IN THE COURT OF APPEALS OF IOWA

No. 0-715 / 10-0442
Filed January 20, 2011

MARY DETERS, as the Executor for the Estate of Leo Deters,
Plaintiff-Appellee,

vs.

USF INSURANCE COMPANY,
Defendant-Appellant.

Appeal from the Iowa District Court for Polk County, Arthur E. Gamble, Judge.

Insurance company appeals bad faith and punitive damages judgment in favor of its insured. **AFFIRMED.**

Mark McCormick and Margaret C. Callahan of Belin McCormick, PlC., Des Moines, for appellant.

Michael S. Jones and Benjamin R. Merrill of Patterson Law Firm, L.L.P., Des Moines, for appellee.

Heard by Eisenhauer, P.J., and Potterfield and Doyle, JJ.

EISENHAUER, P.J.

Mary Deters, as Executor for the estate of her husband, Leo Deters, filed a declaratory judgment action against USF alleging USF breached the terms of an insurance contract and acted in bad faith. The issues were bifurcated with the coverage issue tried first, followed by a separate trial on the issue of bad faith. After an August 2009 trial on the coverage issue, the court ruled USF had a duty to defend and indemnify the Deters Estate against two co-employee gross negligence claims.

After all evidence had been received in the November 2009 bad faith trial, the trial court directed a verdict for the Deters Estate on the objective element of the bad faith claim, concluding USF had no reasonable basis for denying benefits under the commercial general liability (CGL) policy. The court submitted to the jury the subjective element of the bad faith claim: whether USF knew or had reason to know that its denial was without reasonable basis. The jury ruled in favor of the Deters Estate and awarded punitive damages.

USF appeals arguing: (1) it had an objectively reasonable basis for denying coverage; and (2) the jury's award of punitive damages is unconstitutionally excessive. We affirm.

I. Background Facts and Proceedings.

In 1980, Leo Deters incorporated his ongoing Iowa business, Deters Tower Service, Inc. (Tower Inc.). Leo became company president and Mary was secretary and treasurer. Tower Inc. performed maintenance and service on television and radio towers and antennas in a multi-state area. Mary was

employed as the company's bookkeeper. Leo purchased equipment, negotiated the contracts for jobs, and trained, hired, and fired the other employees. Typically, Leo performed the tower work with the other tower workers. Leo determined what hoist/rope to use when the tower did not have an elevator. Tower Inc. had four additional employees—a receptionist and the three tower workers who went out on the road with Leo.

On May 31, 2006, Leo, along with three-month employee Jon McWilliams, nine-month employee Jason Galles, and one-year employee Dan Bickel, worked on an IPTV tower in Council Bluffs. While Dan remained on the ground, Leo, Jon, and Jason went up the tower and subsequently fell to their deaths.

Before the accident, Tower Inc. had purchased insurance coverage through an experienced insurance agent, Greg LaMair of LaMair-Muluck-Condon insurance agency (LaMair Agency). Starting in July 2004, LaMair utilized USF to secure $1,000,000 primary limit CGL coverage for Tower Inc. This coverage was in force at the time of the accident. On the application for coverage Leo Deters was listed as an additional insured. LaMair utilized other insurance companies to secure workers' compensation insurance and a $5,000,000 umbrella policy for Tower Inc. The umbrella policy only provided excess coverage *after* the UFS primary limit CGL coverage was exhausted.

We first summarize the post-accident claims process, the insurance coverage litigation, and the bad faith litigation.

A. Insurance Claim Process.

At trial, LaMair explained LaMair Agency filed three loss notices with the insurance carriers: "One would have been against the work comp carrier, the second against the general liability and the third against the umbrella." Mary's attorney, David Wetsch, also sent UFS a notice of loss. The UFS claim process was handled by Sally Rock and her supervisor, attorney Steve Gabel.

Rock's July 13, 2006 letter replied to Wetsch's notice of loss, stating: "We will be conducting a limited investigation into this matter, as there was an Employer's Liability Exclusion on the policy that would bar any employee to sue their employer in a case such as this one." Rock indicated she had spoken with Mary and learned Mary had been contacted by Jason's father's attorney.

On January 15, 2007, Rock wrote to the attorney representing Jon's family, with copies to Wetsch and LaMair Agency, denying coverage by UFS. Rock quoted the Tower Inc. policy:

> COMMERCIAL GENERAL LIABILITY COVERAGE FORM
> CG 00 01 07 98
> 1. Insuring Agreement
> a. We will pay those sums that the insured becomes legally obligated to pay as damages because of "bodily injury" . . . . We will have the right and duty to defend the insured against any "suit" seeking those damages. However, we will have no duty to defend the insured against any "suit" . . . to which this insurance does not apply. . . .
> . . . .
> 2. Exclusions
> This insurance does not apply to:
> . . . .
> e. Employer's Liability
> "Bodily injury" to:
> (1) An "employee" of *the* insured arising out of and in the course of:
> (a) Employment by *the* insured; or

> (b) Performing duties related to the conduct of *the* insured's business . . . .
>
> . . . .
>
> This exclusion applies:
>
> (1) Whether *the* insured may be liable as an employer or in any other capacity; and
>
> (2) To any obligation to share damages with or repay someone else who must pay damages because of the injury.

(Emphasis added.) Rock next explained:

> Jon McWilliams . . . was an employee of Deters at the time of his injury, and was working in the course and scope of his employment when he was injured. Consequently, there is no coverage by USF Insurance Company available in this matter based on the terms of the policy.

Rock's letter identifies USF's policy as CG 00 01. CG 00 01 is a standard form developed by ISO, a not-for-profit organization. At trial, LaMair explained CG 00 01 is "[b]y far the most common form that insurance companies will use. Rather than drafting their own forms, they sign on to ISO and subscribe to ISO and pay a fee to them to use that form." LaMair described how he stays current on any changes in ISO forms over time: "There are about five organizations that we subscribe to that provide coverage interpretations along with updates . . . ." LaMair discussed the interplay between insurance policies he sold to Tower Inc.:

> Q. Now, as far as the workers' compensation coverage, were those paid on behalf of Deters Tower Service Inc.? A. That's correct. The work comp policy is issued in a corporate name, and it's the corporation's mechanism to provide coverage to the employee for a work-related injury.
>
> Q. So based on your understanding and experience and education in the insurance industry, would it be accurate to say that the corporation has coverage under the workers' compensation policy, but executive officers do not? A. That is correct.
>
> Q. Now, in terms of the general liability policy, the policy provided by USF, would it be accurate to say that the corporation does not have coverage, but that the executive officers do? A. For co-employee claim, that is correct. The work comp and the general

> liability coverage are intended to dovetail together and that's intended to exactly work.

The estates of Jason and Jon filed liability claims against the Deters Estate seeking damages. Their petitions (1) allege Leo was "grossly negligent" causing the plaintiffs' injuries; and (2) assert nine specifications of negligence related to Leo's decisions on the day of the accident.

Wetsch forwarded the petition filed by Jon's estate to UFS. On March 27, 2007, Rock replied, with a copy to LaMair Agency, that the "Complaint seeks an award for damages for injuries sustained by [Jon] who was injured while employed by Deters Tower Service, Inc. . . . . The UFS policy "contained a specific exclusion with regards to employees injured in the course of their employment." Rock then quoted the same policy language as her earlier letter. Rock stated UFS would not file "an answer to the complaint on behalf of [Tower Inc.] or Leo." Further,

> Jon McWilliams, as pointed out in the General Factual Allegations of the Complaint, was an employee of Deters Tower Service, Inc. at the time of his injury, and was working in the course and scope of his employment when he was injured. Regardless of whether Mr. Deters was negligent or not, the exclusion bars any employee recovery against the policy. Consequently, there is no coverage by [USF] available in this matter based on the terms of the policy.

On May 30, 2007, LaMair Agency responded to Rock's letter and attached information from the International Risk Management Institute (IRMI). The agency also informed Rock "similar wording" is contained in the AEI General Liability Law of Insurance under Employers Liability Exclusion, Severability of Interest. LaMair's letter informed Rock: "Essentially, the information states that executive

officers have coverage under the CGL policy for co-employee lawsuits. We are *specifically seeking coverage for the estate of Leo Deters as an executive officer*." (Emphasis added.)

On June 7, 2007, Rock acknowledged the LaMair Agency letter and replied: "Please note that it is our position there is no coverage afforded under the USF Insurance Company Commercial General Liability policy issued to [Tower Inc.] for this matter. We concur with our coverage opinion previously sent . . . ." USF "is not answering the Complaint . . . the CGL policy excludes coverage for injuries to employees of the Insured."

Rock's letter makes no reference to "coverage for the estate of Leo Deters as an executive officer" and does not address the information provided by the LaMair Agency. The USF policy included a "separation of insureds" clause.[1] At trial, USF claims attorney Gabel admitted that clause required potential coverage for Leo Deters to be analyzed separately from potential coverage for Tower Inc.

At trial, LaMair testified IRMI is an educational organization and "the leading publication for coverage analysis." LaMair discussed CG 00 01:

> Q. Now, in terms of the CG 00 01 and its coverage of executive officers for claims by co-employees, are you familiar with how long that coverage would have been provided under the CG 00 01? A. I went back and looked, and IRMI provides a great resource because they compare edition dates of forms. I went all

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[1] This clause states:

> 7. Separation of Insureds
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> Except with respect to the Limits of Insurance, and any rights or duties specifically assigned to this Coverage Part to the first Named Insured, this insurance applies:
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> (a) As if each Named Insured were the only Named Insured; and
>
> (b) Separately to each Insured against whom claim is made or 'suit' is brought.

> the way back to 1973. I didn't go beyond that. And the coverage for executive officers and the intent for executive officers has not changed that entire time. They have made a couple minor clarifications on co-employees, but in terms of executive officers, it's been the intent all the way back to '73 that I have found coverage applies to an executive officer.

LaMair also testified he had been involved in other claims against executive officers of corporations by co-employees filed under the same CG 00 01 form used by USF Insurance. It was LaMair's experience that insurance companies provided coverage for claims against executive officers by co-employees. USF's denial of coverage was the first time LaMair had ever seen an insurance company deny coverage for a gross negligence claim against an executive officer.

At trial, Gabel stated the IRMI analysis provided by LaMair Agency is "commentary by an outside organization. It's not even commentary by a court . . . . I don't agree with it based on our—the analysis." Gabel stated UFS had "various publications at our office," but admitted he could not identify any insurance publication that interprets the CGL policy the way USF interpreted the policy.

Mary hired attorney Michael Jones. On December 5, 2007, Jones wrote to Rock and tendered the defense to USF, stating:

> In previous correspondence USF has taken the position that it has no duty to defend or indemnify . . . . However, under the terms of the policy and Iowa law, USF Insurance is obligated to defend and indemnify. I would direct your attention to the Iowa Supreme Court's decision in *Zenti* . . . .

On December 21, 2007, Rock responded and quoted the same policy language as her prior letters. Rock stated, "there is no coverage for the defense and indemnification you are seeking under the policy:"

> Jon McWilliams was an employee of Deters at the time of his injury, and was working in the course and scope of his employment when he was injured. We note the *Zenti* case you mention . . . however we find that the facts of that case and the facts in this matter are not similar. What is different is the fact that the USFIC policy exclusion adds additional express language not found in the *Zenti* case that makes the employer's liability exclusion applicable "whether the insured may be liable as an employer or in any other capacity". Thus, the USFIC policy is more in line with the Supreme Court's analysis in *American Family Mutual [Ins.] Co. –v– Corrigan*.

In USF's answers to interrogatories, signed by Rock on August 11, 2008, two years after the claim, USF states: "Whether employees accused of gross negligence would also be executive officers is irrelevant. Chapter 85 [workers' compensation] provides the only remedy for a work-related injury against an employer and that is against an individual in the capacity of employee."

In Rock's September 18, 2008 deposition, read into the record at trial, she testifies:

> Q. As part of your handling of this claim did you ever do anything to determine whether Leo Deters was an executive officer of Deters Tower Service, Inc.? A. No.
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> . . . .
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> Q. So you have the named insured, which is Deter Tower Service, Inc., and then you also have executive officers who are insured under the policy? A. Yes.
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> . . . .
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> Q. Are you aware, sitting here today, of any additional exclusions or provisions of the policy . . . which you believe exclude or limit coverage that would be available to the Estate of Leo Deters, other than those shown in your letters of January 15, 2007, June 7, 2007, and December 21, 2007. A. I don't believe so.
>
> . . . .

> And if Leo Deters, by virtue of his position in the company, qualifies as an executive officer as that term is used in the policy, would you also have a duty to fully and thoroughly investigate the claim on behalf of his estate? A. Yes.

At trial, Gabel admitted USF issues a reservation of rights letter when "there is a situation of uncertainty" about coverage. The letter informs the insured that USF can contest coverage, but will defend the case. Gabel stated USF did not issue a reservation of rights letter and defend the Deters Estate because "[i]n our mind there was no possibility of coverage."

We briefly discuss the cases identified in the Rock/Jones correspondence and note the first paragraph in *Zenti* states:

> Defendant-insurer appeals declaratory judgment holding "employee exclusion" in liability policy issued to corporation is inapplicable and thus it was obligated to defend two "executive officers" of the corporation in suit filed by a company employee injured during the course of his employment.

Zenti v. Home Ins. Co., 262 N.W.2d 588, 588 (Iowa 1978).

In *Zenti*, William Buttery was an employee of Venetian Iron Works, Inc. (Venetian Inc.) and was injured on the job. *Id*. Buttery received workers' compensation benefits. *Id*. Subsequently, Buttery sued Venetian Inc.'s executive officers Mario and Samuel Zenti, alleging their negligence caused his injuries. *Id*. Home Insurance provided CGL insurance to Venetian Inc. The policy defined "insured" to include: "any executive officer . . . while acting within the scope of his duties as such." Additionally, the policy provided:

> The insurance afforded under [bodily injury] applies separately to each Insured against whom . . . suit is brought, but the inclusion herein of more than one Insured shall not operate to increase the limit of [Home Insurance's] liability . . . .

Id. at 589. Exclusion section "(i)" of the *Zenti* policy denied coverage for "bodily injury to any employee of *the* Insured arising out of and in the course of his employment by *the* Insured." *Id*. (emphasis added). The *Zenti* court, noting "this is a case of first impression in Iowa," outlined the arguments of the parties:

> Home Insurance contends . . . that the injured employee Buttrey was an "employee of the Insured" within the meaning of exclusion section (i) so that the additional "Insureds" Mario and Samuel Zenti are not entitled to coverage. The Zentis contend the "severability-of-interests" clause requires a finding that the exclusion is to be applied only against the insured for whom workmen's compensation coverage is sought. Because Buttrey was an employee of Venetian Iron Works, Inc., rather than the Zentis at the time of the accident, Zentis argue Home Insurance is obligated to defend them.

Id. The *Zenti* court rejected Home Insurance's argument that household insurance exclusion cases support its position:

> [T]he purposes underlying the employee exclusion and the household exclusion are not similar. The household exclusion was clearly meant to prevent "friendly lawsuits" where the plaintiff and the insured defendant are bound by ties of kinship. *There can be no dispute that an injured industrial worker's suit against executive officers of a corporation does not fit that characterization*.

Id. at 591 (emphasis added). The court ruled the Zentis, as executive officers, were entitled to indemnification and defense:

> [W]e are persuaded that the severability-of-interests clause was inserted into insurance contracts to make clear that *the employee exclusion is applicable only when the person claiming coverage as insured is the employer*. To reach the conclusion urged by Home Insurance would wholly negate this purpose. This we will not do.
>
> Trial court correctly held the employee exclusion was inapplicable here and thus Home Insurance was obligated to defend Zentis as "executive officers" against a suit for damages brought by Venetian Iron Works' employee, William Buttrey.

Id. at 592 (emphasis added).

Next, we note *Corrigan* did not involve an injured industrial worker's suit against the executive officer of a corporation, but rather involved a homeowners policy exclusion for bodily injury arising out of criminal law convictions. *American Family Mut. Ins. Co. v. Corrigan*, 697 N.W.2d 108, 110 (Iowa 2005). In *Corrigan*, the parents of a child injured in Mark Francke's daycare sued Harold, Mark's father, alleging negligent supervision and liability based on Harold's ownership of the home where the injuries occurred. *Id*. Mark was convicted of child endangerment. *Id*. at 109-10. The *Corrigan* court distinguished the exclusion at issue in *Zenti*:

> In contrast to the exclusions at issue in *Zenti* . . . the American Family policy excludes coverage for bodily injury "arising out of . . . violation of any criminal law for which *any* insured is convicted." . . . This court has held that the term "*any* insured" *as used in an exclusionary provision of the property coverage of a homeowners policy* means that coverage is voided as to all insured if any insured committed a prohibited act.

Id. at 116 (emphasis added). The court ruled Harold's homeowner policy did not provide coverage:

> The undisputed facts show the bodily injury resulting from Harold's negligence was proximately caused by Mark Franke's violation of criminal law. This violation was not independent of the negligence clams against Harold as Mark's conduct was a required element in establishing Harold's liability. Therefore, even though the policy is applied separately to Harold, it does not provide coverage.

Id. at 118-19.

B. Insurance Coverage Litigation.

In May 2008, Mary, as executor of the Deters Estate, filed a declaratory judgment action against USF alleging USF breached the terms of the insurance contract and acted in bad faith.

In the fall of 2008, the Deters Estate settled the tort cases filed by Jon and Jason's estates. Jon and Jason's estates accepted an offer by the Deters Estate to confess judgment in the amount of $375,000 per estate and in exchange received $5000 per estate and an assignment of the Deters Estate's right to indemnification under the USF policy. Jon and Jason's estates also agreed to a covenant not to execute against Tower Inc. or the Deters Estate and agreed to only seek to satisfy the remaining judgment from USF proceeds. The Deters Estate retained the failure to defend and bad faith claim and right to recover attorney fees from USF. Jon and Jason's estates intervened in the Deters Estate declaratory judgment action against USF.

Trial on the declaratory judgment action was bifurcated. On August 17, 2009, trial was held on the coverage issue. On August 26, 2009, the district court found the following facts:

> 4. . . . [Leo] was responsible for researching and purchasing the equipment necessary for tower maintenance work. It was Leo's responsibility to make sure the equipment was in working order. For each particular job, he would decide what type of equipment was needed, including the type of rope and hoists necessary to complete the work.
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> 5. On May 31, 2006 . . . the work was more complex than simply unscrewing the burned out light bulbs and screwing new ones back in. The lighting system on a large television tower is complicated. . . . Leo Deters had 26 years of experience in the tower service business. He was the only person in the company with the experience necessary to properly complete the work at the IPTV tower. As the owner and president of the company, Leo was the boss and ran the show. In the exercise of his managerial

> authority, Leo chose the type of winch, rope and pulley system that was used on the IPTV job. Leo assigned [Jon and Jason] to perform the maintenance work along with him on the tower while [Dan] operated the winch. Leo assigned Jon and Jason to ride the rope above him so that Leo could see everything that was going on above and below him as the crew ascended to the top level of the tower.

The court ruled Leo was an "executive officer" as the term is defined in the USF policy. Leo was therefore "insured" under the UFS policy language "WHO IS AN INSURED: . . . Your 'executive officers' and directors are insureds, but only with respect to their duties as your officers and directors."

Noting the duties of an officer are not defined by the CGL, the court concluded: "Leo Deters was an executive officer performing duties as an officer or director of the company on the date in question." The court explained:

> USF argues that Leo's duties as president of [Tower Inc.] were limited to administrative matters like signing documents and deciding benefits packages. Deters' Estate contends Leo's duties as president of the company included operational decisions like which equipment to purchase and which rope and winch to use on a particular job. The Court concludes the policy term "duties of your officers" is reasonably susceptible to either interpretation. Under Iowa law, the policy must be interpreted in a manner most favorable to the insured. [Citation omitted.]
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> This approach was applied by the Missouri Supreme Court to this same CGL term in *Martin v. United States Fid. & Guar. Co*., 996 S.W.2d 506, 510 (Mo. 1999).[2] The [*Martin*] Court considered the question of whether installing the pipe was included in his 'duties as officers' within the meaning of the CGL. [The *Martin* court stated: "As noted above, executive officers are insureds under the policy only with respect to their 'duties as officers.' USF&G argues . . . that the conduct complained of in [the] petition, the installation of a pipe, was not managerial or administrative in character and, therefore, not within the scope of his duties as an

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[2] We note the *Martin* policy language is identical to the USF policy language: "Your executive officers and directors are insureds, but only with respect to their duties as your officers or directors." *Martin v. United States Fid. & Guar. Co*., 996 S.W.2d 506, 508 (Mo. 1999).

> officer. While USF&G does not contest that [his] actions in installing the pipe were within his job responsibilities as chief operator, USF&G argues that 'duties as officers' include only those portions of an officer's position that are managerial in character." *Id*. at 509-10.]
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> The plant operator argued that all job responsibilities performed by executive officers are included in their duties as officers, whether or not the character of the particular act at issue was managerial in nature. The [*Martin*] Court determined . . . "[The plant operator] was an 'executive officer' of [the city], and because he was performing his duties as such when his allegedly negligent conduct occurred, he was an insured under the city's [CGL] policy . . . ."
>
> This Court concludes that the duties performed by [Leo] on May 31, 2006 were well within the scope of his duties as an officer of [Tower Inc.] These duties included directing the manner and method of work, selecting the equipment and crew to do the work and performing complex duties on the tower that only Leo, as president of the company, was qualified to perform. The duties of an executive officer of a small closely-held company like [Tower Inc.] are not limited to the administrative function of signing documents like leases and mortgages or deciding which health insurance to buy for employees. Leo's duties as an executive officer of [Tower Inc.] included the day-to-day management of the company including the work that was performed on the date of the accident. Accordingly, the Court concludes that [Leo] was an insured under [USF's] CGL.

The court next addressed USF's claim its CGL employer's liability exclusion precluded coverage.

> USF argues *Zenti* is distinguishable because the employer's liability exclusion in the CGL policy issued to [Tower Inc.] includes the terms "in any other capacity." The UFS policy states the [employer's liability] exclusion applies "whether the insured may be liable as an employer or in any other capacity." . . . USF argues the inclusion of the language "or any other capacity" includes Deters within the employer's liability exclusion.
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> USF believes *Corrigan* is controlling. . . . USF's reliance on *Corrigan* is misplaced. Unlike the policy language in *Zenti* limiting the employer's exclusion to "the insured," the [*Corrigan*] policy expanded the criminal acts exclusion to "any insured." . . .
>
> USF could have expanded the employer's exclusion in Deters' policy to include "any insured" but it did not. The employer's liability exclusion in the USF policy is limited to "the

insured." The USF policy is more like the policy in *Zenti* than *Corrigan*. The additional language "or in any other capacity" does not equate to the "any insured" language in the criminal acts exclusion at issue in *Corrigan*.

USF's argument in this regard is addressed in the [IRMI] (Aug. 2007) . . . as follows:

"But such an interpretation fails to take into account the opening language of the exclusion, which limits its applicability to injury of an employee of 'the insured.' The term '*the insured'* has been uniformly held by the courts—and understood by the insurance industry itself—to be a reference to the insured against whom a claim has been made and who is seeking coverage under the policy. . . . This point is seldom misunderstood in and of itself, but sometimes becomes confused when the dual capacity language is taken out of the context of the rest of the exclusion. '*Liable as an employer or in any other capacity' still refers only to the insured who is the employer of the injured employee, but who may also have liability exposure connected to some additional relationship with the employee*.'"

. . . The Court concludes that the language "or in any other capacity" does not add Deters, as an executive officer, to the employer's liability exclusion. Instead, that language simply refers to the named insured [Tower Inc.] as the employer of [Jon and Jason] or in any other relationship that [Tower Inc.] might have with these employees.

This interpretation is consistent with the interpretation of the CGL in *Tri-S Corp. v. W. World, Ins. Co.*, 135 P.3d 82 (Haw. 2006).[3] In *Tri-S Corp*., the Court considered the effect of an employer's liability exclusion identical to the UFS policy including the language "whether the insured may be liable as an employer *or in any other capacity*." . . . Citing *Zenti*, the Hawaii Supreme Court held in a case with facts similar to the [Deters Estate] case:

"Based on the foregoing, we adopt the majority rule and hold that where an insurance policy contains a severability-of-interests clause, the phrase 'the insured' in a policy exclusion must be read to refer to the insured seeking coverage as opposed to the 'named insured' or 'any insured.' Here, the insured claiming coverage is Taft; thus the phrase 'employee of the insured' under [the CGL] must be read 'employee of Taft.' However, [plaintiff] was not an employee of Taft, but of Tri-S, so the exclusion does not apply."

In this case, the insured claiming coverage is Leo's Estate. However, [Jon and Jason] were not employees of Leo, but of [Tower Inc.], so the exclusion does not apply. . . .

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[3] Later, the court criticizes Gabel's failure to shepardize *Zenti* to locate/analyze the *Tri-S* case.

Finally, the court addressed and rejected USF's contention the exclusion precludes coverage to the Deters Estate under the severability of interest clause:

> Since the Estate of Leo Deters is an insured under the executive officer's provision and coverage is not excluded under the employer's liability exclusion, the separation of insureds provision does not defeat coverage in this case. The CGL separation of insureds provision requires USF to analyze coverage from the standpoint of not only [Tower Inc.], but also from the standpoint of Leo Deters as an executive officer and as an insured. . . . While coverage for [Tower Inc.] as the employer is excluded, coverage for Leo as an executive officer is not.

The court concluded USF had a duty to defend and indemnify the Deters Estate against the co-employee gross negligence claims brought by the Jon and Jason estates.

C. Bad Faith Litigation.

On November 12, 2009, UFS settled with the Jon and Jason estates for $500,000, and the estates dismissed their claims against UFS. On November 16, 2009, the jury trial of the Deters Estate's bad faith and attorney fees claims commenced. During trial, UFS admitted the Deters Estate's entitlement to attorney fees expended in defending the Jon and Jason estates' litigation.

At the close of all the evidence, the trial court found as a matter of law that UFS had no fairly debatable ground for denying coverage to the Deters Estate for the Jon and Jason estates' lawsuits. The court granted directed verdict in favor of the Deters Estate on that issue and submitted the remaining issues to the jury.

The jury returned a verdict finding: (1) USF knew or had reason to know that its denial or refusal of coverage was without reasonable basis; and (2) USF's conduct constituted willful and wanton disregard for the rights of another and was

directed specifically at the Deters Estate. The jury awarded $1,000,000 in punitive damages.

UFS filed post-trial motions seeking judgment notwithstanding the verdict, a new trial, or remittitur. The trial court denied UFS's motions and entered judgment for the full amount of punitive damages awarded and for $68,908 in attorney fees: $22,224.97 (defending Jon and Jason lawsuits); $15,749.25 (establishing coverage); and $30,934.04 (establishing bad faith and punitive damages).

UFS does not contest the $22,224.97 defense liability fees. On appeal USF argues the court erred in granting a directed verdict to the Deters Estate. USF claims the court should have ruled the coverage issue was fairly debatable, directed a verdict for UFS, and dismissed the bad faith and punitive damages claims. Alternatively, UFS challenges the punitive damages award as unconstitutionally excessive.

II. Standard of Review.

"We review the trial court's ruling on a motion for directed verdict for the correction of errors of law." *Bellville v. Farm Bureau Mut. Ins. Co.*, 702 N.W.2d 468, 473 (Iowa 2005). Appellate review of a punitive damage award on constitutional grounds is de novo. *Wolf v. Wolf*, 690 N.W.2d 887, 894 (Iowa 2005).

III. Bad Faith—No Reasonable Basis.

Bad faith claims serve to redress "the inherently unequal bargaining power between the insurer and the insured, which persists throughout the parties'

relationship and becomes particularly acute when the insured sustains . . . an economic loss for which coverage is sought." *Dolan v. Aid Ins. Co.*, 431 N.W.2d 790, 792 (Iowa 1988). "The tort of bad faith only arises when the insurance company intentionally denies or fails to process a claim without a reasonable basis for such action." *Reuter v. State Farm Mut. Auto. Ins. Co.*, 469 N.W.2d 250, 251 (Iowa 1991). To establish UFS's bad faith, the Deters Estate was required to prove two elements, one objective and one subjective: (1) objective—UFS "had no reasonable basis" for denying benefits under the policy; and (2) subjective—UFS "knew or had reason to know that its denial or refusal was without reasonable basis." *Bellville*, 702 N.W.2d at 473.

UFS limits its appeal to the objective element. Therefore, the determinative question is whether UFS's position was reasonable: "A reasonable basis exists for denial of [coverage] if the insured's claim is fairly debatable either on a matter of fact or law." *Id*. "A claim is 'fairly debatable' when it is open to dispute on any logical basis." *Id*. "[I]f reasonable minds can differ on the coverage-determining facts or law, then the claim is fairly debatable." *Id*.

"Whether a claim is fairly debatable can generally be decided as a matter of law by the court." *Id*. "[T]he most reliable method of establishing that the insurer's legal position is reasonable is to show that some judge in the relevant jurisdiction has accepted it as correct." *Id*. at 484 (citation omitted).

UFS argues the trial court confused the subjective and objective elements when it discussed the inadequate investigation by UFS in analyzing the objective element. The Iowa Supreme Court has ruled:

> Although subjective bad faith may be inferred from an insurer's flawed investigation, an improper investigation, standing alone, is not sufficient cause for recovery if the insurer in fact has an objectively reasonable basis for denying the claim. *Pace v. Ins. Co.*, 838 F.2d 572, 584 (1st Cir.1988).

Reuter, 469 N.W.2d at 254-55. However, the *Pace* court further explained the role of a proper investigation in resolving the objective element:

> But while the subjective element can be inferred from an investigation that recklessly disregards the facts, the objective element must also be shown. This requires establishing that a reasonable insurer, proceeding under the facts and circumstances that a proper investigation would have revealed, would not have denied payment of the claim.

Pace, 838 F.2d at 584. Therefore, the trial court correctly considered whether a reasonable insurer, proceeding under the facts and circumstances revealed by a proper investigation, would have defended the Deters Estate and provided indemnification.[4]

Next, UFS claims the Deters Estate was not entitled to a directed verdict based on the policy language: "WHO IS AN INSURED: . . . Your 'executive officers' and directors are insureds, but only with respect to their duties as your officers and directors." UFS argues: "Leo's decisions regarding the equipment to be used on the fatal job were not broad-based executive decisions involving the design of corporate policy but merely daily operational or managerial decisions." Therefore, "[b]ecause no settled Iowa law exists on the issue of when a 'hands on'" executive acts "with respect to their duties as [the corporation's]

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[4] We find no merit to UFS's claim the trial court improperly shifted the burden of proof by stating there was "no substantial evidence supporting [UFS's] position that it had an objectively reasonable basis for the denial of" policy benefits. The court was ruling on cross-motions for directed verdict and this language refers to UFS's burden of proof on its motion.

officers and directors," under the policy language, the Deters Estate was not entitled to a directed verdict.

We disagree. The existing law and treatises discussed/analyzed above reveal no jurisdiction or treatise supporting UFS's denial. We conclude that after a proper investigation, reasonable minds would not disagree on the coverage-determining facts and law and the issue is not fairly debatable. We adopt the district court's analysis of the objective element in its ruling on the parties' cross-motions for directed verdict:

> [UFS argued Leo is] not an insured because he's a co-employee, without ever considering whether or not [Leo] was not only acting solely in his capacity as a tower maintenance worker slash co-employee, but whether he was working in his capacity as the president of the company, making executive decisions on the date in question. It never really occurred to them because it was irrelevant. And for that reason, there is no reasonable basis to deny the claim on that ground because it was, number one, never investigated and, number two, it's not consistent with any law and, number three, it's not consistent with any insurance treatise and, number four, the insurance company can cite absolutely no authority anywhere in the United States that is consistent with their determination. It's simply not a reasonable basis for the denial . . . of coverage or denial of duty to defend.
>
> You have to go back and look at the Who Is An Insured section of the policy . . . "Your executive officers and directors are insureds, but only with respect to their duties are your officers and directors."
>
> It may be difficult to draw the line between Leo Deters, the tower worker, and Leo Deters, the president, but at least the insurance company has a duty to investigate it, to think about it, if they're going to claim that as a reasonable basis for denial of the claim, and they didn't do that because, as they said, it was irrelevant.
>
> The *Zenti* case was authority for the proposition that there was coverage for claims made by the [Jon and Jason estates] against Leo Deters in his capacity as an executive officer of the company . . . .
>
> And [UFS,] when *Zenti* was brought to their attention, had a duty to read it, know it, understand it, shepardize it, see if it was

> good authority, and they really did not do that. . . . [B]ecause of their outright refusal to actually consider the law, they cannot come back later and claim that their position was reasonable or that they had a reasonable basis to deny coverage or defense.
>
> . . . .
>
> [UFS's] position was not fairly debatable either on the law or the facts. It was not open to dispute on any logical basis. They claim they have a right to debate it, yet many of their positions that they assert now were never even discussed at the time the coverage-determining facts were considered, and that specifically refers to . . . the executive officer analysis.
>
> Focusing on the existence of a debatable issue and not whether, in fact, there was coverage, the Court finds and concludes there was no reasonable basis for denial of the claim, no reasonable basis actually existed, evidence to support the proffered reasonable basis did not exist to justify denial of the claim.
>
> So with regard to Element No. 1, the objective element of the bad faith claim, the Court finds the [Deters Estate's] Motion for Directed Verdict should be sustained, and then viewing the evidence in the light most favorable to the [Deters Estate, UFS's] Motion for Directed Verdict should be denied.

IV. Punitive Damages.

UFS argues the jury's $1 million punitive damages award is unconstitutionally excessive. *See State Farm Mut. Auto Ins. Co. v. Campbell*, 538 U.S. 408, 417, 123 S. Ct. 1513, 1520, 155 L. Ed. 2d 585, 600 (2003) (holding $145million/$1 million ratio grossly excessive and a violation of due process). Punitive damages are "aimed at deterrence and retribution." *Id*. at 416, 123 S. Ct. at 1519, 155 L. Ed. 2d at 600.

In reviewing the jury's punitive damage award for excessiveness, we consider "three guideposts." *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559, 574-75, 116 S. Ct. 1589, 1598, 134 L. Ed. 2d 809, 826 (1996) (holding $2 million/$4000 ratio grossly excessive—defendant's failure to disclose pre-delivery damage and repair to new car). We evaluate:

> (1) the degree of reprehensibility of the defendant's misconduct; (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award; and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

Campbell, 538 U.S. at 418, 123 S. Ct. at 1520, 155 L. Ed. 2d at 601.

A. Degree of Reprehensibility.

The degree of reprehensibility of the actor's conduct is the most important indicium of the reasonableness of a punitive damages award because the damages imposed "should reflect the enormity of [the] offense." *Gore*, 517 U.S. at 575, 116 S. Ct. at 1599, 134 L. Ed. 2d at 826. A number of factors are considered in determining the reprehensibility of UFS's conduct: whether (1) "the harm caused was physical as opposed to economic"; (2) "the tortious conduct evinced an indifference to or a reckless disregard of the health or safety of others;" (3) "the target of the conduct had financial vulnerability;" (4) "the conduct involved repeated actions or was an isolated incident;" and (5) "the harm was the result of intentional malice, trickery, or deceit, or mere accident." *See Campbell*, 538 U.S. at 419, 123 S. Ct. at 1521, 155 L. Ed. 2d at 602. The existence of any one of these factors weighing in favor of the Deters Estate may not be sufficient to sustain a punitive damages award; and the absence of all of them renders the award suspect. *See id*.

We recognize that "trickery and deceit are more reprehensible than negligence and intentional conduct can be the deciding element in a 'close and difficult' case." *See Gore*, 517 U.S. at 576, 116 S. Ct. at 1599, 134 L. Ed. 2d at 827. Further, "infliction of economic injury, especially when done through

affirmative acts of misconduct, or when the target is financially vulnerable, can warrant a substantial penalty." *Id*.

In this case, several of the aggravating factors associated with reprehensible conduct are present. The record reveals "infliction of economic injury . . . through affirmative acts of misconduct" done when the Deters Estate was "financially vulnerable," thereby warranting "a substantial penalty." *See id*.

First, the Deters Estate, valued at $1.3 million, was financially vulnerable. UFS's bad faith denial of coverage and its refusal to defend the multi-million dollar wrongful death claims asserted by the Jon and Jason estates could have resulted in an adverse verdict decimating the entire Deters Estate. UFS's conduct forced the Deters Estate to retain counsel and incur substantial attorney fees and expenses in three cases: (1) wrongful death claims; (2) insurance coverage—duty to defend/indemnify; and (3) tortious bad faith.

Second, UFS's infliction of economic injury was admittedly intentional, not accidental, and the record discloses numerous deliberate acts of affirmative misconduct, trickery, and deceit. We highlight the trial court's discussion (outside the presence of the jury) of Gabel's testimony during the bad faith trial concerning "page one" of the policy. The court stated:

> [Gabel's discussion of] the definition of "insured" at page 1 of the policy and argument that that means "any insured" within the employer's liability exclusion is the first time, to my recollection, that that issue has ever been addressed in this litigation. . . .
>
> I think it's fair cross-examination that that was never raised as a reasonable basis for denial of the claim in any denial letter; that it was never, ever argued as a reasonable basis for denial of the claim in any pleading; that it was never argued as a reasonable basis for denial of the claim or denial of the duty to defend in any motion filed with the Court for summary judgment or resistance

> thereof; that it has never come up in this case ever until this trial on the bad faith claim, and the inference from that would be . . . it's not a reasonable basis for denial of the claim or the duty to defend [and] it was never considered to be a reasonable basis for denial of the claim or the duty to defend.

Gabel's testimony was further analyzed in the court's ruling on motions for directed verdict:

> [F]or the insurance company to come in here and try to say that we considered [policy page one] all along, that was part of our analysis from the beginning, that's our reasonable basis for denial of the claim, when they never once documented it, they never once argued it to the Court, and [Gabel] actually even admitted in his testimony the following: "In fact, this issue about 'the insured' . . . versus 'any insured' came up only a few months ago after His Honor made his ruling, but it's always been part of the policy." That's a post hoc rationalization for a bad decision that was made a long time ago.

Third, UFS made an intentional decision to refuse to even defend the gross negligence cases under a reservation of rights.

Fourth, UFS's conduct involved repeated actions-–issuing five denial letters between July 2006 and December 2007. UFS stubbornly refused to research, reconsider, investigate, and reevaluate its duty to indemnify and defend—even after the Deters Estate provided convincing authority that there was coverage under the CGL policy. Only after the trial court entered its declaratory judgment did UFS accept its duty to indemnify and settle the Jon and Jason estates' claims within the $1 million policy limits.

After considering "the most important indicium of the reasonableness of a punitive damages award," we conclude UFS's conduct was sufficiently reprehensible to justify a $1 million award of punitive damages. *See Gore*, 517 U.S. at 575, 116 S. Ct. at 1599, 134 L. Ed. 2d at 826.

B. Disparity between Actual/Potential Harm and Punitive Award.

"The second . . . indicium of an unreasonable or excessive punitive damages award is its ratio to the actual harm inflicted on the plaintiff." *Gore*, 517 U.S. at 580, 116 S. Ct. at 1601, 134 L. Ed. 2d at 829. UFS argues the Deters Estate's compensatory damages of $45,800 in attorney fees, for establishing the right to coverage and for prosecution of the bad faith claim, at a 20:1 ratio is a outside the ratio "generally deemed constitutionally acceptable." Alternatively, UFS argues if consideration of the $500,000 settlement paid by UFS is found to be an appropriate part of the ratio analysis, then due process requires a reduction of the punitive damages award to $500,000—a 1:1 ratio.

Courts "have been reluctant to identify concrete constitutional limits on the ratio between harm, or potential harm, to the plaintiff and the punitive damages award." *Campbell*, 538 U.S. at 424, 123 S. Ct. at 1524, 155 L. Ed. 2d at 605. The "proper inquiry is whether there is a reasonable relationship between the punitive damages award and *the harm likely to result* from the defendant's conduct as well as the harm that actually has occurred." *Gore*, 517 U.S. at 581, 116 S. Ct. at 1602, 134 L. Ed. 2d at 830 (noting 4:1 and 10:1 ratios had been constitutionally acceptable and ruling "breathtaking" 500:1 ratio a violation of due process). However, the constitutional line is not "marked by a simple mathematical formula." *Id*. at 582, 116 S. Ct. at 1602, 134 L. Ed. 2d at 830. Rather, "[t]he precise award in any case . . . must be based on the facts and circumstances of the defendant's conduct and the harm to the plaintiff." *Campbell*, 538 U.S. at 425, 123 S .Ct. at 1524, 155 L. Ed. 2d at 606. Therefore,

our job is to "ensure that the measure of punishment is both reasonable and proportionate to the amount of *harm* to the [Deters Estate] *and* to the general *damages* recovered." *Id.* at 426, 123 S. Ct. at 1524, 155 L. Ed. 2d at 606 (emphasis added).

First, we note UFS was obligated to pay $68,908 in attorney fees. However, in determining reasonableness we do not mathematically compare the $68,908 compensatory damages to determine if the punitive damages awarded violate due process. We consider also the *potential* harm resulting from USF's bad faith denial of coverage and find it is in the range of the $1 million policy limits, if not more. Further, the *actual* harm was in the range of the total of the $750,000 offers to confess judgment accepted by the Jon and Jason estates and the $500,000 settlement paid by USF to satisfy the underlying judgments after the trial court's declaratory judgment ruling. When all the relevant factors are considered—compensatory damages, potential harm, and actual harm—the $1 million award here is constitutionally permissible.

C. Punitive-Damages Comparison to Civil or Criminal Penalties.

In its analysis of this guidepost, the district court ruled: "[t]here are no civil regulatory penalties or criminal sanctions for a coverage dispute. [The Deters Estate's] remedy for first party bad faith is through civil prosecution of this intentional tort and actual and punitive damages." During oral argument USF conceded there are no comparable civil penalties.

Accordingly, after our analysis of the three constitutional guideposts, we conclude the punitive damage award is supported by the record and is not grossly excessive. *See Wolf v. Wolf*, 690 N.W.2d 887, 896 (Iowa 2005).

AFFIRMED.