



Recovery of Damages for Emotional Distress in Tort, Contract and Statutory Bad Faith Actions

By [Lee Craig](#) and [J. Pablo Cáceres](#)

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Emotional distress damages may be the most significant aspect of any bad faith action in jurisdictions that allow them. This article outlines the several theories that justify the recovery of such damages. It discusses also the impact of a recent Florida Supreme Court decision which authorized recovery for emotional distress under that state's bad faith statute.

Background of Bad Faith Tort Action & Emotional Distress

Any examination of theories for recovery of emotional distress damages in a bad faith case necessarily must consider the historical development of such damages in other kinds of cases. At common law, there was no tort of "bad faith" actionable by an insured against an insurer. The insurance contract governed the obligations of the parties and the consequences of a breach. Traditional contract principles defined the ambit of recoverable damages.⁽¹⁾

Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854), established that contract damages are those contemplated by the parties when the contract was made, or which flowed naturally from the breach. Traditionally, such damages were limited to the monetary value of the contract, had it been performed.⁽²⁾ Emotional distress damages were recoverable only in cases involving contracts of a "personal" rather than commercial nature. Such personal contracts are "so coupled with matters of mental concern or solicitude ... that a breach will necessarily or reasonably result in mental anguish," and the parties should know that such suffering will result from breach.⁽³⁾ Personal contracts included those between carriers and passengers, innkeepers and guests, as well as contracts to provide care, room and board, etc.⁽⁴⁾

The emergence of liability insurance created novel problems for application of these principles. They formed a new kind of relationship between insured and insurer. Early indemnity policies had reimbursed insureds only for actual payments made by an insured pursuant to a judgment or as defense costs, up to policy limits. Insurers were not involved directly in the defense of the action.⁽⁵⁾ Under liability policies, however, insurers became directly involved in the defense of the action. This gave rise to conflicts of interest when claims reached or exceeded policy limits. Under no contractual duty to settle, an insurer might reject a demand for policy limits and "gamble" at the insured's risk by proceeding to trial. The insured, on the other hand, faced possible liability for an excess judgment.⁽⁶⁾

In response to this problem, courts began to impose a duty on insurers to act in good faith (or at least not in bad faith) in handling liability claims.⁽⁷⁾ If an insured suffered a judgment in excess of policy limits due to an insurer's wrongful refusal to settle, the insurer would be liable for the excess regardless of policy limits. However, courts reached this result in diverse ways. Some rested on contract, some on tort, and others on fiduciary theories.⁽⁸⁾

Regardless of the theory, the outcomes arguably were consistent with *Hadley v. Baxendale*. Parties to the insurance contract could well have contemplated economic extra-contractual damages at the time the contract was made. Courts began to move away from this apparent consistency with traditional principles as they allowed damages for emotional distress.⁽⁹⁾

Crisci v. Security Ins. Co.⁽¹⁰⁾ held that emotional distress damages were recoverable in third party bad faith claims for wrongful failure to settle.⁽¹¹⁾ In that case, there was an excess judgment against the insured. As a result, she experienced mental suffering. The trial court found that the insurer had refused wrongfully to settle. The court awarded the insured \$25,000 in damages for emotional distress, as well as the amount of the excess judgment.

In affirming the emotional distress award, the California Supreme Court recalled a previous holding, in another case, that a bad faith action sounds both in contract and tort.⁽¹²⁾ The tort aspect might justify tort damages. Furthermore, California law allowed emotional distress damages for tortious interference with property rights. Thus, the *Crisci* court found no reason to disallow such damages in a case of bad faith refusal to settle.⁽¹³⁾

Six years later, the California Supreme Court imported this tort duty into cases of first party bad faith. In *Gruenberg v. Aetna Ins. Co.*,⁽¹⁴⁾ the court found the same duty to the insured in both third and first party bad faith claims. The insurer's duty to settle fairly the claims of third parties, and the insurer's duty to act fairly on an insured's direct claim, were "merely two different aspects of the same duty."⁽¹⁵⁾ Therefore, tort damages, including emotional distress, may flow from a breach of either.

Since this landmark decision, at least twenty five states have recognized the tort of bad faith in first party insurance claims.⁽¹⁶⁾ Because these actions sound in tort, recovery of emotional distress damages is possible in each of those states. Other "bad faith" states base the cause of action either on contract principles or statutory enactments.

Standards For Emotional Distress Damages Under Bad Faith Tort

Emotional distress damages are relatively easy to recover in tort. Traditionally, the common law required physical injury or that the tortfeasor's conduct be outrageous.⁽¹⁷⁾ These high standards were justified by the need to ensure the legitimacy of the claim. In bad faith tort actions, however, there are no such stringent requirements.

The *Gruenberg* court, for instance, approved recovery for emotional distress when an insured loses even his property due to the tortious conduct of a insurer. The court believed that the danger of fictitious claims would be minimized by a "substantial property loss" requirement.⁽¹⁸⁾

The Nevada Supreme Court adopted a standard only slightly more strict. In *Anderson v. Continental Insurance Co.*,⁽¹⁹⁾ Nevada embraced *Gruenberg's* "substantial damages" test, but required also that the emotional distress be severe.⁽²⁰⁾ Now, several states have applied

some form of the *Gruenberg* or *Anderson* standard of recovery in tort actions for bad faith.⁽²¹⁾

Emotional Distress Damages in Bad Faith Contract Actions

In states which follow traditional contract principles of bad faith, recovery of emotional distress damages is practically impossible. For instance, the Michigan Supreme Court, in *Kewin v Massachusetts Mutual Life Ins Co.*,⁽²²⁾ declined to recognize a tort for bad faith breach of an insurance contract. In *Kewin*, an insured had sued and won damages for mental distress from an insurer that denied disability benefits. The Michigan Court of Appeals reversed the award on technical pleading grounds.

The Michigan Supreme Court held that damages for mental distress were not recoverable in any case. The court restated the *Hadley v. Baxendale* requirement that damages for breach of contract must arise "naturally from the breach" or be "contemplated by the parties at the time the contract was made." Therefore, mental distress damages generally are not recoverable.⁽²³⁾ The court, compared *Kewin's* case to an earlier Michigan case, *Stewart v. Rudner*.⁽²⁴⁾

In *Stewart*, a patient had sued her doctor in contract for failure to perform a promised Caesarean section. The appellate court there upheld an award for mental distress for breach of the contract because such damages were contemplated by the parties. The contract was "personal" it said, not commercial. "When we have a contract concerned not with trade or commerce but with life and death, not with profit but with elements of personality, not with pecuniary aggrandizement but with matters of mental concern and solicitude, then a breach of duty with respect to such contracts will inevitably and necessarily result in mental anguish, pain and suffering."⁽²⁵⁾

The Michigan Supreme Court, in *Kewin*, concluded, over a strong dissent, that disability contracts are commercial. Such contracts are agreements to pay money upon the occurrence of a specified event. Mental distress damages do not flow from the breach of such contracts. They are not "personal."

Standard For Recovery of Emotional Distress In Statutory Bad Faith Actions

Among states that have bad faith statutes, there are various standards of recovery for emotional distress. For example, the Pennsylvania Supreme Court in *D'Ambrosio v. Pennsylvania National Mutual Casualty Ins. Co.*⁽²⁶⁾ ruled that the state's unfair insurance practices act did not allow emotional distress damages. The court was unwilling to supplement or interfere with the Act by recognizing a tort bad faith action.⁽²⁷⁾ The year after *D'Ambrosio*, the Act was amended to authorize recovery for punitive damages but not for emotional distress.⁽²⁸⁾

On the other hand, in Rhode Island, the tort remedy is engrafted on the statute. There, the bad faith statute has been interpreted as codifying existing case law recognizing tort actions for bad faith.⁽²⁹⁾ Therefore, awards for emotional distress are proper.

In Florida, a recent decision goes another way. The Florida Supreme Court, in *Time Ins. Co., Inc. v. Burger*,⁽³⁰⁾ held that emotional distress damages are recoverable under the bad faith statute, but only in actions based on health insurance.

Time Ins. Co., Inc. v. Burger

Time Insurance Company ("Time") provided health insurance to Harvey Burger ("Burger"). Burger had a \$500 medical bill. He submitted the bill to Time. However, because the bill contained a "stray mark" it looked like \$1500 instead of \$500.

In August 1991, Time informed Burger that it was investigating whether he had tried to defraud the company. Time also did not pay Burger's other outstanding medical bills. Allegedly, Burger forewent medical treatment from August, 1991, through November, 1992, because he was unsure if Time would pay.

Around April, 1992, Burger filed suit for statutory "bad faith" under section 624.155 Florida Statutes. The suit either was filed in or removed to Federal Court. In November, 1992, Time paid all the outstanding medical bills.

At trial, Burger claimed that, because Time did not pay his outstanding medical bills until November, 1992, he did not get medical treatment. He alleged this caused him to be depressed and unable to communicate with his family. The jury found that Time had violated Florida's bad faith statute for failing to settle claims in good faith. It awarded Burger \$50,000.00 in compensatory damages and \$1 in punitive damages. Time appealed to the United States Court of Appeals for the Eleventh Circuit. Time argued that, under Florida law, emotional distress damages are available only in actions for the tort of intentional infliction of emotional distress absent physical "impact."⁽³¹⁾ Time had paid all of Burger's outstanding medical bills in November of 1992. Thus, his only unpaid damages were for alleged emotional distress. Time claimed, therefore, that the award of \$50,000 was unsupportable.⁽³²⁾

Burger argued: (1) Florida law should allow damages for emotional distress in a bad faith action; and (2) even if it does not, the facts of this case justified the award.⁽³³⁾

The Eleventh Circuit certified two questions to the Florida Supreme Court: whether emotional distress damages qualify as compensatory damages under the bad faith statute or, alternatively, whether the type of emotional distress suffered by Burger is a "reasonably foreseeable result" of a violation of the statute.⁽³⁴⁾

Burger held that emotional distress damages do qualify as compensatory damages under the bad faith statute. The court noted that, prior to the enactment of the bad faith statute, breach of a health insurance contract gave rise already to contract damages and attorney's fees. The court concluded that by passing the bad faith statute, the legislature "may have contemplated more than the recovery of the same damages already available in a breach of contract action."⁽³⁵⁾

Burger then articulated the following elements of a bad faith claim for emotional distress: (1) the bad faith conduct must have resulted in the insured's failure to receive necessary or timely health care; (2) based on a reasonable medical probability, this failure cause or aggravated the insured's medical or psychiatric condition; and (3) the insured suffered mental distress related to the condition or the aggravation of the condition. Furthermore, these requirements must be substantiated by testimony of a qualified medical examiner.⁽³⁶⁾

In essence, the *Burger* decision follows traditional contract principles. As mentioned,

"personal" contracts long have been a branch of (or an exception to) the rule in *Hadley v. Baxendale*. "Whenever the terms of a contract relate to matters which concern directly the comfort, happiness, or personal welfare of one of the parties . . . he may recover damages for physical suffering or illness proximately caused by its breach."⁽³⁷⁾

Health insurance contracts concern matters of "comfort, happiness and personal welfare." Surely, people buy health insurance policies for physical well-being as well as to avoid the financial burden of medical treatment.

Burger clearly considered the compelling problems faced by an insured when health benefits are denied. "In view of the possibility that an unjustified refusal to pay an insured's medical or hospital bills could result in the inability to obtain health care," the court ruled that Florida's bad faith statute authorizes recovery for emotional distress damages against a health insurance company.⁽³⁸⁾

Conclusion

Practitioners and insurance companies in Florida now are considering what effect the *Burger* decision will have on other kinds of bad faith cases. Will the trial and appellate courts allow damages for emotional distress in bad faith actions based on property, liability, or other insurance coverages? The answer to this question is suggested by the apparent basis for the *Burger* decision. Because a health insurance contract is a kind of "personal" contract, the *Burger* decision can be squared with the traditional analysis of damages which evolved from *Hadley v. Baxendale*. Thus, there is an argument to be made that *Burger* be applied narrowly. Accordingly, the future of emotional distress damages in Florida bad faith actions appears limited to health insurance cases.

Endnotes

1. Roger C. Henderson, *The Tort of Bad Faith in First Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. Mich. J.L. Ref. 1 (1992).
2. *Kewin v. Massachusetts Mutual Life Ins. Co.*, 409 Mich. 401, 414-15 (1980).
3. *Id.* at 434-35 (Williams, J. dissenting).
4. *Id.* at 435.
5. *Henderson, supra* n. 1, at 16.
6. *Id.* at 20.
7. *Id.* at 22.
8. See *Radcliffe v. Frankin National Ins. Co.*, 298 P.2d 1002, 1020-24 (Or. 1956).
9. *Henderson, supra* n. 1, at 22.

10. 426 P.2d 173 (Cal. 1967).
11. Henderson, *supra* n. 1, at 25.
12. *Crisci*, 426 P.2d at 178.
13. *Id.* at 179.
14. 510 P.2d 1032 (Cal. 1973).
15. *Id.* at 1037.
16. See *The Universe Life Ins. Co. v. Giles*, 950 S.W.2d 48, 52-53 (Tex. 1997).
17. See Restatement (Second) of Torts § 46 (1965).
18. *Gruenberg*, 510 P.2d at 1041.
19. 271 N.W.2d 368 (1978).
20. *Id.* at 378.
21. Henderson, *supra* n. 1, 56-57.
22. *Kewen v. Massachusetts Mutual Life Ins. Co.*, 409 Mich. 401 (1980).
23. *Id.* at 414.
24. 84 N.W.2d 816 (Mich. 1957).
25. *Id.* at 824.
26. 431 A.2d 966 (Penn. 1981).
27. *Id.* at 970.
28. See *Duffy v. Nationwide Mutual Ins. Co.*, 1993 U.S. Dist. LEXIS 16197, *10 (E.D. Pa., Nov. 10, 1993).
29. See *Marshall Contractors, Inc. v. Peerless Ins. Co.*, 827 F. Supp. 91, 95 n. 2 (D.C. R.I. 1993); see also *Pace v. Insurance Co. of North America*, 939 F.2d 572, 580 (1st Cir. 1988).
30. No. 90,869, 1998 Fla. LEXIS 1157 (June 12, 1998).
31. Under the "impact" rule, a person cannot recover compensatory damages for mental distress or psychiatric injury in the absence of a discernable physical injury. See, *Brown v. Cadillac Motor Car Division*, 468 So. 2d 903 (Fla. 1985).

32. No. 90,869, 1998 Fla. LEXIS 1157, at *3 (June 12, 1998).

33. *Id.*

34. *Id.*

35. *Id.* at *10.

36. *Id.* at *13-14.

37. *Chelini v. Nieri*, 196 P.2d 915 (Cal. 1948).

38. No. 90,869, 1998 Fla. LEXIS 1157, at *3 (June 12, 1998).

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