

Workers' Compensation and the Duty of Good Faith and Fair Dealing to the Employer and Employee: An Inherent Conflict[†]

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I.

INTRODUCTION

Workers' compensation is a statutory system originally conceived and designed to quickly and efficiently provide comprehensive benefits to injured workers without the need for litigation. It is a "no fault" system, meaning the injured worker recovers regardless of any contributory negligence. Under the system, both workers and employers benefit. Injured employees recover without having to navigate through potentially contentious litigation with their employers. On the other hand, employers cannot be sued by the employee, and they pay statutorily scheduled benefits not subject to jury intervention. Most employers purchase workers' compensation insurance to cover their workers' compensation obligations. That insurance is intended to pay the benefits the employer would otherwise owe the injured employee.

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Any time someone purchases insurance, the insurance carrier owes a duty of good faith and fair dealing to the insured. But to whom does the workers' compensation carrier owe the duty of good faith and fair dealing? Is the duty owed primarily to the employer, who pays the premium, or to the employee, the beneficiary of the policy? This dilemma creates a problem for carriers because the interests of employers and employees are diametrically opposed in the claims context. Employers are primarily concerned with the "bottom line" and want carriers to take a hard line approach that denies questionable claims, makes employees prove their claims, and pays benefits only when ordered. In contrast, employees want carriers to accept claims and pay benefits with no "red tape" and no questions asked.

Most states' workers' compensation systems have a mechanism to address insurance carriers' or self-insured employers' allegedly unfair claims practices. Under most state systems, issues of unfair claims practices are within the exclusive jurisdiction of state workers' compensation departments. Most states impose a wide range of penalties or fines for allegedly unfair practices. In these states, courts have stopped short of finding that a workers' compensation carrier owes a duty of good faith and fair dealing to an injured worker. However, the trend is for courts to impose a duty of good faith and fair dealing on the compensation carrier. As a result, the "price of poker" has gone up for workers' compensation carriers, and they often pay out substantial sums in either settlements or verdicts.

This Article begins by reviewing generally an insurance carrier's duty of good faith and fair dealing. It then provides an overview of the states that allow courts, rather than the state's workers' compensation administrative agency, to consider workers' compensation-



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related claims of bad faith. Next, it discusses how some courts have allowed alternative causes of action to bypass a state agency's bad faith jurisdiction. The Article concludes by examining the legal fallacy of allowing employees to sue carriers for bad faith by examining the Supreme Court of Arizona's decision in *Hayes v. Continental Insurance Co.*¹

II.

THE DUTY OF GOOD FAITH AND FAIR DEALING

*Gruenberg v. Aetna Insurance Co.*² is one of the seminal cases giving rise to the tort of bad faith. In that decision, the California Supreme Court noted that the law of contracts implied a covenant of good faith and fair dealing in every contract, including insurance policies. The duty required that neither party to the contract do anything to injure the other party's right to receive the benefits of the agreement.³ The court noted that "[i]t is the ob-

¹ *Hayes v. Cont'l Ins. Co.*, 872 P.2d 668 (Ariz. 1994).

² 510 P.2d 1032 (Cal. 1973).

³ *See id.* at 1037.

ligation, deemed to be imposed by the law, under which the insurer must act fairly and in good faith in discharging its contractual responsibilities.”⁴

The *Gruenberg* decision has been adopted by many jurisdictions and has been modified and expanded over the years.⁵ As part of the implied duty of good faith and fair dealing, most states require insurers to provide “equal consideration” to the interests of their insureds in addition to their own.⁶ Other states have held that insurers owe duties that are fiduciary in nature.⁷

In the workers’ compensation insurance context, the insured under the policy is clearly the employer. The employer pays the premium. (Typically, the employer also pays a portion of the workers’ compensation benefits.) As the employer is the insured, one would tend to conclude that the insurance carrier’s duty of good faith and fair dealing is owed only to the employer. However, some courts have instead turned the tables, allowing employees to sue compensation carriers for breach of the duty of good faith. As a result, a carrier can be faced with the often impossible situation of attempting to satisfy duties of good faith owed to an insured employer and its employee in a situation where they have opposing goals and interests. As a result, satisfying the duty of good faith owed to one potentially exposes the compensation carrier to a bad faith claim by the other. Courts that allow parties to bypass the state’s administrative agency and to bring direct bad faith suits against compensation carriers ignore two salient points: (1) the injured worker was not a party to the insurance contract; and (2) no consideration was given to the benefit of the bargain, which flows between the employer and the insurance carrier. This decision to bypass the administrative agency flies in the face of settled case law and public policy.

⁴ *Id.*

⁵ See, e.g., *Smith v. Am. Family Mut. Ins. Co.*, 294 N.W.2d 751, 756 (N.D. 1980); *D’Ambrosio v. Penn. Nat’l Mut. Cas. Ins. Co.*, 396 A.2d 780, 786 (Pa. Super. Ct. 1978); *Escambia Treating Co. v. Aetna Cas. & Sur. Co.*, 421 F. Supp. 1367, 1370 (N.D. Fla. 1976) (interpreting Florida law).

⁶ See, e.g., *Salas v. Mountain States Cas. Co.*, 202 P.3d 801, 805 (N.M. 2009); *Ledcor Indus., Inc. v. Mut. of Enumclaw Ins. Co.*, 206 P.3d 1255, 1260 (Wash. Ct. App. 2009); *Kissoondath v. U.S. Fire Ins. Co.*, 620 N.W.2d 909, 916 (Minn. Ct. App. 2001).

⁷ See, e.g., *Short v. Dairyland Ins. Co.*, 334 N.W.2d 384, 387 (Minn. 1983); *Rova Farms Resort, Inc. v. Investors Ins. Co.*, 323 A.2d 495, 503 (N.J. 1974).

III. THE STATES THAT ALLOW EMPLOYEES TO BRING A WORKERS' COMPENSATION-RELATED BAD FAITH CLAIM IN COURT

Several states permit courts, rather than state administrative agencies, to consider claims of workers' compensation bad faith. These states include Arizona,⁸ Colorado,⁹ and Delaware.¹⁰ In addition, the United States District Court for the Eastern District of Pennsylvania has ruled that the Pennsylvania Workers' Compensation Board does not have exclusive jurisdiction over bad faith claims against insurance companies and has effectively opened the door for Pennsylvania courts to consider such claims in the future.¹¹ Similarly, a Texas court of appeals has decided that the state's Industrial Accident Board does not have exclusive jurisdiction over workers' compensation bad faith claims.¹² The Supreme Court of South Dakota has determined that courts may consider claims of bad faith against industrial carriers.¹³ Vermont and Wisconsin also permit their courts to preside over claims of bad faith allegedly committed in workers' compensation claims.¹⁴

Some courts have gone further and held that the insurance carrier's duty of good faith and fair dealing extends to the employee and that the court may consider an injured employee's claim for a breach of that duty. Hawaii's Supreme Court, for example, has held that an insurance carrier has a duty to act in good faith vis-à-vis workers' compensation claimants. A breach of the duty will give rise to a cause of action in tort for insurer bad faith.¹⁵ Iowa courts also recognize a cause of action against workers' compensation insurers for the failure to pay benefits in good faith.¹⁶ Mississippi has determined that the exclusivity provision of its Workers' Compensation Act does not bar a claim by an injured employee against a carrier

⁸ *Hayes v. Cont'l Ins. Co.*, 872 P.2d 668, 678 (Ariz. 1994).

⁹ *Travelers Ins. Co. v. Savio*, 706 P.2d 1258, 1270-71 (Colo. 1985).

¹⁰ *Thurston v. Liberty Mut. Ins. Co.*, 16 F. Supp. 2d 441, 445-46 (D. Del. 1998). In *Thurston*, the court held that workers' compensation insurance companies owe a duty of good faith and fair dealing not only to employers but to the employee as well, and that the employee's failure to seek review at the Industrial Accident Board is not a bar to a claim for bad faith. *Id.* at 445. In addition, Delaware permits workers to file suit in state court to collect unpaid workers' compensation awards. These actions are known as "Huffman" claims. See *Huffman v. C.C. Oliphant & Son, Inc.*, 432 A.2d 1207, 1211 (Del. 1981) (entitling workers to liquidated damages of the unpaid benefits, attorney's fees, and costs against the employer or carrier).

¹¹ See *L.C. Renninger Co. v. VIK Bros. Ins., Inc.*, 180 F.R.D. 272, 274 (E.D. Penn. 1997).

¹² *Liberty Mut. Fire Ins. Co. v. McDonough*, 734 S.W.2d 66, 68 (Tex. Ct. App. 1987).

¹³ See *Walz v. Fireman's Fund Ins. Co.*, 556 N.W.2d 68, 70 (S.D. 1996).

¹⁴ See *Buote v. Verizon New England*, 190 F. Supp. 2d 693, 706 (D. Vt. 2002) (applying Vermont law); *Aslakson v. Gallagher Bassett Servs. Inc.*, 729 N.W.2d 712, 724 (Wis. 2007).

¹⁵ *Hough v. Pac. Ins. Co., Ltd.*, 927 P.2d 858, 869 (Haw. 1996).

¹⁶ See *Boylan v. Am. Motorist Ins. Co.*, 489 N.W.2d 742, 744 (Iowa 1996).

for “an independent intentional tort.”¹⁷ Oklahoma permits employees to sue compensation carriers for bad faith, but only after there has been an award against the employer.¹⁸

IV. THE CAUSES OF ACTION

Some courts have supplanted the bad faith jurisdiction of state administrative boards in several unique ways. Many courts simply conclude that the injured worker is the intended beneficiary of the workers’ compensation insurance policy, and, as such, the carrier owes the employee a duty of good faith and fair dealing.¹⁹ Any violation of the duty is a tort that must be addressed in court. These decisions distinguish between injuries sustained while on the job, before the carrier has adjusted the claim, and damages or injuries sustained by the employee as a result of the carrier’s independent act of adjusting the claim.²⁰ In cases concerning the carrier’s act of adjusting the claim, courts hold that the injuries were committed by the carrier independent of the on-the-job injury. Therefore, the acts by the carrier are no longer within the exclusive jurisdiction of the workers’ compensation commission.

Other courts have shied away from an analysis of the duty of good faith and fair dealing and have focused on causes of action for intentional torts, such as intentional infliction of emotional distress, allegedly committed by industrial carriers, making the claim subject to the court’s jurisdiction.²¹ An example of this approach is found in *Demag v. American Insurance Co.*²² In *Demag*, a widow brought a three-count complaint against the husband’s employer and the employer’s workers’ compensation insurance carrier. The first count was for declaratory relief, claiming that the defendants owed certain death benefits under Vermont law. The Vermont Supreme Court dismissed the declaratory claim, but it ruled that the plaintiff’s tort claim of intentional infliction of emotional distress was the proper subject of court action because that claim arose under common law, not under the Workers’ Compensation Act.²³

¹⁷ See *S. Farm Bureau Cas. Ins. Co. v. Holland*, 469 So. 2d 55, 58-59 (Miss. 1984).

¹⁸ See *Whitson v. Okla. Farmers Union Mut. Ins. Co.*, 889 P.2d 285, 287 (Okla. 1995) (citing *Goodwin v. Old Republic Ins. Co.*, 828 P.2d 431, 434 (Okla. 1992)).

¹⁹ See *Vaughan v. McMin*, 945 P. 2d 404, 409-10 (Colo. 1997); *Universe Life Ins. Co. v. Giles*, 950 S.W. 2d 48, 50-51 (Tex. 1997); *Pierce v. Int’l Ins. Co. of Ill.*, 671 A.2d 1361, 1364 (Del. 1996); *Aranda v. Ins. Co. of N. Am.*, 748 S.W. 2d 210, 212-13 (Tex. 1988).

²⁰ See *Whitson*, 889 P.2d at 287 (holding that tort liability of the workers’ compensation carrier arises against the insurer only after there has been an award against the employer); *Wittig v. Allianz A.G.*, 145 P.3d 738, 748 (Haw. Ct. App. 2006) (“An insurer’s tort liability for bad faith is separate from its liability for a workers’ compensation claim.”).

²¹ See *Demag v. Am. Ins. Cos.*, 508 A.2d 697 (Vt. 1986).

²² *Id.*

²³ *Id.* at 698-99.

V.

HAYS V. CONTINENTAL INSURANCE CO.: LEGALLY FLAWED

The Supreme Court of Arizona's decision in *Hayes v. Continental Insurance Co.*²⁴ is a flawed decision that conferred court jurisdiction on workers' compensation bad faith cases. The case turned on a tortured interpretation of Arizona Revised Statute section 23-930.²⁵ In *Hayes*, the plaintiff claimed to have suffered a back injury while at work. The carrier denied the claim. The employee requested a hearing before the Arizona Industrial Commission to contest the carrier's denial. The carrier provided no justification for its denial, and the Commission awarded benefits to the employee. The employee then filed a lawsuit in state court claiming that the carrier had acted in bad faith for intentionally withholding payment without reasonable justification.²⁶ The carrier moved to dismiss the complaint under section 23-930, claiming that the statute divested the court of jurisdiction.

²⁴ *Hayes v. Cont'l Ins. Co.*, 872 P.2d 668 (Ariz. 1994).

²⁵ Section 23-930 of the Arizona Revised Statutes Annotated (Supp. 2008) states as follows:

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.

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, pursuant to §§ 35-146 and 35-147, in the state general fund.

D. Any party aggrieved by an order of the commission under this section may request a hearing pursuant to § 23-947. The hearing and decision shall be conducted pursuant to the provisions of § 23-941.

E. The commission shall adopt by rule a definition of unfair claim processing practices and bad faith. In adopting a rule under this subsection, the commission shall consider, among other factors, recognized and approved claim processing practices within the insurance industry, the commission's own experience in processing workers' compensation claims and the workers' compensation and insurance laws of this state.

F. This section shall not be construed as limiting or interfering with the authority of the department of insurance as provided by law to regulate any insurance carriers, including the jurisdiction of the department of insurance over unfair claim settlement practices as provided in § 20-461.

²⁶ *Hayes*, 872 P.2d at 670.

The *Hayes* court ignored the exclusive jurisdiction language of the statute that states “[t]he commission has exclusive jurisdiction ... over complaints involving alleged ... bad faith by an ... insurance carrier or claims processing representative,”²⁷ holding instead that the provision was “ambiguous.”²⁸ The court speculated that the statute either potentially deprived the judiciary of all power to hear damage actions sounding in bad faith, or it gave the commission exclusive jurisdiction over only administrative complaints and penalties authorized and created by the statute, leaving intact the court’s jurisdiction over common law damage actions.²⁹ The court examined the statute’s legislative history and claimed to have found nothing expressing any intent on its meaning.³⁰ The court noted that the statute did not have a statement of purpose, nor was it enacted as part of a comprehensive body of legislation.³¹ These factors led to the court’s conclusion of ambiguity.

The *Hayes* court found support for its ruling, relying on the Colorado Supreme Court’s decision in *Travelers Insurance Co. v. Savio*.³² In that case, the court ruled that Colorado’s workers’ compensation laws did not preclude an employee from bringing a common law tort action against a worker’s compensation insurance carrier for bad faith.³³ The court noted that the relevant Colorado statute³⁴ required every workers’ compensation insurance contract to “contain a clause to the effect that the insurance carrier shall be directly and primarily liable to the employee.”³⁵ Unfortunately, the *Hayes* court overlooked that fact that Arizona did not have a similar statute that required the workers’ compensation insurer to be directly and primarily liable to the employee when it relied on Colorado law to support its position.

The *Hayes* court also looked at the statute’s penalty provision. It noted that the statute’s penalties appeared to be modest; therefore, it concluded that the legislature could not have intended them to be the sole remedy.³⁶

The conclusion reached in *Hayes* is not an anomaly. Many other jurisdictions have adopted similar rationales in granting injured workers’ rights and claims against workers’

²⁷ ARIZ. REV. STAT. ANN. § 23-930.

²⁸ *Hayes*, 872 P.2d at 672.

²⁹ *Id.*

³⁰ *Id.* at 673-75.

³¹ *Id.* at 674.

³² *Travelers Ins. Co. v. Savio*, 706 P.2d 1258 (Colo. 1985).

³³ *Id.* at 1273-74.

³⁴ COLO. REV. STAT. ANN. § 8-44-105 (West 2008).

³⁵ *Travelers Ins. Co.*, 706 P.2d at 1272 (quoting COLO. REV. STAT. § 8-44-105 (1973)). The 1973 language of section 8-44-105 quoted by the *Travelers* court is consistent with the current version of that section. COLO. REV. STAT. ANN. § 8-44-105 (West 2008).

³⁶ *Hayes*, 872 P.2d at 676.

compensation insurance carriers.³⁷ By doing so, these courts have created irreconcilable problems for insurance carriers. Essentially, the insurance carrier owes a duty of good faith and fair dealing to two parties with conflicting interests. Any act by the insurance carrier perceived to favor the employer often must then be to the detriment to the injured employee, and vice versa. The carriers' position is akin to an attorney representing both a husband and wife in a divorce proceeding, or an attorney representing two partners in the sale of business by one to the other.

VI. CONCLUSION

The statutory scheme and judicial interpretation of these schemes found in many states are fraught with contradiction. Courts are invading the province of administrative agencies and have ignored statutory schemes, thereby creating an irresolvable conflict for insurance carriers. The Rules of Professional Conduct would not permit an attorney to represent an employer and an employee in an adversarial proceeding.³⁸ However, under the decisions of these courts, an insurance carrier owes the duty of good faith and fair dealing to both an employer and employee when their positions are in inherent conflict with one another. The employer many times wants a claim denied or extensive medical exams to take place, while the employee desires a streamlined process in order to receive immediate care and benefits. Thus, many jurisdictions impose on insurance carriers a duty that is recognized by the professional rules of conduct to be impossible to carry out ethically, and therefore representation of both parties would create a conflict and is prohibited.³⁹ When a carrier can be sued by the employer for overpaying a claim, and yet be sued by an employee for underpaying the same claim, the system, whether judicially or legislatively created, is one that is dangerous to navigate.

³⁷ See *supra* notes 7-19.

³⁸ See MODEL RULES OF PROF'L CONDUCT R. 1.7(a).

³⁹ See *id.*

