SANDBERG PHOENIX

BAD FAITH BLOG

Iowa Rule: First-Party Bad Faith Claim Barred Because Not Brought With Breach of Contract Suit Against Insurer

AUTHOR: SANDBERG PHOENIX

Summary: The insured made significant improvements to its building, thereby increasing building's value. Insurer made initial payments to insured under building, personal property and business income coverages. After substantial negotiations between insurer and insured's counsel, insured filed breach of contract action against insurer. Insured won at trial, and insurer paid the judgment and interest and obtained a satisfaction of judgment.

Villareal v. United Fire & Casualty Company

Three months later, the insured filed another suit against insurer seeking to recover for first-party bad faith. *Id.* at 717. The insured claimed the insurer's bad faith had caused them *additional* damages of lost profits, lost wages, and emotional distress. The trial court granted insurer's motion for summary judgment, finding that the bad faith lawsuit was barred by "claim preclusion." The Court of Appeals reversed the trial court's decision, but the Supreme Court of Iowa reinstated the trial court's grant of summary judgment to insurer.

The Supreme Court concluded that there was no controlling Iowa law and undertook a discussion of law from around the country. The Court concluded that a "great majority of jurisdictions take the view that a breach-of-contract verdict in favor of the insured and against his or her insurer precludes a subsequent action for first-party bad faith, at least where the bad-faith claim is based on events that predate the filing of the breach-of-contract lawsuit." *Id.* at 722.

The Court then recognized two exceptions to this majority rule: (1) where the bad faith claim is based on conduct that occurred during the breach-of-contract lawsuit, and (2) where the bad faith occurs only after the insured has prevailed in its breach-of-contract action.

The Court also took special note of Florida's unique approach to the issue. In Florida a first-party bad faith cause of action does not accrue until the conclusion of the underlying breach-of-contract litigation. There can be no claim preclusion in Florida based on the adjudication of the insured's initial suit against the insurer seeking to collect policy benefits. The Supreme Court of Iowa expressly rejected Florida's approach.

The Court also explored whether discovery and trial of the breach-of-contract and bad faith actions should be bifurcated. The Court concluded that "during the pretrial stages of a first-party case like this one, we see no difficulty in combining the breach-of-contract and bad-faith claims." *Id*. at 727. However, the Court concluded that Iowa allows bifurcated trials, which should be conducted.

The Supreme Court ultimately concluded that it would adopt the majority rule (essentially the Restatement (Second) of Judgments approach) and held that a first-party bad faith claim ordinarily arises out of the same transaction as a first-party breach of contract claim. A final judgment in the breach-of-contract lawsuit bars the bringing of a subsequent, bad-faith action, with the exceptions noted above regarding conduct during or after the breach-of-contract action. There were also multiple dissenting opinions taking issue with the majority's conclusion that the two causes of action arose out of the same transaction and questioning whether the judicial efficiency touted by the majority opinion justified adoption of this rule.

By Kenneth R. Goleaner