UIC Law Review

Volume 16 | Issue 3 Article 1

Summer 1983

Section 767 of the Illinois Insurance Code: Does it Pre-empt Tort Liability, 16 J. Marshall L. Rev. 471 (1983)

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SECTION 767 OF THE ILLINOIS INSURANCE CODE: DOES IT PRE-EMPT TORT LIABILITY?

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INTRODUCTION: AN OVERVIEW

Over the past decade a growing number of jurisdictions have been faced with suits seeking to impose extra-contractual liability upon insurers who, in an effort to force a disadvantageous claim settlement upon their insureds, unjustifiably breach the insurance contract. Reasons for and against imposing such liability vary from jurisdiction to jurisdiction. Controversy centers on what may be recovered for such conduct, as well as whether the conduct may itself serve as a basis for tort liability. Broadly speaking, the insurer's position is that unjustified delay or denial of benefits constitutes mere breach of contract, and therefore, the plaintiff's remedy is limited to the contractual obligation of the insurer. The insured takes the position, on the other hand, that the conduct of the insurer goes beyond mere breach of contract, constituting a tort independent of the contractual relationship because the injury suffered is palpably greater than the loss of the insurance benefits. Thus, while the insurer's conduct constitutes breach of contract, mere contractual damages may prove wholly inadequate to compensate the insured under the particular circumstances of the case.

Often the environment in which the breach occurs contributes to the extent of the extra-contractual injury and exacerbates the onerous nature of the insurer's conduct. For example, where the policy involved provides disability or fire insurance coverage, a "take-what-we-offer-or-nothing" position manifestly prays on the insured's vulnerability and insecurity, to the insured's disadvantage.

The breach usually occurs when the insured is under considerable stress from the event underlying the claim. The insurer's unjustifiable refusal, actual or threatened, to perform its contractual obligation is designed to play on and increase that

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pre-existing stress. Such actions place the insured in humiliating and emotional dilemmas. Financial concerns assume inordinate proportions. The insured may have to borrow heavily or rely on the charity of family members, churches and private organizations. The cost of self-support may be more than the insured can meet without the insurance proceeds and he may be forced to accept public welfare funds for support and medical needs.

When physical injuries are severe and a prolonged course of recovery seems likely, the loss of insurance proceeds, or the acceptance of less than the policy limits, may force the insured or the insured's family to face the decision of what level of medical care and rehabilitation the insured will receive. Where the insured requires special therapeutic attention to maximize physical recovery, but such attention cannot be paid for without the full policy benefits, the insured may suffer permanent physical impairment due to the lower level of care. Likewise, fire losses can have far-reaching consequences if not promptly handled. Families suffer the disruption and inconvenience of prolonged living in temporary quarters, as well as the financial drain of replacing lost necessities. Businesses still have accounts to pay, but no cash flow to meet the bills. Depending on the insured's financial status before the fire and the extent of the fire loss, bankruptcy is a genuine possibility where an insurer delays.

Under such circumstances, what should the insured be allowed to recover? On what theory should recovery be allowed? By which theories, if any, should recovery be limited?

In Illinois, recovery depends on the nature of the claim advanced. If the insured is limited to an action on the contract, punitive damages, as a general rule, are precluded.[1] If the insurer's actions, and the resultant injury to the insured, are recognized as a basis for an action in tort, several theories of tort liability are available.[2] Within this tort area, several new theories of recovery have evolved, and new applications for existing theories have been found.

The Illinois Supreme Court has yet to directly address tort liability of an insurer arising from outrageous breach of contract. The five Illinois Appellate Courts have taken markedly different positions when faced with suits for extra-contractual

1. Ledingham v. Blue Cross Plan, 29 Ill. App. 3d 339, 350, 330 N.E.2d 540, 548 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976).

2. *See, e.g.*, Eckenrode v. Life of America Ins. Co., 470 F.2d 1 (7th Cir. 1972) (liability for intentional infliction of emotional distress); Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981) (outrageous conduct); Hoffman v. Allstate Ins. Co., 85 Ill. App. 3d 631, 407 N.E.2d 156 (1980) (liability for breach of the duty of good faith and fair dealing).

damages in this context. While some recognize tort liability on various theories others have refused to recognize such liability, primarily on the assertion that section 767 of the Illinois Insurance Code pre-empts tort liability. This article will present those Illinois cases which establish each district's position on this cause of action. It will then examine the conduct giving rise to the liability, and the interpretation of section 767 which is the major obstacle to tort liability in this context.

ILLINOIS CASES

Ledingham v. Blue Cross Plan[3] presented an Illinois appellate court, in 1975, with its first opportunity to address the existence of a cause of action sounding in tort arising from conduct constituting breach of an insurance contract. The health insurance policy underlying the suit became effective on August 1, 1969, but provided an exemption of coverage for illness occurring within the 270 days preceding the effective date. Ledingham had established a routine of having gynecological examinations every six months, and in fact had such an examination approximately one month before seeking medical insurance. The test results were negative, but on August 3, 1969, the plaintiff suffered the onset of a series of episodes culminating in a hysterectomy on November 25, 1969. The defendant insurer refused coverage under the 270-day exemption clause, asserting that the severity of the illness indicated it could not have developed during the two days the policy was in force. There was no evidence indicating bad faith on the insurer's part.[4] Nonetheless, a jury reached a verdict in favor of the plaintiff and awarded her damages in the amount of $9,200, a sum that included punitive damages.

On appeal, the defendant argued that the award of punitive damages for wilful and wanton misconduct constituted reversible error because the action was brought on the contract; to the extent that the award included punitive damages, it was in violation of the general prohibition against punitive damages in con-

3. 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976).

4. Plaintiff filed suit in three counts: Count I, for wilful and wanton conduct, sought actual and punitive damages; Count II alleged negligence and sought compensatory damages; Count III sought compensatory damages for breach of contract. Plaintiff voluntarily dismissed Count II during the trial and judgment on Counts I and III was entered on a general verdict for $9,200.00 plus costs. *Id.* at 341, 330 N.E.2d at 542.

The appellate court found that the evidence presented at trial supported compensatory damages of $1,592.85. The balance constituted punitive damages. *Id.* at 351-52, 330 N.E.2d at 549.

tract actions.[5] The plaintiff argued that the action sounded in tort, notwithstanding the contractual relationship of the parties.[6]

The Illinois Appellate Court for the Fifth District first examined the 1883 supreme court case of *Nevin v. Pullman Palace Car Company*,[7] in which the plaintiff was allowed an extra-contractual recovery because a recovery on the contract would have been limited to the price of his railway tickets, which the *Nevin* court deemed inadequate.[8] The *Ledingham* court interpreted *Nevin* to be authority for the proposition that a tort action can arise from conduct which also constitutes breach of contract.[9] After examining other relevant authority,[10] the court found that in Illinois: 1) punitive damages may not generally be awarded in an action on the contract; 2) the breach of a contract may itself constitute an unusual case where an independent wilful tort will be found; 3) in the life and health insurer-insured relationship there is a duty upon both parties to act in good faith and deal fairly with the other party to the contract; and 4) breach of this duty implied by law is both a breach of the contract and a tort.[11]

The court observed that while this tortious conduct could give rise to an action for intentional infliction of emotional distress, Illinois precludes recovery of punitive damages on this theory.[12] The court stated, however, that

> threatened and actual bad faith refusals to make payments under the policy, maliciously employed by defendants in concert with false and threatening communications directed to the policyholder for the purpose of causing him to surrender his policy or disadvantageously settle a nonexistent dispute constitutes a tortious interference with a protected property interest of its insured for which damages may be recovered. Punitive damages may properly be awarded in such a case.[13]

In the case at bar the court found that the defendant had drawn reasonable inferences from the medical facts and had in-

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5. *Id.* at 342, 330 N.E.2d at 543.

6. *Id.* at 344, 330 N.E.2d at 544.

7. 106 Ill. 222 (1883).

8. *Id.* at 231-33. Due to special relationships between contracting parties the law imposes implied duties. *Id.* at 233.

9. 29 Ill. App. 3d at 344, 330 N.E.2d at 544.

10. *See* Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 510 P.2d 1032, 108 Cal. Rptr. 480 (1973); Fletcher v. Western National Life Ins. Co., 10 Cal. App. 3d 376, 89 Cal. Rptr. 78 (1970); Knierem v. Izzo, 22 Ill. 2d 73, 174 N.E.2d 157 (1961); Krutsinger v. Illinois Casualty Co., 10 Ill. 2d 518, 141 N.E.2d 16 (1957). *See generally* Annot., 37 A.L.R.2d 538 (1954).

11. 29 Ill. App. 3d at 350, 330 N.E.2d at 548.

12. *Id.* at 350-51, 330 N.E.2d at 548-49.

13. *Id.* at 351, 330 N.E.2d at 549.

voked the exemption clause in good faith.[14] The compensatory damages award was proper because it had been determined at trial that the defendant had erroneously denied benefits.[15] Thus, the court reversed the judgment to the extent of the punitive damages awarded because the facts did not demonstrate a bad faith attempt to use the plaintiff's plight as a lever to force a disadvantageous settlement.

The Third District confronted a suit seeking extra-contractual damages in *Debolt v. Mutual of Omaha*.[16] The plaintiff had purchased a disability income policy from the defendant on May 20, 1970. Debolt became disabled under the terms of the policy in December of 1973. His disability payments fell in arrears and, when a substantial amount was due and owing, the defendant offered to repurchase the policy at an amount well below the policy reserve. Debolt brought suit alleging intentional infliction of emotional distress and breach of the duty of good faith and fair dealing, and sought punitive damages.[17] The trial court dismissed the complaint and the plaintiff appealed.[18]

The appellate court scrutinized the complaint, concluding: "[W]e find that it is fraught with conclusions of fact unsupported by allegations of specific facts, i.e., that defendant instilled in plaintiff a fear for his life and that defendant instituted a policy designed to coerce the plaintiff into surrendering his policy."[19] Therefore, the court concluded that the plaintiff failed to allege specific facts which demonstrated outrageous conduct by the defendant, and held the emotional distress count to have been properly dismissed.[20]

The court next addressed the count seeking punitive damages for breach of the duty of good faith and fair dealing. It stated, "We have carefully examined the case of *Ledingham*, and . . . do not feel constrained to accept the result reached as being precedential in the instant case. . . ."[21] The court discussed the authorities relied on in *Ledingham*,[22] noting that *Nevin* was inapposite because the defendant there was a common carrier and therefore subject to a higher standard of care in

14. *Id.* at 352, 330 N.E.2d at 549.

15. *Id.*

16. 56 Ill. App. 3d 111, 371 N.E.2d 373 (1978).

17. *Id.* at 112, 371 N.E.2d at 374-75. Plaintiff brought suit in three counts. Count I, which plaintiff voluntarily dismissed, was for breach of contract. That count was not involved in the appeal. *Id.* at 375.

18. *Id.*

19. *Id.* at 113, 371 N.E.2d at 375.

20. *Id.*, 371 N.E.2d at 375-76.

21. *Id.* at 114, 371 N.E.2d at 376.

22. *Id.* at 114-15, 371 N.E.2d at 376-77.

tort actions.[23] The court also distinguished from the facts before it the duty-to-settle cases, wherein an insurer wrongfully refuses to settle within policy limits, thereby exposing the insured to liability for a judgment beyond policy limits. The court focused on the fact that in those cases breach of the duty led to monetary damages to the insured which could not be recovered in an action on the contract.[24] In contrast, Debolt could have sued on the contract to recover any benefits due.[25] Finally, the court criticized *Ledingham*'s reliance on several California decisions allowing punitive damages for breach of the duty of good faith and fair dealing.[26]

The court then turned to a discussion of section 155[27] of the Insurance Code of Illinois.[28] This section, headed "Attorney's Fees", permitted the insured to recover the lesser of twenty-five percent of the plaintiff's recovery or $1,000, provided the court first finds the insurer's refusal to pay to be "vexatious and without reasonable cause."[29] The Third District interpreted this section to evidence a legislative intent to provide a remedy to an

23. *Id.* 371 N.E.2d at 376.

24. *Id.* at 115, 371 N.E.2d at 377. *See* Cernocky v. Indemnity Ins. Co., 69 Ill. App. 2d 196, 216 N.E.2d 198 (1966).

25. 56 Ill. App. 3d at 115, 371 N.E.2d at 377. This facile argument does not stand up to close consideration. The implication is that the plaintiff has somehow contributed to his injury by not instituting suit on the policy earlier. To say that a plaintiff could have instituted an action at any time upon the contract ignores that the defendant who wrongfully forces a party to resort to litigation is in fact using the reality of the time-consuming modern litigation process to coerce that party into a possibly disadvantageous settlement. Indeed, being forced into litigation only tends to heighten the severity of the plaintiff's plight. Moreover, in the duty-to-settle cases extra-contractual injury is the basis of extra-contractual recovery. Thus, the distinction is dubious. The obligation of the insurer to pay benefits is not tantamount to a right to inflict injury simply because the obligation will provide money to the injured party.

Further, when has the plaintiff's cause of action ripened? The insurance company must be allowed reasonable time to conduct reasonable investigation when there is a genuine question of liability. At what point has the insurer breached under these circumstances? Prematurely filing an action will not help a plaintiff in distress. Given the length of time it can take to move a case through the court system, starting a contract action to obtain benefits due under a disability income policy may assure adequate recovery, but timely recovery to avert further harm is unlikely. The plaintiff suffers injuries patently compensible in tort law should they arise under a recognized theory of recovery.

26. *Id.* at 115-16, 371 N.E.2d at 377. *See* cases cited *supra* note 11.

27. Section 155 of the Illinois Insurance Code of 1937 is the predecessor of the current § 767. *See* ILL. REV. STAT. ch. 73, § 767 (1981). Throughout the case law in this area references to sections 155 and 767 are made interchangeably. For all practical purposes, they are snynonymous.

28. *See* ILL. REV. STAT. ch. 73, § 767 (1981).

29. *Id.* at § 767(1).

insured encountering "unnecessary difficulties";[30] that remedy being the award of attorney's fees and costs under section 767.[31] The practical effect of this holding was that in any insurance contract action for an amount in excess of $4,000,[32] the sole remedy of the insured for extra-contractual injuries suffered as a result of the breach, and the maximum punishment of the breaching insurer, was the award of $1,000 in attorney's fees.[33]

The Fourth District was the next to be presented with a claim for extra-contractual damages for conduct in breach of an insurance contract. In *Urfer v. Country Mutual Insurance Co.*,[34] the plaintiff sought $2,000 in hospital and medical costs and disability income provided under a "no fault" automobile insurance

30. Debolt v. Mutual of Omaha, 56 Ill. App. 3d 111, 116, 371 N.E.2d 373, 377 (1978). "Unnecessary difficulties" is a broad phrase encompassing a vast range of behavior, including delays occasioned by activities which do not rise to the level or character of those specified in *Ledingham* as being tortious. No attempt was made to distinguish the different forms of wrongful conduct.

31. *Id.* at 117, 371 N.E.2d at 378. The court weakened its position on this point by stating: "It may well be that the statutory remedy should provide greater relief but we hold that to be a matter for legislative determination." *Id.* at 117, 371 N.E.2d at 378.

The court attempted to bolster its position by citing Cunningham v. Brown, 22 Ill. 2d 23, 174 N.E.2d 153 (1961), an Illinois Supreme Court decision which refused to recognize an asserted common-law cause of action to compliment recovery under the Dram Shop Act, ILL. REV. STAT. ch. 43, § 135 (1957). The Third District failed to appreciate, however, the distinction between an entire statutory scheme, such as the Dram Shop Act, which defines tortious conduct and the rights of its victims, and merely one section of another statutory scheme, itself based on contractual relationships, which regulates the rights of parties to such contracts. In the latter context, § 767 is more consonant with the entire statutory scheme where it is interpreted as statutory authority for the allowance of costs in an action on a contract, rather than as a legislative attempt to limit tort liability of the insurer.

32. This is true because § 767 provides for the allowance of the lowest figure derived in one of three ways: (1) 25% of the amount in issue; (2) $1,000; or, (3) the excess of the amount recovered over the amount the insurer offered. Therefore, in an action for less than $4,000, the lowest amount derived by the first or third method of calculation would be the amount allowed. In an action where $4,000 or more is in issue, the $1,000 limit would be the lowest amount authorized by the section.

33. In rebutting *Ledingham*'s reliance on California decisions, the *Debolt* court noted that California had no statute comparable to § 767, and, therefore, punitive damages in that jurisdiction had not been pre-empted by legislative act. 56 Ill. App. 3d at 117, 371 N.E.2d at 378.

34. 60 Ill. App. 3d 469, 376 N.E.2d 1073 (1978). While this decision does not reflect the Fourth District's present position on the question of tort liability and punitive damages against an insurer, it is included here because of the role it played in subsequent decisions in other districts.

Urfer had been injured on September 19, 1972, in a collision with a school bus. He filed suit against the school distict, accepted a $50,000 settlement, and then tendered medical reports to the defendant insurer on December 19, 1975; a full three years and three months after the occurrence. *Id.* at 471, 376 N.E.2d at 1074.

policy. The amended complaint sought to state a cause of action on the principles and authorities enunciated in *Ledingham*.[35] The trial court dismissed the complaint and the appellate court affirmed for failure of the pleadings to state facts rather than conclusions of law.[36] The court took note of *Debolt* in dicta, but expressly declined to address the issues raised in that case.[37]

Justices Mills and Craven wrote separate opinions in *Urfer* in direct opposition to one another. Justice Mills' opinion was the first Illinois articulation of the concept of section 767 as "legislative pre-emption" of a tort action for compensatory and punitive damages in this context.[38] He would have followed the *Debolt* reasoning, but stated: "Adequate remedy? Perhaps not."[39] Like the *Debolt* court, he was troubled by this possibility, but would shift the responsibility for rectifying it to the legislature.[40] Justice Craven, on the other hand, found *Ledingham* "clear authority for the proposition that there is a cause of action sounding in tort for a wilful and intentional refusal to pay a clear contractual obligation."[41]

In 1979, the Illinois Appellate Court for the First District took up the question of extra-contractual damages for an insurer's bad faith breach of contract in *Tobolt v. Allstate Insurance Co*.[42] After his home was substantially damaged by fire, the plaintiff sought benefits under a fire loss policy the defendant had issued. When the defendant refused to pay the amounts claimed, the plaintiff filed suit. The trial court dismissed the claims seeking damages for intentional infliction of severe emo-

35. *Id*. Plaintiff first sought relief under Article XXXV of the Illinois Insurance Code ("no-fault" insurance) and the provisions therein which allowed treble damages where the insurer's refusal was wilful. The first complaint was dismissed at defendant's suggestion that Grace v. Howlett, 51 Ill. 2d 478, 283 N.E.2d 474 (1972), which found the Illinois "no-fault" statute unconstitutional, precluded plaintiff's action. 60 Ill. App. 3d 469, 376 N.E.2d 1073 (1978). *But cf*. Pinson v. Allstate Ins. Co., 68 Ill. App. 3d 788, 386 N.E.2d 638 (1979) (contract between the parties could incorporate in its terms the provisions of the no-fault statute, the unconstitutionality of that statute notwithstanding).

36. 60 Ill. App. 3d at 473, 376 N.E.2d at 1076-77.

37. *Id*. at 475, 376 N.E.2d at 1077.

38. *Id*. (Mills, J., concurring in part and dissenting in part).

39. *Id*.

40. *Id*. Mills' separate opinion makes *Urfer* significant for two reasons. First, it plays a role in the development of the First District's position in Tobolt v. Allstate Ins. Co., 75 Ill. App. 3d 57, 393 N.E.2d 1171 (1979). *See infra* notes 43-49 and accompanying text. Second, in Lynch v. Mid-America Fire & Marine Ins. Co., 94 Ill. App. 3d 21, 418 N.E.2d 421 (1981), the Fourth District recognized the tort action underlying Justice Craven's dissent in *Urfer* without one line of dissent from Justice Mills, thereby undermining the reasoning and strength of *Tobolt*.

41. 60 Ill. App. 3d at 476, 376 N.E.2d at 1078 (Craven, J., dissenting).

42. 75 Ill. App. 3d 57, 393 N.E.2d 1171 (1979).

tional distress and punitive damages for the defendant's failure to act in good faith.[43] The appellate court found the allegations and the evidence in the record demonstrated merely the existence of a dispute concerning the amounts of adjustments and benefits due. No facts were alleged demonstrating outrageous conduct by Allstate. On the contrary, the court found that Allstate was "only insisting upon its legal rights in a permissible way."[44] Plaintiff thus failed to state a cause of action.

Having found an absence of outrageous conduct, it would have been a simple matter to affirm the dismissal of the punitive damages claim as baseless. However, the First District chose not to do so. Instead, the court leapt into the fray, citing *Debolt* and *Urfer* as authority for holding that section 767 had pre-empted a cause of action for breach of the duty of good faith and fair dealing.[45] It quoted at length the separate opinion of "Mr. Presiding Justice Mills" in *Urfer*.[46] The court further supported its finding noting that "[i]n 1977 the legislature agreed that section 155 had pre-empted the field when it amended that section to increase the recovery for vexatious delay."[47] The court declined to follow contrary language interpreting section 155 in *Eckenrode v. Life of America Insurance Co*.[48]

In 1980, the Second District had an opportunity to decide a claim for punitive damages based on an insurer's breach of the duty of good faith and fair dealing in *Hoffman v. Allstate Insurance Co*.[49] Hoffman's car was damaged in an auto accident and towed to a nearby service station. It was subsequently towed to an undisclosed location. Eight days after the accident, one of the defendant's adjusters advised the plaintiff that the car was deemed a total loss and tendered a draft in full payment. Hoffman questioned certain deductions and ultimately returned the check. He twice requested disclosure of the location of the auto so he could have the wreck independently appraised, but he was never given the location. Hoffman sued in five counts.[50] The trial court granted the defendant's motion to dismiss four of the

43. *Id.* at 58-68, 393 N.E.2d at 1172-78.

44. *Id.* at 66, 393 N.E.2d at 1177.

45. *Id.* at 68-70, 393 N.E.2d at 1179-80.

46. *Id.* at 70, 393 N.E.2d at 1180 (citing Urfer v. Country Mutual Ins. Co., 60 Ill. App. 3d 469, 376 N.E.2d 1073 (1978)).

47. 75 Ill. App. 3d at 70, 393 N.E.2d at 1180.

48. 470 F.2d 1 (7th Cir. 1972). This federal decision interpreted and applied Illinois law prior to any of the decisions discussed in this article.

49. 85 Ill. App. 3d 631, 407 N.E.2d 156 (1980).

50. *Id.* at 632, 407 N.E.2d at 157-59.

counts, including one which alleged breach of the fiduciary duty and sought punitive damages.[51]

In affirming the trial court's dismissal of this claim, the appellate court cited *Tobolt*, *Urfer*, and *Debolt* and held that section 767 pre-empted an award of punitive damages in these circumstances.[52] The court further stated:

> However, paragraph 767, on its face, does not preempt a plaintiff's right to claim compensatory damages for a breach of good faith and fair dealing. An examination of plaintiff's Count IV reveals that it alleges spurious deductions, failure to allow for salvage value, and refusal to reveal the location of the vehicle, and that these acts were willful breaches of the defendants' fiduciary duties. In our view these allegations are sufficient to withstand a motion to dismiss, and as to compensatory damages, Count IV should be remanded for trial.[53]

Thus, the Second District carved a middle position between *Ledingham* and *Tobolt*. In so doing, it allowed recovery of damages in tort, thereby implicitly recognizing the existence of a tort cause of action in the conduct of the insurer.

The Fourth District in 1981 finally came fully to grips with the issue of breach of the duty of good faith and fair dealing, and the availability of extra-contractual damages for such conduct, in *Lynch v. Mid-America Fire and Marine Insurance Co*.[54] The plaintiffs in *Lynch* were partners in a business which the defendant insured against fire loss. On September 4, 1973, fire damaged the plaintiffs' building and stock of inventory. The next day, the defendant's agent visited the site, instructed the plaintiffs to prepare and submit a list of all items lost, and instructed them to lock the building. The plaintiffs followed the instructions. About six weeks later, however, Mid-America refused to pay the claim and the plaintiffs sued.[55]

Count I of the complaint alleged breach of contract and sought policy benefits plus attorney's fees under section 767 for unreasonable and vexations refusal to pay benefits.[56] Count II sought compensatory and punitive damages for the defendant's breach of the duty of good faith and fair dealing in handling the plaintiffs' claim.[57] The plaintiffs prevailed in a jury trial and the court entered judgments for $39,314.11 on Count I and for $150,000.00 in compensatory damages and $100,000.00 in punitive damages on Count II,[58] from which Mid-America appealed.

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51. *Id.* at 632, 407 N.E.2d at 157.
52. *Id.* at 634-35, 407 N.E.2d at 159.
53. *Id.*
54. 94 Ill. App. 3d 21, 418 N.E.2d 421 (1981).
55. *Id.* at 22, 418 N.E.2d at 423.
56. *Id.*
57. *Id.*
58. *Id.* at 23, 418 N.E.2d at 423.

The appellate court affirmed the judgment on Count I and on Count II as to liability for compensatory damages,[59] but remanded Count II for a new trial on the amount of such damages.[60] The award of punitive damages was reversed.[61] Mid-America had argued that Count II failed to state a recognized common-law cause of action,[62] but the *Lynch* court rejected this argument, finding that such a tort action did exist in Illinois based on *Ledingham*, *Debolt*, *Tobolt*, *Urfer*, and *Hoffman*.[63] The court refused to recognize the pre-emption of such a tort action by section 767 of the Insurance Code as it existed at the time the cause of action arose.[64] The court noted that it is improper for a court to tax attorney's fees as costs and award them to an adversary in an action on a contract, absent statutory authority to do so.[65] This, the court indicated, is precisely what the original section 767 was intended to be: statutory authorization to allow taxation of attorney's fees as costs in an action on an insurance contract.[66] "The tenor of the section gives no indication that it was intended to cover the field of awarding compensation for bad faith or vexatious dealing by insurers."[67] The Fourth District addressed the First District's assertion in *Tobolt* that the 1977 amendments to section 767 constituted legislative ratification of the pre-emption interpretation. Citing the doctrine that legislative amendments expressly granting a power constitute a legislative acknowledgment that the power was previously lacking,[68] the court found that the 1977 amendments bolstered its holding that, prior to 1977, a tort cause of action existed for outrageous conduct by an insurer.[69] Finally, the court noted that in 1978 the Illinois Supreme Court had cited *Ledingham* for the proposition that a separate tort cause of action may arise from

59. *Id.* at 31, 418 N.E.2d at 429.

60. *Id.*

61. *Id.* at 29-31, 418 N.E.2d at 428-29.

62. *Id.* at 23, 418 N.E.2d at 423.

63. *Id.* at 23-25, 418 N.E.2d at 424-25.

64. *Id.* at 25-26, 418 N.E.2d at 425. *But cf.* 20 AM. JUR. 2D *Costs* § 7 (1965), indicating that the law in effect at the time of judgment rather than at the time of the occurrence or when the action commenced governs what is allowable as costs. By this rule, the decision rendered in 1980 should not have been governed by pre-1977 § 767.

65. 94 Ill. App. 3d at 25-26, 418 N.E.2d at 425.

66. *Id.*

67. *Id.* The court expressly declined to address whether the post-1977 version of § 767 pre-empts the field of tort liability and left open the question of the validity of the pre-emption interpretation. Thus, the question arises: should this grant-of-authority interpretation be extended to the present § 767?

68. *Id. See* People *ex rel.* Scott v. Cardet Int'l Inc., 24 Ill. App. 3d 740, 746-47, 321 N.E.2d 386, 392 (1974).

69. 94 Ill. App. 3d at 25-26, 418 N.E.2d at 425.

conduct which also constitutes breach of contract.[70] The *Lynch* court distinguished bad faith acts from outrageous conduct by an insurer and addressed only the former. Thus, the tort action it recognized as having existed prior to the 1977 amendments to section 767 arises when something less than outrageous conduct has occurred.[71]

Justice Craven filed a separate opinion in *Lynch*, concurring in the majority's decision in all respects except the reversal of the award of punitive damages.[72] In Craven's view, the evidence on the issue was "close", and he felt that the appellate court should defer to the determination of the trial court and the jury. After presenting the standards for the award of punitive damages in Illinois and applying them to the facts of the case, he concluded that the award was proper.[73]

Robertson v. Travelers Insurance Company,[74] the most recent case in this area, presented the Fifth District with an oppor-

70. *Id.* at 26, 418 N.E.2d at 426. *See* Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 187, 334 N.E.2d 353, 360 (1978).

71. Defendant Mid-America had pled the affirmative defense of other insurance coverage. This assertion proved unfounded and the Fourth District felt this bore on Mid-America's good faith. 94 Ill. App. 3d at 28, 418 N.E.2d at 427.

72. *Id.* at 31-33, 418 N.E.2d at 429-30 (Craven, J., concurring in part, dissenting in part).

73. *Id. See* Crumble v. Blumthal, 549 F.2d 462 (7th Cir. 1977) (punitive damages not necessarily awarded in every case of reckless or intentional tort); Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 384 N.E.2d 353 (1978) (punitive damages intended to punish and deter); Mattyasovsky v. West Towns Bus Co., 61 Ill. 2d 31, 330 N.E.2d 509 (1975) (recovery allowed for fraud, actual malice, or wilful and wanton conduct); O'Brien v. State Street Bank & Trust Co., 82 Ill. App. 3d 83, 401 N.E.2d 1356 (1980) (defendant's conduct must go beyond that which is the basis of the action to support punitive damages); Galayda v. Penman, 80 Ill. App. 3d 423, 399 N.E.2d 656 (1980) (punitive damages not allowed for mere negligence); Shaw v. Miller, 64 Ill. App. 3d 743, 381 N.E.2d 985 (1978) (punitive damages award should be reversed only if abuse of discretion is shown); Glass v. Burkett, 64 Ill. App. 3d 676, 381 N.E.2d 821 (1978) (punitive damages are not favored); Delano v. Collins, 49 Ill. App. 3d 791, 364 N.E.2d 716 (1977) (whether punitive damages are appropriate is a question of law; the amount is a fact question).

74. 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981) *rev'd*, 95 Ill. 2d 411, 448 N.E.2d 866 (1983). The Illinois Supreme Court's reversal in *Robertson* does not, however, undermine the logic of the principles advanced in this article because the court does not address the lower court's treatment of § 767.

The reversal is based on § 5(a), ILL. REV. STAT. ch. 48, § 138.5(a) (1973) (exclusive remedy provision), § 19(k), ILL. REV. STAT. ch. 48, § 138.19(k) (1973) (penalty provision based on unreasonable or "vexatious" delay) and the court's determination that the "essence" of Robertson's complaint was "delay." 95 Ill. 2d at 441, 448 N.E.2d at 866. The supreme court stated that the appellate court used too narrow of a standard when it applied § 5(a). *Id.* at 446, 448 N.E.2d at 869. The court's position is bolstered by its determination that § 19(k), while applicable in ordinary cases of unjustifiable delay, is no less applicable in cases involving malicious delay. The court refers to "vexatious" (as used in § 19(k)) as meaning intended to harass. *Id.* at 447,

tunity to examine and refine its decision in *Ledingham*.

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448 N.E.2d at 869. An intent to harass, however, is not the same as an intent to injure; the latter is the essence of malicious conduct.

Furthermore, in a somewhat ambiguous statement, the supreme court appears to assert that the remedies provided by the Act extend to injuries beyond its scope. The court stated: "A common law action should not, without other evidence of legislative intent, be held to survive the Act's exclusivity provisions merely because the remedy provided in the Act for the injury alleged applies to other kinds of injuries as well." *Id.* at 447, 448 N.E.2d at 869. The author believes that this is a dubious position at best.

Section 5(a) applies to "injury . . . sustained while in the line of . . . duty as [an] employee." ILL. REV. STAT. ch. 48, § 138.5(a) (1973). This has been interpreted as requiring the injury to arise out of and in the course of employment. Martin v. Travelers Ins. Co., 497 F.2d 329, 330-31 (1st Cir. 1974). The phrase "arising out of" has repeatedly been interpreted by the supreme court as referring to the causal connection between the injury and the employment. Associated Vendors, Inc. v. Industrial Comm., 45 Ill. 2d 203, 258 N.E.2d 354 (1970). The position taken by the supreme court presumes such a relationship. It cannot be said, however, that the employment *caused* the insurer's independent malicious act. The phrase "in the course of employment" has been interpreted to refer to the time, place, and circumstances of the injury. *Id.* The injury inflicted by malicious delay does not occur at the work place while the employee is on the job. Indeed, the employee is *unable* to work at the time the injury is sustained. It is difficult at best to see how such an injury could be "sustained while in the line of duty as an employee." Therefore, the injury does not occur in the course of employment and is not within the scope of injuries compensable under the Act.

In addition, § 5(a) should not be interpreted as precluding a tort action resulting from an insurer's dilatory tactics. The court expressed no view, however, "as to whether a plaintiff in a case such as *Unruh* [Unruh v. Truck Ins. Exch., 7 Cal. 3d 616, 498 P.2d 1063 (1972) (defendant's investigators kept claimant under surveillance and displayed films of her at worker's compensation hearing thereby causing emotional distress)] may claim in tort for emotional distress resulting from outrageous activity apart from delay." 95 Ill. 2d at 450, 448 N.E.2d at 871. The supreme court therefore reasoned that a tort action for *delay* is preempted by the Worker's Compensation Act. Not *all* tort liability, however, is so preempted. Section 5(a) should not preclude a tort action based upon delay because the penalties provided for by § 19(k) are intended to deter dilatory tactics by an insurer. The trigger language in § 19(k) goes to delay in proper payment of compensation benefits due. The fact that delay is one tactic used to coerce a compensation plaintiff should not preclude recovery for injuries suffered through the *malicious* use of such delay as well as the injuries sustained by virtue of other aspects of the defendant's conduct. To hold otherwise is to limit the liability of an insurer for the consequences of his delay and, in extreme cases, invite such delay as a means of limiting such liability. There is no indication, however, that the penalties provided for by § 19(k) are in fact compensation for injuries resulting from such tactics. Such injuries do not arise out of or in the course of employment and therefore fall beyond the scope of the Act. It follows that § 5(a) should not preclude a tort action for such injuries.

Two other recent decisions are worthy of consideration. The first is Kelly v. Stratton, 552 F. Supp. 641 (N.D. Ill. 1982), where the court held that § 767 does not preempt an action in tort for the bad faith conduct of an insurer. *Id.* at 648. Although this decision reaches the same conclusion as this article, it does so by different reasoning.

The court noted the same progression of cases discussed by this author in establishing the divergent appellate district positions and that the Illinois Supreme Court had not, at that time, addressed the issue. Defining the issue as one of statutory construction, the court noted that there are several

Robertson had been employed by Kaskaskia Constructors, for

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reasonable constructions. The first is the Debolt v. Mutual of Omaha, 56 Ill. App. 3d 111, 371 N.E.2d 373 (1978) and Tobolt v. Allstate Ins. Co., 75 Ill. App. 3d 57, 393 N.E.2d 1171 (1979) approach which construes the statute as placing a duty on the insurer to not refuse or unreasonably delay paying benefits due and limiting recovery for breach of this duty. These two cases reason, therefore, that the legislature has manifested a policy of limiting insurer liability so that tort liability is precluded. Stratton, 522 F.Supp. at 645-46. The second construction recognizes a statutory penalty in addition to the contract recovery. Tort liability is not preempted, however, because the statutory language refers to the amount the insured is "entitled to recover" and this language does not preclude tort recovery. Therefore, the statute does not address the availability of tort recovery. *Id.* at 646. The third construction is that set out in Hoffman v. Allstate Ins. Co., 85 Ill. App. 3d 631, 407 N.E.2d 156 (1980); the statutory language refers to a penalty which is punitive in nature and, therefore, punitive damages are preempted. Compensatory damages for a bad faith breach of contract, however, are not preempted. Stratton, 522 F. Supp. at 645-46.

Applying the rules used by Illinois courts in construing statutes, the federal court reviewed the legislative history. *Id.* at 647. That history makes reference to the Insurance Laws Study Commission. The report of that Commission states, in part:

> The Commission thought the insurance industry might have taken the opportunity to utilize Senate Bill 517 to establish statutory limits on the amount of punitive damages. This was not done. Perhaps this disinterest reflects the disquietude which the Illinois Supreme Court has had with regard to whether punitive damages may be constitutional.

Id. at 648 (quoting the Illinois Insurance Laws Study Commission, Final Report to the Governor and 80th General Assembly 18-19 (1977)). On this basis the federal court stated:

> [W]e conclude that the purpose of § 767, as amended in 1977, was to aid plaintiffs by establishing a right to a limited recovery of a liquidated sum if they can make the minimal showing that the insurance company acted vexatiously and unreasonably. It does not limit the right of such plaintiffs to prove that the insurance company's actions violated an independent duty in tort and to recover all damages allowed by the common law as a result of the tort.

Id.

Noting that *Debolt*, *Tobolt*, and *Hoffman* had not considered the legislative history, the federal court found that the Illinois Supreme Court, if faced with the issue, would decide that § 767 does not limit the right of the insured to pursue an action in tort for the bad faith of an insurer. *Id.* When this decision is read in conjunction with the body of this paper, it becomes apparent that there are substantial reasons for holding that § 767 does not preempt tort liability.

The second decision is Perschall v. Metropolitan Life Ins. Co., 113 Ill. App. 3d 233, 446 N.E.2d 570 (1983). It is interesting to note that Justice Mills, *see supra* note 41, began this decision with the following observation: "Disability Insurance Claim. 'Vexatious' delay in benefits? The trial court so held. We affirm." *Id.* at 235, 446 N.E.2d at 571. The decision refers to the trial court award (based on plaintiff's post trial motion) as "punitive damages." Neither party presented any evidence to support their views although the court held a hearing on the motion thus affording them the opportunity. The award was therefore based on the evidence adduced at trial and the arguments heard on the motion. *Id.* at 238, 446 N.E.2d at 574. The defendant insurance company argued that the question of vexatious delay should be put to the jury. The trial court, however, held that the statute provides for judicial resolution of this issue. *Id.* at 238-39, 446 N.E.2d at

whom Travelers provided workers' compensation coverage. On June 25, 1971, Robertson fell while at work and injured at least one and, allegedly both, knees. Travelers paid most of his immediate medical expenses. One payment was sent on March 22, 1972, and was received by Robertson on March 30, 1972.[75] The Workers' Compensation Act[76] then in effect required any claim for adjustment to be filed with the Industrial Commission within one year of receipt of the last compensation payment.

On March 13, 1973, Robertson informed Travelers that he would undergo surgery on both knees in April of 1973. He was told that he could put Travelers' name on the hospital bill. There was a dispute as to whether he was told that a final decision concerning the coverage of the surgery had not yet been made.[77] In-house memoranda of the company demonstrated that it was operating under the mistaken belief that the one year limitation for filing a workers' compensation claim would run on March 22, 1973, one year from the date the final compensation payment was sent. No effort was made to inform Robertson of the statute until after that date. On March 20, 1973, an agent of Travelers interviewed Robertson at length; he did not remind Robertson of the statute of limitations, but did ask whether Robertson had retained counsel or filed a claim for adjustment. Robertson stated that he had done neither. On March 29, 1973, the agent wrote to Robertson advising him that the company believed that the complaints requiring bilateral knee surgery were unrelated to his on-job injury and refused coverage for the surgery. Robertson received the letter on April 2, 1973, consulted an attorney, and filed his claim with the Industrial Commission the same day. Nine days later a memo was written to Travelers' file which noted the running of the statute and described Travelers' position as being "home free."[78]

Travelers raised the statute of limitations defense before the Industrial Commission.[79] The Illinois Supreme Court ultimately decided the issue and held that Travelers was estopped from asserting the defense because Robertson had refrained from filing a compensation claim in reliance on Travelers' repre-

574. The appellate court found no abuse of discretion and therefore affirmed the decision. *Id.* at 240, 446 N.E. 2d at 575.

75. 100 Ill. App. 3d at 846, 427 N.E.2d 304-05.

76. *See* ILL. REV. STAT. ch. 48, §§ 138.6(c)(3), 138.8(a) (1969).

77. 100 Ill. App. 3d at 846-47, 427 N.E.2d at 305, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

78. 100 Ill. App. 3d at 848, 427 N.E.2d at 306, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

79. *Id.*

sentation.[80] Only then, in 1975, did the company pay the plaintiff's claim, with interest.

Robertson was recovering from surgery on both knees during the pendancy of this action and was unable to work. He borrowed from relatives, went on public aid, and accepted charity from the volunteer fire department to which he belonged. Robertson sued Travelers alleging that it had committed the tort of "outrage", thereby subjecting him to severe mental anguish.[81] The jury found for Robertson, awarding him $150,000 in compensatory damages and $2,000,000 in punitive damages.[82]

Travelers argued on appeal that Robertson's cause of action was pre-empted by section 767.[83] The Fifth District rejected this argument, noting that, on its face, section 767 applies to insurers and insureds. Robertson was a third-party beneficiary to the insurance contract between Travelers and his employer; therefore, section 767 could not apply to his cause of action.[84]

Travelers next argued that a provision of the Workers' Compensation Act, which provides a penalty for unreasonable or vexatious delay in paying a claim, precluded the plaintiff's action.[85] The court held this section to be inapplicable, reasoning that the section applied even absent an intent to injure the payee. Robertson had alleged an intent to injure, and Travelers had refused payment rather than merely denying it.[86]

The Fifth District then addressed the tort of outrage as applied to the insurance industry in Illinois. The court recognized two separate and distinct theories of recovery for outrageous conduct. The first, intentional infliction of emotional distress, will lie where the insurer's actions are both outrageous and in bad faith. It will support the recovery of compensatory damages.[87] The second, characterized by the insurer's threatened and actual bad faith refusals to pay benefits due, accompanied by false and threatening communications intended to coerce the

80. *See* Kaskaskia Constructors v. Industrial Comm'n, 61 Ill. 2d 532, 535, 337 N.E.2d 713, 715 (1975).

81. 100 Ill. App. 3d at 848, 427 N.E.2d at 306, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

82. 100 Ill. App. 3d at 846, 427 N.E.2d at 304, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

83. 100 Ill. App. 3d at 848, 427 N.E.2d at 306, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

84. *Id.*

85. 100 Ill. App. 3d at 850, 427 N.E.2d at 307, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983). *See* ILL. REV. STAT. ch. 48, § 138.19(k) (1979).

86. *Id.*

87. *Id.* at 851-52, 427 N.E.2d at 308-09, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983), (citing Eckenrode v. Life of America Ins. Co., 420 F.2d 1 (7th Cir. 1972)).

insured into surrendering his policy or settling disadvantageously, may be sufficient to support the award of punitive damages.[88]

The court analogized Robertson's case to *Eckenrode v. Life of American Insurance Company*,[89] where the the defendant had used the plaintiff's plight to apply "economic coercion" to force a compromise when no valid defense to payment of the claim existed.[90] Noting that Robertson had suffered comparable injury and that "[i]n some respects, the deviousness of Travelers employees renders their actions even more reprehensible,"[91] the court found Travelers' conduct "significantly more outrageous" than the insurer's conduct in *Ledingham*, *Debolt*, and *Tobolt*.[92] Thus, a cause of action in tort for outrageous conduct was stated under the first theory which the court had defined.

The court next turned to *Knierim v. Izzo*,[93] where the Illinois Supreme Court first recognized a cause of action for intentional infliction of emotional distress. The supreme court there stated: "[s]ince the outrageous quality of the defendant's conduct forms the basis of the action, the rendition of compensatory damages will be sufficiently punitive."[94] Finding Robertson's suit to be one brought on this theory, the Fifth District reversed the award of punitive damages as contrary to the law of Illinois.[95] The case was remanded for a new trial on the issue of compensatory damages in light of the *Knierim* rationale.[96]

It is apparent from the foregoing decisions, that some disagreement exists among the appellate districts as to the nature of the tort action available, the relationship of section 767 to such a tort, and the availability of punitive damages resulting from the conduct at issue. The First District holds that section 767 pre-

88. 100 Ill. App. 3d at 851, 427 N.E.2d at 308, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983), (citing Ledingham v. Blue Cross Plan, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976)).

89. 420 F.2d 1 (7th Cir. 1972).

90. *Id.* at 4-5. The *Eckenrode* court did not observe the distinction between reckless actions of an insurer, leading to liability for intentional infliction of emotional distress, and malicious behavior leading to liability for outrageous conduct, including punitive damages. Thus, while confronted with conduct fitting into the malicious category, the court classified it as intentional infliction of emotional distress and found liability attaching under Illinois law. *Id.* at 1.

91. 100 Ill. App. 3d at 853, 427 N.E.2d at 309, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

92. *Id.*

93. 22 Ill. 2d 73, 174 N.E.2d 157 (1961).

94. *Id.* at 88, 174 N.E.2d at 165.

95. Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 853, 427 N.E.2d 302, 310 (1981), *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

96. 100 Ill. App. 3d at 854, 427 N.E.2d at 310, *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

empts the field of tort liability for breach of the duty of good faith and fair dealing in the insurance contract, as well as punitive damages for bad faith acts and vexatious conduct. The Second District has taken the position that section 767 pre-empts the award of punitive damages for breach of the duty, but it does not pre-empt a tort cause of action seeking compensatory damages.

The Third District's position is unclear. In *Debolt* the court declined to recognize a tort claim for breach of the duty of good faith and fair dealing, stating that it did not feel constrained to follow *Ledingham*, given the facts before it. The situation in *Debolt* was precisely and adequately addressed by section 767; therefore, section 767 was the proper remedy. The court did not directly address whether an action would lie for breach of the duty where compensatory damages are sought, but it did hold that section 767 pre-empts an action for punitive damages based on such a breach. The court described section 767 as a legislatively-provided remedy for an insured encountering "unnecessary difficulties," but it made no effort to define this phrase or the scope of conduct it embraces. As of this writing, the Third District has not been faced with a suit seeking compensatory damages for the breach. The tenor of *Debolt* indicates that the court would not recognize such an action.

The Fourth District recognizes a tort cause of action for breach of the duty of good faith and fair dealing based on its interpretation of section 767, as it existed prior to the 1977 amendments. It interprets section 767 as statutory authority for the allowance of attorney's fees as taxable costs in an action on an insurance contract. It has not expressed an opinion on what effect, if any, the 1977 amendments have on this interpretation. The Fourth District overturned an award of punitive damages for bad faith acts in *Lynch*, based on the absence of any authority allowing such an award for bad faith alone. It did not address the availability of punitive damages for outrageous conduct, but it did distinguish between bad faith and outrageous conduct.

The Fifth District recognizes two distinct theories for recovery in tort arising from conduct constituting breach of the duty of good faith and fair dealing. Both are based on outrageous conduct. The first theory is the tort of intentional infliction of emotional distress. In Illinois, the award of punitive damages on this theory is precluded. The second theory is confined to situations where the insurer makes malicious use of threatened or actual bad faith refusals to pay benefits due, accompanied by false or threatening communications designed to coerce surrender of the policy or a disadvantageous settlement of the claim by

the insured. Punitive damages may properly be awarded in such a case, although the Illinois appellate courts have yet to affirm a punitive damage award in any case presented.

THE HIERARCHY OF WRONGFUL CONDUCT BY INSURERS: A MODEL

Any interpretation of section 767 requires a determination of the conduct it addresses. Thus, a preliminary consideration is wrongful conduct generally. It is axiomatic that wrongful conduct is not *per se* tortious conduct. The cases considered above demonstrate that there is, within the insurance context, a range of conduct for which tort actions will lie. That range of conduct falls within the upper level of what might be conceptualized as a hierachy of wrongful conduct. At the base of that hierarchy are tactics which might generally be described as improper claims practices;[97] at the top of the hierarchy, and the most egregious of the insurer's practices, would be outrageous conduct maliciously employed.

The second level in the above described hierarchy is unreasonable delay or vexatious litigation forced upon the insured to collect benefits due under an insurance policy. This is not necessarily characterized by bad faith, although any delay occassioned by bad faith would seem unreasonable. Whether the delay was unreasonable, or the litigation vexatious, is a factual question which must be determined by the totality of the circumstances.[98] One example is litigation resulting from the insurer's refusal to use a correct standard of damages in arriving at a settlement offer once the use of the wrong standard is brought to the insurer's attention.[99] Other examples include the use of any dilatory tactics in settling claims, such as sending the claim file out of state for evaluation or "accidentally" losing a file.[100] The crux of such conduct is using delay to induce compromise of a claim. In such instances, liability is not denied, but prompt payment is not forthcoming. Generally, there is an ascertainable degree of deliberateness in the insurer's conduct.

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97. *See* ILL. REV. STAT. ch. 73, § 766.6 (1981).

98. Fassola v. Montgomery Ward Ins. Co., 104 Ill. App. 3d 825, 433 N.E.2d 378 (1982). But note that § 767 is applicable whether the action is a bench trial or jury trial. The statute, on its face, reserves the determination of unreasonable delay or vexatious litigation for the court, rather than the trier of fact. Thus, even though a jury is present, the statute appears to make this determination one of law rather than fact. *See* ILL. REV. STAT. ch. 73, § 767 (1981).

99. Fassola v. Montgomery Ward Ins. Co., 104 Ill. App. 3d 825, 833-34, 433 N.E.2d 378, 383 (1982).

100. *See, e.g.*, Debolt v. Mutual of Omaha, 56 Ill. App. 3d 111, 371 N.E.2d 373 (1978).

On the third level of the hierachy is conduct which goes beyond unreasonable conduct and which begins to be characterized by bad faith. The insurer breaches the implied duty of good faith and fair dealing as well as the general fiduciary duty owed by an insurer to its insured. For such conduct, an action will lie not only in contract but also in tort. The insurer has acted in bad faith and has benefitted at the expense of the insured. Examples of this conduct include the use of spurious deductions to arrive at a settlement offer,[101] the assertion of a defense to liability which could readily be determined to be unfounded,[102] and the failure to take actions within its rights and power to mitigate the amount of the insured's loss.[103] *Robertson* presented another example of this conduct.[104] There, the insurer knowingly allowed the insured to rely on representations of coverage by its agents until the insured's right of action under the Workers' Compensation Act was barred by the statute of limitations. The insurer denied coverage and asserted the statute as a defense. The insurer litigated the issue all the way to the Supreme Court of Illinois before paying any portion of the claim. Forcing the insured to resort to litigation to collect benefits unquestionably due constitutes a bad faith refusal to pay. It is palpably more than litigation occassioned by an unreasonable delay, because litigation is the only means by which benefits due may be obtained. This conduct may result in extra-contractual damages resulting from the lack of insurance proceeds. Foreclosure of mortgages and even bankruptcy can be foreseeable consequences of the refusal. The fact of such extra-contractual damages militates for an extra-contractual recovery. Thus, the breach of contract notwithstanding, tort liability may properly be imposed for a breach of the duty of good faith and fair dealing.

The fourth level of the hierarchy is reached when the circumstances of the insured render him particularly dependant on prompt payment of the policy proceeds and those circumstances are or should be known to the insurer.[105] At this point the bad faith refusal to pay takes on an outrageous character,

101. *See, e.g.*, Hoffman v. Allstate Ins. Co., 85 Ill. App. 3d 631, 407 N.E.2d 156 (1980).

102. *See, e.g.*, Lynch v. Mid-America Fire & Marine Ins. Co., 94 Ill. App. 3d 21, 418 N.E.2d 421 (1981).

103. *Id.*

104. Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981), *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983). *See supra* notes 75-97 and accompanying text.

105. *See, e.g.*, Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981), *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983). *See also* RESTATEMENT (SECOND) OF TORTS § 46, comments c, e, f (1965).

primarily because of the deliberate violation of the insurer's fiduciary duty. When the insured's circumstances are known to the insurer, the violation is reckless because those circumstances render the insured susceptible to severe emotional distress, and the insurer acts in a manner likely to inflict such distress. Thus, where the circumstances combine with a bad faith refusal to cause emotional distress, an action in tort on the theory of intentional infliction of severe emotional distress will lie.[106] In Illinois, however, recovery on such a theory is limited to compensatory damages.[107]

The fifth and highest level of the hierarchy is encountered where an insured in vulnerable circumstances is faced with actual or threatened bad faith refusals to pay, combined with false or threatening communications designed to induce the insured to surrender his policy or settle his case disadvantageously. In this case, the insurer pursues a course of conduct that goes beyond recklessness. It is malicious behavior; the insurer deliberately acts to heighten the economic plight of the insured, preying upon the very contingency the underlying contract was designed to alleviate. This is not economic coercion in the sense of two commercial entities dealing with one another at arm's length. It is overbearing, unconscionable conduct combining elements of all the lower levels in the hierarchy, and borders on fraud. As such, it is a proper instance for the award of punitive damages.[108]

Section 767 of the Insurance Code

The cases considered above demonstrate that the major stumbling block to the imposition of tort liability upon insurers is the interpretation which holds that section 767 constitutes legislative pre-emption of such liability. A proper interpretation of section 767 requires consideration of the legislative history of the section, the language of the section, and the hierarchy of wrongful conduct presented above in order to determine the legislative purpose and scope of the section.

Legislative History

Section 767 originated as section 155 of the Illinois Insur-

106. *See* Restatement (Second) of Torts § 46, comments c, e, f (1965).

107. Knierim v. Izzo, 22 Ill. 2d 73, 174 N.E.2d 157 (1961).

108. *See* Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981), *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983); Ledingham v. Blue Cross Plan, 29 Ill. App. 3d 339, 330 N.E.2d 540 (1975), *rev'd on other grounds*, 64 Ill. 2d 338, 356 N.E.2d 75 (1976).

ance Code of 1937.[109] Summarized, section 155 provided that, upon the court's determination that the lawsuit before it was vexatious, or the result of an unreasonable refusal to pay benefits due, the court could allow the prevailing party to collect reasonable attorney's fees. These fees would be a part of the taxable costs of the action, over and above other costs of the action, and were subject to a maximum allowance of $500.00.[110]

The language of this section remained unchanged until 1967. In that year two changes were made: section 767(1)(a) had "25%" substituted for the phrase "twenty-five percentum"; and section 767(1)(b) was amended, raising the ceiling on recovery under the section from $500.00 to $1,000.00.[111] The body of section 767 remained unchanged until 1977, when five changes were made in the text of the section. These changes resulted in a substantial change in the operation of the section. To comprehend these amendments, it is first necessary to understand the operation of the section prior to the 1977 amendments. The 1977 changes will then be presented and considered.

The Pre-1977 Section 767

In his 1937 law review article,[112] Harold C. Havinghurst, Chairman of the committee of the Illinois State Bar Association Insurance Law Section which drafted the basic version of the Insurance Code as passed in 1937, addressed the purpose of section 155. He stated:

> In the absence of any allowance of attorneys' fees, the holder of a small policy may see practically his whole claim wiped out by expenses if the company compels him to resort to court action, although the refusal to pay the claim is based upon the flimsiest sort of pretext. *The strict limit on the amount allowable makes the section significant only for small claims.* It should prove wholesome in its effect upon companies unreasonably withholding payment of such claims.[113]

Thus, the original section was intended to address an action sounding in contract on a *small* insurance policy.

The general rule regarding costs holds that they are to be born by the party incurring them, absent statutory authority to the contrary.[114] Section 155 was meant to be such statutory au-

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109. ILL. REV. STAT. ch. 73, § 767 (1937).

110. *Id.*

111. ILL. REV. STAT. ch. 73, § 767 (1967).

112. Havinghurst, *Some Aspects of the Illinois Insurance Code*, 32 ILL. L. REV. 391 (1937).

113. *Id.* at 405 (emphasis added).

114. Galowich v. Beech Aircraft Corp., 92 Ill. 2d 157, 441 N.E.2d 318 (1982); Murczek v. Powers Label Co., 31 Ill. App. 3d 939, 335 N.E.2d 172 (1975).

thority, specifically authorizing attorneys' fees, which would not otherwise be part of the costs of the action.[115] The limitation of the allowance to a $500.00 maximum[116] was the device by which the legislature made the allowance most effective where the amount of the claim was small, limiting by effect the scope of the section.

Prior to the section's enactment, the expense of litigating a claim on a small policy was a *de facto* disincentive to pursuing such litigation.[117] This gave rise to a concommitant incentive for the insurer to force litigation upon its insured, or use the threat of it abusively, where the claim was small. The effect of section 155 was to remove the disincentive and simultaneously create an incentive for prompt payment of such claims.[118] The drafters of the section saw its scope limited to contract actions on small policies. Thus, the section presumes suit upon the contract.

Therefore, remedy for tortious conduct which also constitutes breach of contract falls beyond the scope of section 155. Indeed, tort theories such as the intentional infliction of emotional distress were unknown at law when the section was enacted.[119] It follows that tort liability could not have been preempted by this section as it was never considered.

In the hierarchy of wrongful conduct presented above, the type of conduct which triggers this section does not reach the level at which tort liability arises. The "trigger language" addresses conduct which amounts to misuse of the litigation process by the insurer. This conduct is not tortious *per se*, but it may give rise to a proper case for taxation of costs against the insurer.[120] The taxation of costs is penal in nature but does not constitute an award of punitive damages in a tort action, for tort liability is not present. Costs are allowances generally in the nature of incidental damages, awarded by law to reimburse for expenses necessarily incurred in asserting one's right in court.[121]

The 1967 amendments did nothing to change the substance of the section. Therefore, this interpretation remained valid until the 1977 amendments took effect. The only significant change made in 1967 was the increase of the amount allowable from

115. Lynch v. Mid-America Fire & Marine Ins. Co., 94 Ill. App. 3d 21, 25, 418 N.E.2d 421, 425 (1981).

116. *See* ILL. REV. STAT. ch. 73, § 767 (1937).

117. *See supra* notes 114-15 and accompanying text.

118. *See supra* note 114 and accompanying text.

119. The tort of intentional infliction of emotional distress was first recognized in Illinois in Knierim v. Izzo, 22 Ill. 2d 73, 174 N.E.2d 157 (1961).

120. *See* 20 AM. JUR. 2D *Costs* (1965).

121. *See* Galowich v. Beech Aircraft Corp., 92 Ill. 2d 157, 441 N.E.2d 318 (1982).

$500.00 to $1,000.00.[122]

The 1977 Amendments

The 1977 amendments to section 767 made a significant change in the structure of the section. The amount of attorney's fees allowable was removed from the statutory limits and made subject to a standard of reasonableness.[123] The effect was to broaden the scope of section 767 beyond small policy claims. This is accomplished by removing the statutory "cap" on the amount recoverable under the section. The section authorizes the allowance of fees and other costs in any action where the statutory criteria for such an allowance is met. It allows the amount of the fees to be proportionate to the complexity of the action.[124] However, the statute also provides for an award of a deterrent, subject to a $5,000 maximum, as part of the taxable costs of the action.[125] Attorney's fees allowed on a reasonable basis would be proportionately smaller where the amount of the

122. ILL. REV. STAT. ch. 73, § 767 (1967).

123. The specific amendments made in 1977 are set forth below. Language deleted by the amendments has been lined out. Language added to the section is indicated in italics.

> In any action by or against a company wherein there is in issue the liability of a company on a policy or policies of insurance or the amount of the loss payable thereunder, *or for an unreasonable delay in settling a claim* ~~if the company has brought suit to cancel the policy or policies or refused upon demand prior to the commencement of the action to pay the amount of the loss~~, and it appears to the court that such *action or delay* ~~suit or refusal~~ is vexatious and *unreasonable* ~~without reasonable cause~~, the court may allow ~~to the party who by the finding of the court or jury is entitled to prevail against the company, reasonable attorney fees~~, as part of the taxable costs in the action *reasonable attorney fees, other costs, plus an amount not to exceed any one of the following amounts:*
>
> (a) 25% of the amount which the court or jury finds such party is entitled to recover against the company, exclusive of all costs;
>
> (b) ~~$1,000~~ *$5,000*;
>
> (c) the excess of the amount which the court or jury finds such party is entitled to recover, exclusive of costs, over the amount, if any, which the company offered to pay in settlement of the claim prior to the action.
>
> (2) Where there are several policies insuring the same insured against the same loss whether issued by the same or by different companies, the court may fix the amount of the allowance so that the total attorney fees on account of one loss shall not be increased by reason of the fact that the insured brings separate suits on such policies.

ILL. REV. STAT. ch. 73, § 767 (1977). *See also* Songer v. State Farm Fire & Casualty Co., 106 Ill. App. 3d 141, 435 N.E.2d 948 (1982) (interpreting and applying current § 767; upholding the allowance of $9,565.75 in attorney fees as reasonable).

124. *Id.* The *Songer* decision presents a full discussion of the factors and considerations relevant to making a determination of a reasonable amount of attorney fees to be taxed against an insurer under § 767.

125. ILL. REV. STAT. ch. 73, § 767 (1977). *See supra* note 124.

claim was small. Without such a deterrent, the problem which prompted enactment of the original section 155 could again crop up; that is, a small policy holder could see substantially all of his policy recovery consumed by fees and expenses. Therefore, the legislature separated the allowance of attorney's fees from the deterrent provision. The separate deterrent retains the same structure as the original statute, and addresses the same circumstances as the original. Where the claim is small and the litigation fairly simple, this deterrent provision is of greater significance than the allowance of attorney fees because the amount of the fee will be less. Therefore, the provision will provide the deterrent effect of the original section 155. As the complexity of the legislation and the amount at stake increases, so does the significance of the allowance of attorney fees, for these fees are not limited by the $5,000.00 maximum on the deterrent.[126]

The modification of the first paragraph to allow reasonable attorney's fees changed the mechanisms by which the section operates. The scope of the section was broadened to the extent that these mechanisms operate; that is, reasonable attorney's fees can now be allowed in all actions on insurance policies, regardless of the amount, so long as the statutory criteria for applying section 767 are met.[127] The "trigger" language, as with the original section 155, also limits the scope of the section. Section 767 is still activated by wrongful conduct which does not rise to the level of tortious conduct. Section 767, on its face, addresses actions where the issues are liability on a policy or the amount of loss payable under a policy, or where the action is for an unreasonable delay in settling a claim.[128] Liability under section 767 arises where the court determines that the action itself, or the delay, is vexatious and unreasonable. That liability is for taxable costs of the action. These costs have three distinct elements: (1) reasonable attorney fees; (2) other costs; and, (3) a deterrent amount not to exceed $5,000.[129] None of the issues addressed by the trigger language are tort issues. Like its predecessor, section 767 presupposes an action on the contract; there is nothing in the section which addresses tortious conduct or tort liability. It simply remains statutory authority for the allowance of costs, including attorney's fees, in an action at law on an insurance contract.

126. ILL. REV. STAT. ch. 73, § 767 (1977).
127. *Id.*
128. *Id.*
129. *Id.* The exact amount of the penalty is determined in one of three ways; the penalty should not exceed the lowest figure arrived at after determining the penalty by each of these methods. *Id.*

The purpose served by the 1977 amendments is best demonstrated by considering the section in operation before and after those amendments. The pre-1977 version was intended to operate most effectively in actions where the claim was small.[130] Its allowance of attorney fees where the claim was more substantial had very little significance. When fees were deemed available under this section, they were limited to a maximum of $1,000, regardless of the amount wrongfully withheld.[131] If that amount was substantial and the litigation protracted, the insurer could earn on the withheld proceeds an amount far in excess of the penalty provided. Rather than a scourge for wrongful conduct, section 767 could be used as a shield to avoid effective penalties. The deterrent nature of the section could be completely circumvented.

The present section discourages dilatory tactics and protracted litigation, regardless of the amount at issue. An insurer who abuses the litigation process will increase the amount at risk with each delay. The section has a deterrent tenor which encourages prompt, fair, good faith settlement of all claims, and serves the public policy underlying the entire code.[132]

The legislative history of section 767, the language of the section both before and after its amendments, and the type of behavior which triggers its application militate one conclusion: the section does not in any way address tortious conduct. In the face of this conclusion, it is patently improper to hold this section has pre-empted tort liability for extra-contractual damages arising from conduct which also constitutes a breach of contract. This conclusion is consonant with the Illinois Supreme Court's citation of the *Ledingham* decision for the proposition that tort liability may arise from conduct constituting breach of contract.[133]

Moreover, this conclusion precludes the absurd result which would be obtained if the pre-emption theory was adopted. As demonstrated in *Robertson*, an insured party would be precluded from recovering tort damages from his insurer, while a third-party beneficiary to the same insurance contract would

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130. *See* Havinghurst, *supra* note 113, at 405.

131. *See* ILL. REV. STAT. ch. 73, § 767 (1967). *See also* Songer v. State Farm Fire & Casualty Co., 106 Ill. App. 3d 141, 435 N.E.2d 948 (1982).

132. Regulation, control, and supervision of the industry is warranted by the public interest with which it is imbued. People *ex rel.* Barber v. Hargraves, 303 Ill. App. 387, 388, 25 N.E.2d 416 (1940).

133. *See* Kelsay v. Motorola, Inc., 74 Ill. 2d 172, 384 N.E.2d 353 (1978). *See also* cases cited *supra* note 74.

not.[134]

Interpreted as statutory authority for the allowance of costs in an action on the contract, including reasonable attorney fees, section 767 is consonant with the statutory scheme of the entire Insurance Code, which regulates insurance companies and the contracts they enter.[135] If section 767 were interpreted as pre-empting any aspect of tort liability, it becomes the only section of the Code to do so, and then only by judicial interpretation. This is an incongruous result.

The conclusion that tort liability can arise in the proper setting leads to the conclusion that punitive damages may be available in a proper case. The deterrent provision in section 767 is aimed at conduct which is detrimental to the public interest, but which does not rise to the level of tortious conduct. Where tortious conduct is present, and other requirements for the award of punitive damages are demonstrated, they should also be allowed. The two awards are based on different conduct, and would be sought under different counts in the pleadings. There is no basis for extending the scope of section 767 beyond the type of conduct which the section addresses. That conduct does not reach the threshold for consideration of punitive damages in a tort action. Therefore, in a proper case, where the conduct of the insurer is malicious and constitutes a tortious interference with the proprietory interest of the insured in the proceeds of the policy, the award of punitive damages should be allowed.

CONCLUSION

This article does not imply that tortious conduct by insurers is commonplace in the affairs of the industry. As the cases show, however, such conduct is not unknown. The fact that the industry is imbued with a public interest is demonstrated by the fact that in 1979, 191.8 billion dollars of life insurance coverage alone was in force on the lives of Illinois residents.[136] That public interest requires strict protective scrutiny of the actions of insurers. An interpretation of the law which tends to insulate insurers from any form of liability for wrongful conduct is contrary to that public interest because it invites such wrongful conduct to be committed with impunity.

134. *See* Robertson v. Travelers Ins. Co., 100 Ill. App. 3d 845, 427 N.E.2d 302 (1981), *rev'd*, 95 Ill. 2d 441, 448 N.E.2d 866 (1983).

135. ILL. REV. STAT. ch. 73, § 613 (1981). *See also* T.J. Fox v. Industrial Casualty Ins. Co., 98 Ill. App. 3d 543, 424 N.E.2d 839 (1981) (Insurance Code does not provide exclusive private remedies for alleged wrongful conduct of an insurer).

136. Alexander, *Punitive Damages in Illinois Insurance Cases—Beyond Ledingham, Debolt, and Kelsay*, 70 ILL. B.J. 645 (1982).

When an insurer engages in conduct that inflicts extra-contractual injury on the insured, the insurer should be held accountable for that action. When the action rises to the level of tortious conduct, tort liability should attach. When that conduct warrants punitive damages, they should be available under the established standards for their award.

The insurance industry is one which deals in risks. The predictable course of a particular insurer in given circumstances will be that course which minimizes the insurer's risk. Thus, an insurer is particularly susceptible to the deterrent effects of extra-contractual liability because engaging in conduct which exposes the insurer to such liability increases the insurer's risk. The deterrent effect of the availability of punitive damages in an appropriate case is that much greater as a consequence of the insurer's interest in minimizing its risk. Therefore, the public interest with which the industry is imbued is best served by the availability of extra-contractual liability; and, in an appropriate case, punitive damages.