged.[114] It was argued that the statute violated the "open courts" provision of the Indiana Constitution[115] because the statute improperly granted the Board authority to consider claims beyond work-related incidents.[116] The Court upheld the constitutionality of the statute finding that the Indiana Legislature, in enacting the bad faith statute, had merely acted to restrict the remedy available for a breach of duty imposed upon the worker's compensation insurance carrier.[117] Additionally, the Court in *Borgman* noted that the statute did nothing more than designate the proper forum for bringing the enumerated claims against the worker's compensation insurance carrier and did not operate to strip the Borgmans of an established right of recourse.

While the Wisconsin and Indiana Legislatures were successful in re-establishing exclusivity after their courts had permitted a common-law bad faith tort, the Arizona Legislature was unsuccessful. In two opinions

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[111] *Stump*, 601 N.E.2d at 331.
[112] IND. CODE ANN. §22-3-4-12.1(a) (West 2011).
[113] Borgman v. State Farm Ins. Co., 713 N.E.2d 851, 855 (Ind. Ct. App. 1999).
[114] *Id.*
[115] *Id.* at 855.
[116] *Id.*
[117] *Id.* at 856.

the Arizona Court of Appeals held that the exclusivity doctrine of Arizona's Workers' Compensation Act did not bar common-law actions for bad faith against workers' compensation carriers.[118] In response to these cases, the Arizona Legislature enacted ARIZ. REV. STAT. § 23-930 which provides in relevant part:

> A. The Commission has exclusive jurisdiction as prescribed in this section over complaints involving alleged unfair claim processing practices or bad faith by an employer, self-insured employer, insurance carrier or claims processing representative relating to any aspect of this chapter. The commission shall investigate allegations of unfair claim processing or bad faith either on receiving a complaint or on its own motion.
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> B. If the Commission finds that unfair claim processing or bad faith has occurred in the handling of a particular claim, it shall award the claimant, in addition to any benefits it finds are due and owing, a benefit penalty of twenty-five per cent of the benefit amount ordered to be paid or five hundred dollars, whichever is more.
>
> C. If the Commission finds that an employer, self-insured employer, insurance carrier or claim processing representative has a history or pattern of repeated unfair claim processing practices or bad faith, it may impose a civil penalty of up to one thousand dollars for each violation found. The civil penalty shall be deposited in the state general fund.

Under ARIZ. REV. STAT. § 23-930(E), the Commission was charged with adopting rules to define unfair claim processing practices and bad faith. In formulating those rules and definitions, the Commission was statutorily required to consider "among other factors, recognized and approved claim processing practices within the insurance industry, the Commission's own

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[118] Boy v. Fremont Indem. Co., 742 P.2d 835 (Ariz. Ct. App. 1987); Franks v. U.S. Fid. & Guar. Co., 718 P.2d 193 (Ariz. Ct. App. 1985).

experience in processing workers' compensation claims and the workers' compensation and insurance laws of [Arizona]."

In *Hayes v. Continental Ins. Co.*, the Arizona Supreme Court considered the Legislature's adoption of ARIZ. REV. STAT. § 23-930. The issue before the Court was whether the statute deprived the courts of jurisdiction over plaintiff's common-law action for bad faith. The Court in *Hayes* questioned whether the timing of the statute's adoption expressed a legislative intent to overrule the prior case law establishing a common-law tort of bad faith.[119] The Court noted that the penalties imposed by ARIZ. REV. STAT. § 23-930 were relatively modest. Although the penalty amount was not dispositive in itself to the Court's ruling, the Court observed that it could not say that the penalties were so flexible, and the administrative remedies so comprehensive, that the Legislature must have intended for them to provide the sole remedy for, or deterrent to, the serious abuses that the common-law addresses.[120] At the conclusion of its statutory analysis, the Court in *Hayes* concluded that ARIZ. REV. STAT. § 23-930 did not divest Arizona courts of jurisdiction over the common-law causes of action previously recognized by the courts.[121]

III. STATUTORY PENALTIES AND DETERRENCE.

Workers' compensation statutes often contemplate questionable denials of benefits and provide remedies to the injured employee by providing a forum for the resolution of those types of disputes and, in many

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[119] Hayes v. Cont'l Ins. Co., 872 P.2d 668, 672 (Ariz. 1994).

[120] *Hayes,* 872 P.2d at 675 (citing Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 216 (1994) (statutory scheme so comprehensive that it, along with statute's history, demonstrated legislative intent to preclude district court review of administrative orders); CETA Workers' Org. Comm. v. City of N.Y., 617 F.2d 926, 930-31 (2d Cir. 1980) (the statutes comprising the Comprehensive Employment and Training Act cannot be construed to authorize a private right of action for breach because "the totality of these provisions, comprehensive and well-crafted to the Act's administrative, institutional, and political exigencies, affirms the primacy and suggests the exclusivity of the [administrative] procedures . . . ."). *See also* Carpentino v. Transport Ins. Co., 609 F. Supp. 556, 561 (D. Conn. 1985) (relatively low penalties are an important factor in determining whether to allow common-law tort actions); Southern Farm Bureau Cas. Ins. Co. v. Holland, 469 So. 2d 55, 58 (Miss. 1985) (penalty provisions for workers' compensation bad faith inadequate to deter intentional carrier wrongdoing).

[121] *Hayes*, 872 P.2d at 678.

cases, contain penalty provisions designed to provide a remedy for unreasonable conduct on the part of the insurance company.[122] As an example, in Texas an insurer is subject to a 15% penalty if the insurer fails to pay benefits or file a notice of controversion within 20 days of receiving notice of the claim.[123] Additionally, a 12% penalty plus "reasonable attorney's fees for the prosecution and collection of the claim" may be imposed as a sanction against an insurer who fails to promptly pay the proceeds of a settlement.[124] In Alaska, an employer can be subjected to a civil penalty up to $1,000 for the failure to file reports[125] and can face a 20% penalty on unpaid awards payable under the terms of an award. The Workers' Compensation Commission can also award attorney's fees to claimants.[126] Significantly, an employer can face felony liability for failure to pay compensation due.[127]

In *Robertson v. Travelers Ins. Co.*[128] the Illinois Supreme Court held that the common-law tort of bad faith was barred by the exclusivity provisions of Illinois' Workers' Compensation Act. Central to the Court's finding was the observation that Section 19(k) of the Illinois Workers' Compensation Act provided for the payment of penalties of 50% of the amount of compensation payable whenever "there has been any unreasonable or vexatious delay of payment or intentional underpayment of compensation, or proceedings have been instituted or carried on by the one liable to pay the compensation, which . . . are merely frivolous or for delay."[129] The Court found that the statute was applicable not only to cases involving ordinary delay without justification, but also where the delay was malicious.[130] The Court held that a common-law action should not, without other evidence of legislative intent, be held to survive the Act's exclusivity

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[122] *See, e.g.*, Robertson v. Travelers Ins. Co., 448 N.E.2d 866, 870-72 (Ill. 1983) (claim for vexatious delay and alleged outrageous conduct held to be within the penalty provision of the Illinois Workers' Compensation Act and such remedy was exclusive).

[123] TEX. REV. CIV. STAT. ANN. art. 8306, § 18(a) (repealed by Acts 1989, 71st Leg., 2nd C.S., ch. 1, § 16.01(7) to (9), eff. Jan. 1, 1991).

[124] TEX. LAB. CODE ANN. § 410.208(d) (West 2005).

[125] ALASKA STAT. § 23.30.155(c).

[126] *See* ALASKA STAT. § 23.30.145.

[127] *See* ALASKA STAT. § 23.30.255.

[128] Robertson v. Travelers Ins. Co., 448 N.E.2d 866, 867 (Ill. 1983).

[129] ILL. REV. STAT.1973, ch. 48, par. 138.19(k).

[130] *Robertson*, 448 N.E.2d at 869.

provisions merely because the remedy provided in the Act for the injury alleged applies to other kinds of injuries as well.[131]

However, some jurisdictions have allowed bad faith claims despite the existence of statutory penalties. In general, these jurisdictions have based their conclusions on two factors: (1) the failure of the relevant statutes to identify specific penalties for bad faith or injurious delay of payment; and (2) a failure to provide penalties to adequately compensate employees for the real harm suffered as a result of delayed payments.[132] Examples of the former reasoning can be found in Iowa and Colorado. An example of the latter reasoning can be found in Arizona.

The Iowa and Colorado courts have permitted bad faith lawsuits because their state WCA statutes did not have penalty provisions specifically addressing bad faith. The Court in *Boylan v. American Motorists Ins. Co.* concluded that it was "unlikely that the legislature intended the penalty provision in [Iowa's WCA] to be the sole remedy for all types of wrongful conduct by carriers with respect to the administration of workers' compensation benefits."[133] The Court in *Boylan* observed that Iowa's penalty provisions only applied to delays in the commencement or termination of workers' compensation benefits[134] but did not address issues

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[131] *Id.* In Perfection Carpet, Inc. v. State Farm Fire & Cas. Co., 630 N.E.2d 1152, 1156 (Ill. App. Ct. 1994), the Court observed that the purpose of the Workers' Compensation Act was to provide financial protection to workers for accidental injuries arising out of and in the course of employment. Under Section 5(a) of Illinois' Workers' Compensation Act, workers do not have a common law or statutory right to recover damages from their employer for an injury sustained while in the line of duty other than the compensation provided in the Act. Illinois' Workers' Compensation Act also recognized that under certain circumstances additional compensation or penalties should be assessed against the insurance carrier. Section 19(k) provided penalties in the amount of 50% of the amount of compensation payable where "there has been any unreasonable or vexatious delay of payment or intentional underpayment of compensation." The Court noted that Section 19(l) provided additional compensation where "the employer or his insurance carrier shall without good and just cause fail, neglect, refuse or unreasonably delay the payment of weekly compensation benefits due to an injured employee during the period of temporary total disability." The Court reaffirmed the *Robertson* decision.

[132] *See, e.g.*, Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220, 220 (Me. 1978); Aranda v. Ins. Co. of North Am., 748 S.W.2d 210, 210 (Tex. 1988); Coleman v. Am. Universal Ins. Co., 273 N.W.2d 220, 220 (Wis. 1979).

[133] Boylan v. Am. Motorists Ins. Co., 489 N.W.2d 742, 744 (Iowa 1992).

[134] *Id.*

regarding compensation benefits themselves because there was no provision within the Iowa statute for penalty benefits for failing to provide appropriate medical care.[135] The Court in *Boylan* implicitly suggested that the penalty provisions were nothing more than some sort of administrative prod to dissuade insurance carriers from negligence in claims handling, but that the penalty statutes did not specifically contemplate willful, reckless, or otherwise egregious acts that the recognition of a tort of bad faith would be presumed to cover.[136] The Colorado Supreme Court in *Travelers Ins. Co. v. Savio*, observed that while the penalty provisions in Colorado's Workers' Compensation Act applied to conduct which violated the Act, the penalty statutes[137] did not provide any direct remedy to employees who may claim injuries from the same conduct which is proscribed by the penalty provisions. [138]

There is wide variation regarding the nature and extent of penalties provided by the various state Workers' Compensation Acts. Courts have reached differing conclusions as to whether penalty provisions provide adequate deterrence for insurer misconduct in the workers' compensation context. As an example, in Arizona, the courts have determined that the penalty statutes in Arizona's Workers' Compensation Act do not provide significant deterrence. In *Hayes v. Continental Ins. Co.*, the Arizona Supreme Court noted that the penalties imposed by the Workers' Compensation Act[139] were relatively modest.[140] In assessing the strength of

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[135] *Id.* (citing Klein v. Furnas Elec. Co., 384 N.W.2d 370, 375 (Iowa 1986)).

[136] *See* Michelle M. Lasswell, *Workers' Compensation – Employee's Allegations that Workers' Compensation Insurer Terminated His Benefits in Bad Faith Stated Bad Faith Tort Claim Against the Insurer – Boylan v. American Motorists Ins. Co.,* 489 N.W.2d 742 (Iowa 1992), 43 DRAKE L. REV. 477, 478 (1994); Fenton, *supra* note 12, at 850-51.

[137] *See* 3 COLO. REV. STAT. §§ 8-43-304, 8-43-305, 8-43-306, 8-43-401, 8-43-401.5 (2010).

[138] Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1276 (Colo. 1985).

[139] ARIZ. REV. STAT. § 23-930 (1987).

[140] Hayes v. Continental Ins. Co*.,* 178 Ariz. 872 P.2d 668, 675 (citing Thunder Basin Coal Co. v. Reich, 510 U.S. 200, 216 (1994) (statutory scheme so comprehensive that it, along with statute's history, demonstrated legislative intent to preclude district court review of administrative orders)); CETA Workers' Org. Comm. v. City of N.Y.*,* 617 F.2d 926, 930-31 (2d Cir. 1980) (the statutes comprising the Comprehensive Employment and Training Act cannot be construed to authorize a private right of action for breach because "the totality of these provisions, comprehensive and well-crafted to the Act's administrative,

the penalty provisions set forth in ARIZ. REV. STAT. § 23-930(B), the Court in *Hayes* noted:

> A.R.S. § 23-930(B) authorizes a penalty, payable to the claimant, of 25% of the amount wrongfully withheld or $500, whichever is greater. In addition, under section (C), if the Commission finds a pattern of abuse, it may impose a civil penalty of up to $1,000 for each violation, payable to a special fund rather than to the claimant. This penalty structure seems to discourage claimants from bringing bad faith claims if the amount in controversy is small because there is little chance of recovering enough money to pay an attorney. It is an equally weak deterrent to bad faith practices in larger cases because a 25% penalty can easily be absorbed by an insurer who selectively targets abusive practices to those cases likely to succeed. Moreover, even if an insurer faces the added penalty for a pattern of abuse, the penalty is only $1,000, regardless of the amount the insurer wrongfully withholds. Thus, in cases in which a $1,000 fine is small compared to the amount the insurer would stand to gain, the fixed fine provides little deterrent to unfair practices if the insurer selects only those cases in which the practices are most likely to succeed in preventing workers from pressing genuine claims. It is therefore questionable whether these penalties are adequate to discourage bad faith practices. This, of course, is not to say that the legislature could not have meant a relatively weak set of remedies to be the sole remedy for bad faith practices, but it more logically indicates the opposite intent.[141]

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institutional, and political exigencies, affirms the primacy and suggests the exclusivity of the [administrative] procedures . . . ."). *See also* Carpentino v. Transport Ins. Co., 609 F. Supp. 556, 561 (D. Conn. 1985) (relatively low penalties are an important factor in determining whether to allow common-law tort actions); Southern Farm Bureau Cas. Ins. Co. v. Holland, 469 So. 2d 55, 58 (Miss. 1985) (penalty provisions for workers' compensation bad faith inadequate to deter intentional carrier wrongdoing).

[141] *Hayes*, 872 P.2d at 676 n.14.

However, the New Mexico Supreme Court observed that New Mexico's Workers' Compensation Act penalty provisions provided sufficient deterrence to prevent an insurer from denying benefits in bad faith while enforcing the public policy against the bad faith handling of workers' compensation claims. In *Cruz v. Liberty Mut. Ins. Co.*, the New Mexico Supreme Court interpreted Section 52-1-28.1 and considered its effect on bad faith claims.[142] Specifically, the New Mexico Supreme Court considered the size of the award available to the worker. The Court stated:

> Further, Section 52-1-28.1 provides an adequate remedy. The purpose of the bad-faith action in the Act is to secure benefits for the employee and penalize the employer or insurer. Under Section 52-1-28.1, the employee receives all compensation for benefits due and owing and "shall receive" an extra "benefit penalty" of up to twenty-five percent of the claim. Section 52-1-28.1(B). Although this penalty may not be a great amount when the amount of the claim is small, it provides sufficient deterrence to prevent an insurer from denying benefits in bad faith and enforces the public policy against the bad-faith handling of workers' compensation claims. In addition, although this Section may not provide a recovery for emotional distress or an award of punitive damages, we previously have held that "the employer or insurer's liability is limited to that set forth in the Act."[143]

IV. UNIFYING REMEDIES FOR BAD FAITH THROUGH EXCLUSIVITY AND INCREASED PENALTIES.

Cogent legal analysis supports the competing views adopted by various courts in deciding whether to permit or disallow a common-law cause of action for insurance company bad faith in the workers' compensation context. Judicial reluctance to permit a common-law bad faith remedy as an exception to the exclusive remedy rule stems from a judicial unwillingness to tamper with what courts see as the fixed terms of the carefully designed legislative bargain underlying workers'

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[142] Cruz v. Liberty Mut. Ins. Co., 889 P.2d 1223, 1226 (N.M. 1995).
[143] *Id.*

compensation.[144] Courts taking this view regard the exclusive remedy rule as a reluctantly conceded bargaining chip essential to the original deal and, in turn, to the preservation of the compensation system.[145] Some of these courts perceive that their authority to modify the bargain is constrained and therefore they defer to legislatures for the enactment of any needed reforms.[146] Indeed there are sound policy reasons for denying such claims. As an example, the Court in *Noe v. Traveler's Ins. Co*. 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." [147] The Court observed "the uniform 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."[148]

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[144] The Workers' Compensation Acts shift from the employee to the employer the risk of work-related injuries incident to modern industrial activity. In return, they require the worker, as a condition for receiving the benefits of the Acts, to surrender his or her right to sue a common law. This balancing of advantages is embodied in the exclusive rights and remedies provision of the respective Act. The exclusive remedy provision typically bars all actions against an employer where a personal injury to an employee comes within the Act. The exclusive remedy provision makes the Act the exclusive means of settling all such claims. However, the amount of compensation available under the Act may be substantially less than could be recovered in a successful common-law action; but in other cases, the employee will receive benefits he would not otherwise have enjoyed because of his inability to establish the employer's common-law liability. This is the balance that was struck by the state legislatures in order to afford the widest practical coverage for work-related injuries.

The Workers' Compensation Act provides an exclusive remedy of compensation and derogation of common-law rights and is not cumulative or supplemental thereto but wholly substitutional. The compensation afforded by the Act is statutory in character, and the right of any claimant thereto is dependent upon the terms and conditions of the statute. These include the procedures for adjudicating a compensation claim as well as the terms and conditions of substantive entitlement.

[145] *See* Note, *Exceptions to the Exclusive Remedy Requirements of Workers' Compensation Statutes*, 96 HARV. L. REV. 1641, 1654 (1983).

[146] *Id.*

[147] Noe v. Travelers Ins. Co., 342 P.2d 976, 979 (Cal. Ct. App. 1959).

[148] *Id.* at 979-80.

One commentator has correctly observed that a bad faith cause of action "stems" from the same source as the original action – a compensable workers' compensation injury.[149] Certainly, a cause of action for bad faith arises out of the originating statutory proceedings. "[T]he fact that a claimant makes application for workers' compensation benefits under the policy and under the Act is tied to the fact that there was a compensable injury in the first place."[150]

It is hard to argue, conceptually, with the notion that insurer bad faith is "inextricably interwoven" with the insurer's status in the workers' compensation process. Reasoning that investigation by an insurer "constitutes a service 'inextricably interwoven' with the insurer's status," the Court in *Unruh v. Truck Ins. Exch.* concluded that as long as the insurer acts within the role contemplated by the Act, liability should not be imposed beyond the provisions within the Act.[151] However, the tortious conduct constituting bad faith occurs "after the injury, outside the workplace, and away from the employer. It occurs in the context of administration and investigation of the claim under the insurance policy . . . ."[152]

Courts have circumvented the exclusivity provisions of workers' compensation statutes by allowing an independent action against an insurer for intentional infliction of emotional distress.[153] As an example, in *Unruh v. Truck Ins. Exch.*, the Court allowed the claimant to recover for the intentional torts committed by the insurer under the dual capacity doctrine.

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[149] Lasswell, *supra* note 136.

[150] Fenton, *supra* note 12, at 851.

[151] Unruh v. Truck Ins. Exch., 498 P.2d 1063, 1071 (Cal. 1972). The Court reinstated the counts alleging assault and battery, intentional infliction of emotional distress, and punitive damages for the reason that such insurer conduct removed the insurer from its normal role. *Id.* at 1073.

[152] Fenton, *supra* note 12, at 851.

[153] *See* Martin v. Travelers Ins. Co., 497 F.2d 329, 331 (1st Cir. 1974) (intentional infliction of mental and emotional suffering under Maine law); Stafford v. Westchester Fire Ins. Co. of New York, 526 P.2d 37, 39, 42 (Alaska 1974) (conscious infliction of mental distress); Unruh v. Truck Ins. Exch., 498 P.2d 1063, 1073 (Cal. 1972) (intentional infliction of emotional distress); *see also* Robertson v. Travelers Ins. Co., 427 N.E.2d 302, 307 (Ill. App. Ct. 1981) (intentional infliction of emotional distress); Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220, 222 (Me. 1978) (intentional infliction of physical and emotional distress); Hayes v. Aetna Fire Underwriters, 609 P.2d 257, 261-62 (Mont. 1980) (intentional infliction of emotional distress).

[154] The dual capacity doctrine allows an injured employee a separate tort against his employer who has dual legal personalities; one as an employer and another in a secondary non-employer capacity.[155] The Court in *Unruh* found that the insurer had stepped out of its proper role of "insurer"[156] by embarking upon a detestable course of conduct and, therefore, as one acting under a different capacity, should not be afforded protection under the workers compensation exclusivity provision.[157]

As this case law developed, courts appeared to act upon a concern that there would be a wave of tort actions based on intentional delays and

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[154] *Unruh*, 498 P.2d at 1063 (Cal. 1972).

[155] *See* Duprey v. Shane, 249 P.2d 8, 13-15 (Cal. 1952).

[156] Some employers do not purchase workers' compensation insurance at all. They are authorized to act as self-insurers under the state's Workers' Compensation Act. Some courts have held that self-insureds may be held directly liable for bad faith in the handling of a worker's compensation claim. *See, e.g.*, Falline v. GNLV Corp., 823 P.2d 888, 893 (Nev. 1991); Sizemore v. Cont'l. Cas. Co., 142 P.3d 47, 54 (Okla. 2006). The Court in Reedy v. White Consol. Indus., Inc., 503 N.W.2d 601, 603 (Iowa 1993), observed: "[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."

Some states levy fines against self-insureds who delay payments but it has been observed that "although administrative fines may have some deterrent effect on self-insured employers, they do not purport to address the plight of the injured worker who may suffer great deprivation as a result of the tortuous denial or delay of his or her benefits." Falline, 823 P.2d at 894; *see also* Hough v. Pac. Ins. Co., 927 P.2d 858, 868 (Haw. 1996). At least one court has found that a self-insured's bad faith exposure cannot be avoided by contracting out its claim handling functions to a third-party administrator (TPA). *See, e.g.*, Scott Wetzel Servs., Inc. v. Johnson, 821 P.2d 804 (Colo. 1991) (en banc).

A question arises as to whether a TPA can be held directly liable for bad faith. The few courts that have considered this issue are split on the issue. As an example, some jurisdictions have held that because the covenant of good faith and fair dealing imposes obligations of a non-delegable nature and because there is a lack of privity between the TPA and the insured employee, the TPA cannot be held directly liable. *See, e.g.*, Simmons v. Congress Life Ins. Co., 791 So. 2d 360, 365 (Ala. Civ. App. 1998) *rev'd on other grounds sub nom*. Ex parte Simmons, 791 So. 2d 371 (Ala. 2000). *See also* Walter v. Simmons, 818 P.2d 214 (Ariz. Ct. App. 1991). However, other courts have found that TPAs may be directly liable "even in the absence of contractual privity with the employee." *E.g.*, *Scott Wetzel Services, Inc.*, 821 P.2d at 813; *see also* Dellaira v. Farmers Ins. Exch., 102 P.3d 111, 115 (N.M. Ct. App. 2004).

[157] *Unruh*, 498 P.2d at 1077.

terminations of payments. Some courts began to demand that the insurer's conduct be "conspicuously contemptible."[158] Under this rationale, an insurer's mere delay in making compensation payments would not be a sufficient basis on which to ground an action in tort.[159]

Generally, outrageous or deceitful conduct was needed to maintain a tort action outside the exclusive remedy provision.[160] Mere delay in making compensation payments would not be a sufficient basis to ground an action in tort while only extreme and outrageous conduct would be actionable at common law.[161] Clearly, the conduct which gives rise to the

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[158] *See* Martin v. Travelers Ins. Co., 497 F.3d 329, 330 (1st Cir. 1974) (insurer stopped payment on valid compensation payments only after claimant had deposited and made withdrawals against them, resulting in severe embarrassment and emotional distress); Coleman v. Am. Universal Ins. Co., 273 N.W.2d 220, 221 (Wis. 1979) (action for tort of bad faith and intentional infliction of emotional distress after insurer stopped payments three times, causing plaintiff to be evicted).

[159] *See Martin*, 497 F.2d at 331 (mere late payment not sufficient basis for tort action); Stafford v. Westchester Fire Ins. Co. of N.Y. Inc., 526 P.2d 37 (1974) (tortuous conduct must go beyond untimely payments to pierce exclusivity defense); *Unruh*, 498 P.2d at 1071-72 (mere negligence of compensation carrier will not give rise to tort liability); *Coleman*, 273 N.W.2d at 224 (mere delay is adequately compensated by 10% penalty award).

[160] Ricard v. Pac. Indem. Co., 183 Cal. Rptr. 502, 506 (Cal. Ct. App. 1982) (outrageous and deceitful conduct needed to maintain tort action outside exclusive remedy provision); Robertson v. Travelers Ins. Co., 427 N.E.2d 302, 307 (Ill. Ct. App. 1981) (outrageous conduct required to state action in tort).

[161] The state of Alabama has attempted to reconcile the concept of exclusive remedy with the provision of the limited intentional torts of "outrageous conduct" or "intentional infliction of emotional distress." This approach addresses standard or simple bad faith under the Workers' Compensation Act while extreme bad faith is handled outside the Act. This leaves a gap where moderate bad faith is not adequately addressed by the Act and not allowed as an independent tort.

A tort claim against a workers' compensation insurer alleging a bad faith failure to pay an insurance claim is barred by the exclusivity provisions of Alabama's Workers' Compensation Act. Stewart v. Matthews Indus., Inc., 644 So. 2d 915, 918 (Ala. 1994) (citing ALA. CODE §§ 25-5-11, -52, -53 (1975); Farley v. CNA Ins. Co., 576 So. 2d 158 (Ala. 1991); Garvin v. Shewbart, 442 So. 2d 80 (Ala. 1983)); Oliver v. Liberty Mut. Ins. Co., 548 So. 2d 1025, 1026 (Ala. 1989); Nabors v. St. Paul Ins. Co., 489 So. 2d 573 (Ala. 1986); Moore v. Liberty Mut. Ins. Co., 468 So. 2d 122 (Ala. 1985); Waldon v. Hartford Ins. Grp., 435 So. 2d 1271 (Ala. 1983). Although the Alabama Supreme Court has held that a claim alleging bad faith failure to pay an insurance claim, in the context of a workers' compensation claim, is barred by the exclusivity provisions of the Act, the court

has also recognized that the tort of outrageous conduct or intentional infliction of emotional distress can occur in a workers' compensation setting. *See, e.g.*, *Farley*, 576 So. 2d at 158 and *Garvin*, 442 So. 2d at 80. The Court in *Stewart* observed:

> The [Workers' Compensation] Act is designed to compensate those who are injured on the job and provides immunity from common law suits for those employers and carriers who come within the Act. A suit seeking recovery under the tort of outrageous conduct does not seek compensation [or] medical benefits for the original on-the-job injury. The connection with the physical injury that gave rise to the original workmen's compensation claim is tenuous. *The conduct giving rise to the tort of outrageous conduct in the context of this kind of case can be more accurately characterized as mental assault than as failure to pay compensation or medical benefits even though it may arise in a failure to pay context.* Conduct constituting the tort of outrageous conduct cannot reasonably be considered to be within the scope of the Act. When the employer or carrier's conduct crosses the line between mere failure to pay and intent to cause severe emotional distress, the cloak of immunity is removed.

Stewart, 644 So. 2d at 918 (emphasis added) (citing *Garvin*, 442 So. 2d at 83).

Under Alabama law, the tort of outrageous conduct or intentional infliction of emotional distress involves "extreme and outrageous conduct" by one who "intentionally or recklessly causes severe emotional distress to another." Am. Road Serv. Co. v. Inmon, 394 So. 2d 361, 365 (Ala. 1980). In order to present a case of outrageous conduct, the plaintiff must show that the conduct was "so outrageous in character and so extreme in degree as to go beyond all possible bounds of decency, and to be regarded as atrocious and utterly intolerable in a civilized society." *Am. Road Serv. Co.*, 394 So. 2d at 365. *See also* Cates v. Taylor, 428 So. 2d 637 (Ala. 1983); Bearden v. Equifax Services, 455 So. 2d 836 (Ala. 1984); Strickland v. Birmingham Bldg. & Remodeling, 449 So. 2d 1242 (Ala. 1984).

The severe emotional distress required for the tort of outrage requires the following:

"The emotional distress … must be so severe that no reasonable person could be expected to endure it. Any recovery must be reasonable and justified under the circumstances, liability ensuing only when the conduct is extreme." *Am. Road Serv. Co.*, 394 So. 2d at 365.

tort of bad faith can be independent enough from the workplace injury to be considered as not being truly under the umbrella of the workers' compensation system.[162] The problem lies in finding the separation point where the exclusive remedy principle becomes a tangential issue to the recognition of a tort remedy for bad faith rather than a sticking point which calls into question the entire cause of action. Some bad faith conduct is extreme in nature which separates the tortious bad faith conduct by the insurer or its agent from the original workplace injury, which was otherwise meant to be compensated by the no-fault workers' compensation system.

Statutory remedies may provide a reasonable method to resolve common cases of payment delay or refusal, however some remedy provisions do not contemplate the harm which may arise from an insurer's intentional bad faith conduct.[163] Compensation laws should be exclusive only when they provide an adequate remedy.[164] Are the penalties adequate?

Virtually all states have enacted statutory penalty provisions to provide a remedy for an insurer's inexcusable or unreasonable withholding of benefits.[165] The penalties are added to the amount of unpaid compensation[166] and range from 10%[167] to 200%.[168] In some states

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The outrageous conduct must be established by clear and convincing evidence. *Farley,* 576 So. 2d at 158.

[162] Boylan v. Am. Motorists Ins. Co., 489 N.W.2d 742, 743-44 (Iowa 1992).

[163] Gibson v. Nat'l Ben Franklin Ins. Co., 387 A.2d 220, 223 (Me. 1978) (penalty provision of Workers' Compensation Act not sufficient to redress claimant since fines assessed to insurer paid to state rather than claimant); *Coleman*, 273 N.W.2d at 224 (10% remedy provision does not adequately compensate worker for detriment occasioned by intentional tort).

[164] *Stafford*, 526 P.2d at 43.

[165] *See, e.g.*, GA. CODE ANN. § 34-9-221(e) (2011) (providing 15% penalty for insurer's inexcusable delay of compensation benefits); ME. REV. STAT. ANN. tit. 39, § 104-A(2) (1984) (forfeiture of $25 per day for insurer's failure to pay compensation); TEX. REV. CIV. STAT. ANN. art. 8306, § 18a(a) (West 1985) (providing for 15% penalty of all past due compensation).

[166] *See, e.g.*, LA. REV. STAT. ANN. § 22:658 (West 1978) (12% of difference between amount tendered or paid and amount found due); 820 ILCS 305/19(k) (percentage award of compensation "additional to that otherwise payable"); W.S.A. § 102.18(1)(bp) (percentage of "total compensation due").

[167] *See* CAL. LAB. CODE § 5814(b) (West 2004) (10% for delay); FLA. STAT. ANN. § 440.20(7) (West 2011) (punitive penalty of 20% of unpaid installment).

attorney's fees may be awarded.[169] Oftentimes the penalty provisions are fixed to a specific percentage of the compensation award irrespective of the quality of the insurer's misconduct.[170] Some states have adopted penalty provisions which take into consideration instances where an insurer acts intentionally or unreasonably in denying benefits by increasing the percentage awarded to the claimant.[171]

The penalties can be significant. As an example, the Illinois statute increases the penalty to 50% of the benefits due where the insurer has unreasonably or vexatiously delayed payments, intentionally underpaid compensation, or instituted frivolous proceedings for the purpose of delay where no real controversy ever existed as to the insurer's liability for paying the compensation.[172] Under Wisconsin's penalty provision, a claimant may have his or her unpaid compensation benefits increased by 25% where the insurer has not acted in "good faith" in processing a claim.[173] The Wisconsin penalty statute also provides for those instances when a carrier engages in "malicious or bad faith" conduct by awarding a claimant "the lesser of 200% of total compensation due or $15,000."[174] Under the Wisconsin statute, the Department of Labor defines what conduct demonstrates malice or bad faith in assessing a penalty. Under

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[168] *See* WIS. STAT. ANN. § 102.18(1)(bp) (West 2011) (up to 200% or $30,000 penalty may be assessed against insurer for malicious or bad faith failure to pay compensation benefits).

[169] *See* ILL. COMP. STAT. ANN. 48/138.16 (West 2011) (reasonable attorney's fees are recoverable where insurer's delay is unreasonable); LA. REV. STAT. ANN. § 22:658 (punitive penalty of 12% and "all reasonable attorney's fees for the prosecution and collection of such amount").

[170] *See, e.g.*, CAL. LAB. CODE § 5814(b) (West 2004) (penalty fixed at 10% of compensation award); GA. CODE ANN. § 114-705(e) (2011) (penalty designated at set rate of 15% after 14 days); TEX. REV. CIV. STAT. Ann. art. 806, § 18a (West 2011) (penalty not to exceed 15% of unpaid compensation).

[171] *See* 215 ILL. COMP. STAT. 5/155 (2004) (penalty imposed against insurer whose actions are "unreasonable," "vexatious," or "intentional"); LA. REV. STAT. ANN. § 23:1201 (percentage penalty plus attorney's fees where insurer's conduct "arbitrary, capricious, or without probable cause"); MINN. STAT. ANN. § 176.225(1) (penalty assessed against insurer who acts "unreasonably or vexatiously"); WIS. STAT. ANN. § 102.18(1)(bp) (penalty imposed where insurer's conduct malicious or in bad faith).

[172] *See* 820 ILL. COMP. STAT. ANN. 305/19 (k) (West 2011).

[173] *See* WIS. STAT. ANN. § 102.18(1)(b) (West 2010).

[174] *See id.* § 102.18(1)(bp).

Wisconsin common law, however, in order to show an insurer's "bad faith" the plaintiff must show "[t]he absence of a reasonable basis for denying benefits of the policy and the defendant's knowledge or reckless disregard of the lack of a reasonable basis for denying the claim."[175]

Penalty statutes can hold an insurer accountable for its actions by imposing fair and adequate penalties where the circumstances dictate. Penalty statutes can also provide the claimant with an adequate remedy for any detriment he or she may have suffered and create an incentive for the insurer to act reasonably in settling an employee's claim. Additionally, by barring common-law recoveries, exclusive remedy penalty provisions can foreclose the possibility of high damage verdicts being assessed against an insurer and the possible disintegration of the workers' compensation scheme. Certainly the adoption of a bad faith tort action can assist in equalizing the bargaining power between the worker and insurer during claim processing by prompting the insurer to act reasonably and in good faith in processing claims.[176] Significant penalties can also achieve this goal.

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[175] *See* Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 376 (Wis. 1978).

[176] *See* Kranzush v. Badger State Mut. Cas. Co., 307 N.W.2d 256, 261 (Wis. 1981) (bad faith action good policy since promotes assurance workers "exclusive remedy will not be denied through the intentional wrongdoings of the insurer"); *accord* Eckenrode v. Life of Am. Ins. Co., 470 F.2d 1, 5 (7th Cir. 1972) (insureds forced to take insurance contracts "as is," leaving little or no remedy); Christian v. Am. Home Assur. Co., 577 P.2d 899, 902 (Okla. 1977) (insured has essentially no bargaining power in insurance contract; relegated to terms of contract as basis of decision to extend insured's bad faith tort action). *But see* Hayes v. Aetna Fire Underwriters, 609 P.2d 257, 262-63 (Mont. 1980) (Harrison, J., specially concurring) (recognition of independent action may place insurers at disadvantage in settle claims).

In *Izaguirre v. Texas Employers' Ins. Ass'n*, 749 S.W.2d 550 (Tex. App. 1988), the court found that the penalties provided by Texas' Workers' Compensation Act were not exclusive remedies for any wrongful denials or delays of payments stating "a special relationship arises out of the parties' unequal bargaining power and the nature of insurance contracts which would allow unscrupulous insurers to take advantage of their insured's misfortunes in bargaining for settlement or resolution of claims." *Id.* at 554. The court in *Izaguirre* went on to state that the statutory regulation and existing statutory penalties were not adequate to equalize the bargaining power between workers and insurers in settling claims. *Id.* at 554-55. *But see* Bowen v. Aetna Life & Cas. Co., 512 So. 2d 248, 250 (Fla. Dist. Ct. App. 1987); Robertson v. Travelers Ins. Co.,

One commentator has observed that through the promulgation of statutory penalties and guidelines, a state legislature can fashion a "bad faith" remedy to compensate employees for the detriment they may suffer as a result of insurer "bad faith" while the insurer is protected by limiting the amount which may be recovered.[177] The commentator's legislative proposal was modeled after the statutes which had been enacted in Illinois, Minnesota and Wisconsin.[178] The proposal, which includes statutorily regulated penalties for an insurer's bad faith conduct, is aimed at balancing the bargaining powers between the parties by creating an incentive for the insurer to deal fairly and in good faith when processing a claim."[179] The following is the proposed amendment to state Workers' Compensation Acts:

> **Additional Award as Penalty for Bad Faith Conduct of Insurance Carriers or Employers in the Processing or Settlement of Employee Claims**
>
> (a) After notice and a hearing or upon the opportunity to be heard,[180] the [insert name of jurisdictional body, *i.e.,* Industrial Commission], or upon appeal, a court of competent jurisdiction, may in its discretion award additional compensation which it considers just, up to, but not exceeding, the lesser of 200% of the compensation then past due or $70,000[181] in any case where an insurance carrier or employer has:

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448 N.E.2d 866 (Ill. 1983); Gonzales v. U. S. Fid. & Guar. Co., 659 P.2d 318, 320 (N.M. Ct. App. 1983).

[177] Frederick L. Streck, III, *Bad Faith Claims Practices in Texas – Do They Exist?: Extending a Bad Faith Cause of Action to Texas Workers' Compensation Insurance Claimants*, 16 ST. MARY'S L.J. 679, 703 (1985).

[178] *Id.* at 704 (citing 820 ILL. COMP. STAT. ANN. 305/19(k) (West 2011); MINN. STAT. ANN. § 176.225(1) (West 1985); WIS. STAT. ANN. § 102.18(1)(bp) (West 2010)).

[179] Streck, *supra* note 178, at 704.

[180] *See* MINN. STAT. ANN. § 176.225(1) (West 1985) (providing party against whom proceeding brought opportunity to be heard so as to refute charges against him and provide due process under law) *cited in* Streck, *supra* note 178, at 704 n.137.

[181] *See* WIS. STAT. ANN. § 102.18(1)(bp) (West 2010) (where the compensation commission was empowered to award just compensation "not to

(1) instituted proceedings and/or interposed a defense where no real or present controversy exists as to the carrier's liability to pay the compensation, but which are only frivolous or are for delay;[182] or

(2) unreasonably, vexatiously, or in bad faith delayed or refused compensation payments;[183] or

(3) intentionally underpaid compensation.[184]

(b) The penalty award as provided in this section is to be the employee's exclusive remedy against an insurance carrier or employer for engaging in conduct described in subsection (a)(1), (a)(2), or (a)(3).

(c) Actions or conduct rising to the level described in subsections (a)(1), (a)(2), or (a)(3) are to be defined by

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exceed the lesser of 200% of total compensation due or $15,000") *cited in* Streck, *supra* note 178 at 704 n.139.

[182] *See* 820 ILL. COMP. STAT. ANN. 305/19(k) (West 2011) (penalty available where "proceedings have been instituted or carried by one liable to pay the compensation, which do not present a real controversy, but are merely frivolous or for delay"); MINN. STAT. ANN. § 176.225(1)(a) (West 1985) ("instituted a proceeding or interposed a defense which does not present a real controversy but which is frivolous or for the purpose of delay") *cited in* Streck, *supra* note 178 at 704-05 n.140.

[183] *See* 820 ILL. COMP. STAT. ANN. 305/19 (k) (West 2011) (penalty imposed where insurer's conduct unreasonable or vexatious in delaying payments); WIS. STAT. ANN. § 102.18(1)(bp) (West. 2010) (statute sets applicable standard of recovery for bad faith action) *cited in* Streck, *supra* note 178, at 705 n.141.

[184] *See* MINN. STAT. ANN. § 176.225(1)(d) (West 1984) (penalty may be imposed where employer or insurer has "intentionally underpaid compensation"') *cited in* Streck, *supra* note 178, at 705 n.142.

> rule of the [insert name of jurisdictional body, *i.e.,* Industrial Commission].[185]

The commentator contemplates that the penalty provision will be discretionary with the governing Industrial Commission or the courts.[186]

The proposed amended statutory penalty provision addresses the social cost associated with permitting tort liability in the workers' compensation context.[187] The author of the amendment provides the following support for the amendment's adoption:

> The exclusive remedy proviso of the legislative enactment has the distinct advantage of guaranteeing greater protection for the employee and, at the same time, the proposal adequately insulates the insurer from liability in tort and its resultant high damages. The insulation of the insurer from excessive liability in tort will also ultimately protect the consumer by indirectly maintaining the price of goods. In a workers' compensation situation, the employer pays the premium to the insurer with the employee being named as a third-party beneficiary. When the insurer is burdened with a tort verdict, the penalty passed on to the employer in the form of increased premiums are thereafter transferred to the consumer through an increase in the cost of the employer's goods and services. This 'passing the buck' situation would be almost nonexistent under the proposed legislation due to the reduced likelihood of insurer tort liability.[188]

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[185] *See* WIS. STAT. ANN. § 102.18(1)(bp) (West 2010) ("department may, by rule, define actions which demonstrate malice or bad faith") *cited in* Streck, *supra* note 178, at 705 n.144.

[186] *See, e.g.*, WIS. STAT. ANN. § 102.18(1)(b) (West 2010) (imposition of penalty left to discretion of department of labor); *see also* MINN. STAT. ANN. § 176.225(1) (West 1985) (assessment of penalty award discretionary with compensation judge or court) *cited in* Streck, *supra* note 178, at 705 n.145.

[187] *See* Glenn L. Allen, *Insurance Bad Faith Law: The Need for Legislative Intervention*, 13 PAC. L.J. 833, 857 (1982) (society as the consumer ultimately bears the risk of loss in the form of higher premiums for policies sold occasioned by unlimited tort verdicts rendered against insurers).

[188] Streck, *supra* note 178, at 706.

The proposed amended statutory penalty provision is triggered by a single act of bad faith and the available penalty compensation is based upon a specific delayed payment. An alternative approach would be to establish a two tier monetary penalty provision. Instructive is the National Association of Insurance Commissioners' ("NAIC") Model Unfair Claims Settlement Practices Act which utilizes a two tier penalty structure.

The first tier of monetary penalties under the NAIC Model Unfair Claims Settlement Practices Act has a per-violation cap of $1,000 and an aggregate cap for all violations of $100,000.[189] Second tier penalties are applicable where the violation was committed "flagrantly and in conscious disregard of [the] Act."[190] Many jurisdictions trigger tier two penalties where the insurance company knew or should have known that its conduct violated their respective Acts.[191] Second tier penalties are capped at $25,000 for each violation with an aggregate cap of $250,000.[192]

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[189] *See, e.g.*, ALASKA STAT. § 21.36.125(a)(13) (2000); ARIZ. REV. STAT. ANN. § 20-461(A)(12) (2002); IOWA CODE ANN. § 507B.4(9)(l) (West 1988); KY. REV. STAT. ANN. § 304.12-230(12) (West 2004).

[190] *See, e.g.*, NEB. REV. STAT. § 44-1542(1) (2004); N.Y. INS. LAW § 2601 (McKinney 2000); N.C. GEN. STAT. § 58-63-15(11) (2003); N.D. CENT. CODE § 26.1-04-03 (2000).

[191] *See, e.g.*, COLO. REV. STAT. § 10-3-1108(a) (2004); CONN. GEN. STAT. ANN. § 38a-817(b) (West 2000); DEL. CODE. ANN. tit. 18 § 2308(a)(1) (2005); GA. CODE ANN. § 33-6-8(a)(1) (2000); HAW. REV. STAT. § 431:12-201(a)(1) (1993). The Alaska Legislature provided its Commissioner with the elements to be considered and weighed in assessing the amount of a monetary penalty. The Alaska Commissioner is to consider: (1) the amount of loss or harm caused by the violation; (2) the amount of benefit derived by the insurance company by reason of the violation; (3) the seriousness of the violation; (4) the promptness and completeness of the insurance companies remedial action; (5) whether a single act or a pattern of practice was involved; and (6) deterrence. ALASKA STAT. § 21.36.320 (2004).

The South Dakota Legislature provided similar guidance to its Commissioner. In determining an appropriate penalty, the Division of Insurance will balance four specific factors of the insurance company and the insured: (1) the magnitude of the harm to the insured or claimant; (2) the actions taken by the insurance company, insured and/or claimant that either lessen or worsen the result of the violation; (3) any impediments that the insured or the claimant caused to the insurance company in either the process or the settling of the claim; and (4) the actions of the insurance company, specifically those that worsen the harm to the claimant or the insured from the violation. S.D. CODIFIED LAWS § 58-33-68 (2000).

In order to use a two tier penalty system where the most severe penalties are based upon both flagrant and conscious disregard of the Workers' Compensation Act, there would need to be built into the Workers' Compensation Act a provision for monitoring insurance company misconduct across various claims.

In the context of the NAIC Model Unfair Claims Settlement Practices Act, seventeen states have adopted provisions in their Act which require insurance companies to maintain records regarding complaints of

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Vexatious conduct has been elaborately addressed by the Missouri Legislature in the context of third party claim settlement practices. MO. ANN. STAT. § 375.420 (West 2002). There are seven elements that the Missouri courts look to in conducting an analysis of vexatiousness under the Unfair Claims Act. First, the insured's claim must be assessed and determined as it was presented to the insurance company at the time it was presented. Hopkins v. Am. Econ. Ins. Co., 896 S.W.2d 933, 939 (Mo. Ct. App. 1995). Second, the insured must show that the refusal to pay by the insurance company "was willful and without reasonable cause of excuse, as facts would have appeared to a reasonable person before trial." *Id.*; *accord* State ex. rel. Pemiscot County, Missouri v. Western Surety Co., 51 F.3d 170, 174 (8th Cir. 1995); Nelson v. Aetna Life Ins. Co., 359 F. Supp. 271, 298 (W.D. Mo. 1973); Bickerton, Inc. v. Am. States Ins. Co., 898 S.W.2d 595, 602 (Mo. Ct. App. 1995). Third, the "existence of a litigable issue, either factual or legal, does not preclude the statutory penalty where there is evidence that the insurer's attitude was vexatious and recalcitrant." Liberty Life Ins. Co. v. Schaffer, 853 F.2d 591, 592 (8th Cir. 1988). Fourth, a holding that coverage is adverse to the insurance company in and of itself does not mandate damages be assessed to the insurer's vexatious delay in paying. *Id.* at 593; *see also* Morris v. J.C. Penney Life Ins. Co., 895 S.W.2d 73, 76 (Mo. Ct. App. 1995). Fifth, the insurance company is liable for vexatious delay in paying when it continues to refuse to pay even after it becomes aware that its defense is without merit. Kostelec v. State Farm Fire & Cas. Co., 64 F.3d 1220, 1227-28 (8th Cir. 1995); Allen v. State Farm Mut. Auto Ins. Co., 753 S.W.2d 616, 620-21 (Mo. Ct. App. 1988). Sixth, despite the fact that the insurance company may have had a valid dispute on a question of law or fact up through trial, does not prevent a statutory penalty for unfairly treating the insured. DeWitt v. Am. Family Mut. Ins. Co., 667 S.W.2d 700, 710 (Mo. 1984) (*en banc*). Seventh, a jury may consider all of the evidence and surrounding circumstances of the case and even without any direct evidence, find the insurance company guilty of a vexatious delay. Laster v. State Farm Fire & Cas. Co., 693 S.W.2d 195, 197 (Mo. Ct. App. 1985).

[192] ALASKA STAT. § 21.36.125(a)(11) (2004); ARIZ. REV. STAT. ANN. § 20-461(A)(10) (2002); CONN. GEN. STAT. ANN. § 38a-816(6)(j) (2000).

improper claim handling.[193] Typically these states require insurance companies to keep a "complete record of all complaints of its insureds." Most states that impose this requirement specify that the records must indicate the total number of complaints, their classification by type of insurance, the nature of each complaint, the disposition of the complaint, and the time it took to process each complaint.[194] While most states require information regarding "complaints," four states (Vermont,[195] Florida,[196] Kansas[197] and Massachusetts[198]) also require recordation of any "grievance" in addition to "complaints." Only New Hampshire requires an annual report to the insurance department regarding complaints.[199] Moreover, New Hampshire permits claimants to use this information in administrative and judicial proceedings.[200]

> Evidence as to the numbers and types of complaints to the insurance department against an insurer, and said department's complaint experience with other insurers writing similar lines of insurance, shall be admissible in evidence in an administrative or judicial proceeding brought under this title, provided that no insurer shall be

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[193] ARK. CODE. ANN. § 23-66-206 (4)(A) (West 2001); CONN. GEN. STAT. § 38a-816(7) (West 2004); DEL. CODE. ANN., tit. 18 § 2304(17); FLA. STAT. ANN. § 626.9541 (1)(i)(3)(j); KAN. STAT. ANN. § 40-2404(10) (West 2000); LA. REV. STAT. § 22:1214(17) (2006); MASS. GEN. LAWS Ch. 176D § 3(a)(10) (West 2007); MICH. COMP. LAWS SERV. § 500.2026(2) (LexisNexis 2008); MONT. CODE ANN. § 33-21-105(i) (2011); N.H. REV. STAT. ANN. § 417:4(XV)(a)(13) (209); N.J. STAT. ANN. 17:29B-4(10) (West 2007); N.Y. INS. LAW § 2601(b) (McKinney 2009); OKLA. STAT. ANN. Tit. 36 § 1250.5(14) (West 2011); 40 PA. STAT. ANN. §1171.5(a)(11) (West 1999); TEX INS. CODE ANN. § 21.21-3(b)(6) (repealed 2005); VT. STAT. ANN. tit. 8 § 4 724(10) (2005); W. VA. CODE § 33-11-4(10) (LexisNexis 2011).

[194] Arkansas, Connecticut, Delaware, Kansas, Louisiana, Massachusetts, Michigan, New Jersey, Oklahoma, Pennsylvania, Texas, Vermont, and West Virginia.

[195] VT. STAT. ANN. tit. 8 § 4724(10) (2005).

[196] FLA. STAT. ANN. § 626.9541 (1)(i)(3)(j) (West 2004).

[197] KAN. STAT. ANN. § 40-2404(10) (West 2000).

[198] MASS. GEN. LAWS ANN. Ch. 176D § 3(a)(10) (West 2007).

[199] N.H. REV. STAT. ANN. § 417:4(XV)(a)(13) (2009).

[200] *Id.* § 417:4(XV)(b).

> deemed in violation of this section solely by reason of the numbers and types of such complaints.[201]

The standard time frame for keeping this complaint information is from the date of the last insurance department examination. However, Massachusetts only requires the information to be kept for two years;[202] Oklahoma requires information to be kept for three years or since the date of its last financial examination, whichever is longer;[203] Texas requires the information be kept for three years or since the date of its last examination, whichever time is shorter;[204] and Pennsylvania requires the information to be kept for a four year period.[205]

To effectively work within the workers' compensation context, insurers would be required to keep statistics on each penalty imposed, including the nature of the misconduct and the penalty award amount, during the processing of a claim. The insurer would also need to maintain statistics which allow aggregate calculations to be generated. To some extent, misconduct would need to be aggregated into categories and each award would have to identify the specific misconduct category(ies) found as the basis of the award. Categorization would permit necessary standardization to permit the statistical analysis. Penalties could also be categorized to correspond to the misconduct type. Statistics would be state specific.

Abandoning a common-law tort of bad faith in favor of an exclusive penalty regulatory approach has three distinct advantages: (1) uniformity in the standard of conduct; (2) an efficient administrative hearing process; and (3) accurate record keeping.

A. UNIFORMITY IN THE STANDARD OF CONDUCT.

A regulatory approach would bring certainty regarding appropriate and inappropriate conduct. Currently, the common-law tort of bad faith is defined by vague legal constructs like "good faith and fair dealing" or "fair debatability." The creation of a specific inventory of regulated improper claim handling practices would provide greater certainty to the insurance

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[201] *Id. See also* N.Y. INS. LAW § 2601(b) (McKinney 2009).
[202] MASS. GEN. LAWS ch. 176D § 3(a)(10) (West 2007).
[203] OKLA. STAT. ANN. tit. 36 § 1250.5(14) (West 2011).
[204] TEX. INS. CODE ANN. § 542.005 (West 2005).
[205] 40 PA. STAT. ANN. § 1171.5(a)(11) (West 1999).

industry regarding what conduct is forbidden in the workers' compensation context and, conversely, what specific conduct should be engaged in. As an example, the NAIC Model Act proscribes fourteen unfair claims practices. The Model Act contains a general requirement that insurance companies "adopt and implement reasonable standards for the prompt investigation and settlement of claims arising under its policies."[206] The various Industrial Commissions could do the same.

B. AN EFFICIENT ADMINISTRATIVE HEARING PROCESS

A regulatory administrative adjudicatory process would have the benefit of a knowledgeable trier of fact. The administrative adjudicatory process, utilizing administrative hearing officers or administrative law judges, brings to the hearing process a knowledgeable trier of fact who understands the purpose of the WCA as well as the focused workers' compensation segment of the insurance industry and its standards, customs and practices. Because the trier of fact will have a significant understanding of the insurance industry, the workers' compensation penalty hearing process can be abbreviated and become more focused upon creating a record regarding each individual claim which can then be aggregated into an annual report for oversight purposes.

Utilization of a regulatory administrative hearing process can lead to speedy resolution of disputed claims through an abbreviated administrative hearing process that limits discovery. By limiting discovery and abbreviating the overall process, lower costs in presenting the claim should be realized.

C. ACCURATE RECORD KEEPING

A regulatory administrative approach would permit a better record to track improper claim handling practices within an insurance company so that when penalties are assessed there is an adequate record, especially for tier two penalties, to prove a pattern or frequency in improper claim handling. Although the aggregate of penalties in a given year may approximate a large monetary loss, insurance company executives will not

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[206] *See, e.g.*, 2 Nat'l Ass'n Ins. Commissioners Proc. 367-70 (1976). The Act and regulations are also set out at II National Association of Insurance Commissioners Official NAIC Model Insurance Laws, Regulations and Guidelines, 890-1 to 890-4, 900-1 to 900-10 (2011).

be able to be dismissive about what produced the financial loss, i.e., a rogue jury.

The availability of accurate information regarding the failure of a particular insurance company's claim handling guidelines within its field offices is essential to positive change. Presently, only 13 states require insurance companies to keep records regarding all complaints and/or grievances made as the result of perceived claim mishandling under the NAIC Model Act.[207] A uniform adoption of mandatory record keeping in the workers' compensation context must be a focus of any regulatory approach to claim handling practices. Requiring insurance companies to provide detailed annual reports to the insurance department and industrial commission in the states in which they underwrite business regarding the number of complaints and grievances classified by type of violation and information regarding the nature of each complaint, together with the complaint's disposition would assist not only insurance departments in regulating the industry, and assist administrative law judges in assessing penalties but would also assist insurance company executives. Information regarding fines/penalties imposed which can be allocated by classification, together with a report of attorney's fees expended would bring to the forefront the true cost of claim mishandling.

V. CONCLUSION

Courts are equally divided on whether a common-law tort of bad faith should be permitted in the workers' compensation context. The legal analysis used by courts for these competing viewpoints on this issue are cogent and cannot be dismissed easily.

The respective state Workers' Compensation Acts provide an efficient mechanism for employees and insurers to resolve disputes relating to work-related injuries in a timely and expeditious manner. The system provides a knowledgeable trier of fact through experienced hearing officers and administrative law judges. Utilizing the existing workers' compensation system to resolve issues involving alleged insurer misconduct and bad faith would permit a timely resolution of any impediments to the disposition of an employee's compensation for work-related injuries. However, in order to provide sufficient deterrence,

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[207] Arkansas, Connecticut, Delaware, Kansas, Louisiana, Massachusetts, Michigan, New Jersey, Oklahoma, Pennsylvania, Texas, Vermont and West Virginia.

substantial penalties for insurer misconduct and bad faith must be provided to the trier of fact.

Any regulatory penalty framework must include a requirement that insurers track penalties that have been awarded with sufficient specificity to create a positive informational feedback to insurance company executes regarding the actual and cumulative cost of inappropriate claim processing.