

## NEWSSTAND

### Consequential Damages: New Developments in New York Case Law Regarding an Insured's Right to Recover Extra Contractual Damages

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One of the more significant developments of 2008 in New York insurance law came courtesy of two companion decisions by the state's highest court which held that, in addition to recovering policy proceeds, policyholders may recover consequential damages resulting from an insurer's breach of a policy, at least in certain circumstances where the insurer is found to have breached its duty of good faith and fair dealing and the damages were foreseeable and quantifiable; *Bi-Economy v. Harleystown Ins. Co. of N.Y.* and *Panasia Estates v. Hudson Ins. Co.*<sup>1</sup>

Consequential damages resulting from a breach of contract have previously been available to parties under traditional contract principles, to the extent they were a foreseeable result of the breach and "within the contemplation of the parties" at the time of contracting. Until recently, however, recovery of consequential damages was not a remedy generally available to policyholders for an insurer's breach of its policy under New York law.<sup>2</sup>

With *Bi-Economy* and *Panasia*, insureds have gained strong grounds to recover – or at least plead – consequential damages in addition to policy proceeds where the insurer's denial of policy benefits allegedly breaches the covenant of good faith and fair dealing and the consequential damages were foreseeable at the time of contracting. The decisions are significant because New York does not recognize the independent tort of bad faith for an insurer's breach of the policy so as to support an award for extra-contractual damages, absent a pattern of egregious conduct warranting punitive damages.<sup>3</sup> These decisions provide a potential new avenue for recovery of extra-contractual damages from insurers.<sup>4</sup>

#### Setting The Stage: *Bi-Economy* and *Panasia*

The New York Court of Appeals set the stage for the pleading of consequential damages claims by insureds against insurers in its *Bi-Economy* decision. *Bi-Economy* dealt with an insurer's breach of the insured's right to prompt adjustment and payment of first party business interruption coverage under a commercial property insurance policy. In upholding the insured's right to assert a claim for consequential damages, the Court set forth specific requirements that an insured would need to meet in order to plead and prevail on such a claim.

The Court held that an essential factor of a consequential damages claim is that the risk was foreseen, or should have been foreseen, at the time of contracting. This does not mean the insurer has to foresee the breach or the particular way the loss occurred, but that loss from a breach was "foreseeable and probable." To satisfy this requirement, it must be determined whether consequential damages were "reasonably contemplated by the parties," and to do so "courts must look to the nature, purpose and particular circumstances of the contract known by the parties."<sup>5</sup>

The nature of the coverage in issue was a significant factor in *Bi-Economy*. The Court reasoned that the "very purpose" of business interruption coverage "would have made [the insurer] aware that if it breached its obligations under the contract to investigate in good faith and pay covered claims, it would have to respond in damages to *Bi-Economy* for the loss of its business as a result of the breach."<sup>6</sup> The Court further held that proof of consequential damages cannot be "speculative or conjectural," and must be proved with "reasonable certainty and be capable of measurement based upon known reliable factors without undue speculation."<sup>7</sup> While the plaintiff had asserted a cause of action for bad faith claims handling, the right to plead consequential damages was based on the Court's holding that implicit in a contract of insurance is a covenant of good faith and fair dealing that includes a promise to investigate in good faith and pay covered claims.

The majority opinion distinguished consequential damages from punitive damages, noting that the purpose of consequential damages was not a punishment to the insurer but “to give the insured its bargained-for-benefit,” whereas punitive damages are intended to punish the breaching party.<sup>8</sup> The Court viewed the prompt payment of business interruption losses to be a bargained-for-benefit, as the purpose of business interruption coverage is to receive money promptly and avoid collapse of the business. Thus, failure to provide that benefit rendered additional damages foreseeable.

There was a strong dissent, which argued that the bargained-for-benefit of an insurance contract is coverage up to the policy limits, and that the parties to a policy generally do not contemplate consequential damages or, if they did, it would be rejected by the insurer.<sup>9</sup> The dissent considered the majority to be simply re-labeling punitive damages as consequential damages, and essentially allowing recovery of punitive damages without the requisite showing of a pattern of egregious conduct directed at the public.

In the companion case of *Panasia*, the Court relied on its opinion in *Bi-Economy* to uphold an insured’s right to recover consequential damages for an insurer’s alleged breach of the covenant of good faith and fair dealing in failing to promptly investigate, adjust and pay a claim made under builders risk coverage included in a commercial property insurance policy. However, the Court noted that the court below had failed to consider whether the consequential damages sought were foreseeable as the result of the insurer’s breach, and thus remanded the case. *Panasia* confirmed that the question of whether a plaintiff’s consequential damages were a reasonably foreseeable result of the breach and within the contemplation of the parties at the time of contracting is a question of fact, dependent on the circumstances and the nature and purpose of the insurance contract at issue.<sup>10</sup>

#### **Application of *Bi-Economy* and *Panasia* by Lower Courts and the Extension to Third Party Liability Coverage**

Policyholders have been quick to assert the right to plead consequential damages in the wake of *Bi-Economy* and *Panasia*. The subsequent caselaw suggests that the effect of these decisions may be more expansive than the Court of Appeals perhaps intended.

In *Hoffman v. Unionmutual Stock Life Ins. Co. of N.Y.*,<sup>11</sup> a New York appellate court relied on *Bi-Economy* to allow an insured’s allegations of bad faith claims handling to be incorporated into its claim for wrongful denial to pay disability benefits, thereby opening the door for the insured to seek consequential damages. Significantly, while the court dismissed the tort cause of action for a breach of the duty of good faith, it held that allegations of breach of good faith were incorporated into the breach of contract claim, and that was a sufficient basis for seeking consequential damages.

An insured’s right to seek consequential damages for the “distress, aggravation and inconvenience” purportedly caused by its insurer’s alleged refusal to adjust, settle, compromise or pay a first party claim under a homeowner’s policy was upheld in *Chaffee v. Farmers New Century Ins.*<sup>12</sup> There, the claim arose from an insurer’s alleged failure to pay a claim for fire losses under a homeowner’s policy. Although the court found that the insureds’ claim for consequential damages is properly part of its breach of contract claim and not a separate cause of action, it also noted allegations that the insurer violated the implied covenant of good faith. Thus, the decision underscores that the right to seek consequential damages requires more than just ordinary breach of contract without associated improper conduct.

Courts have also relied upon *Bi-Economy* and *Panasia* to sustain an insured’s right to seek consequential damages in the context of third party coverage.

In *Silverman v. State Farm Fire & Casualty Co.*,<sup>13</sup> the court sustained an insured’s right to seek consequential damages based on the insurers’ alleged improper failure to provide third party liability coverage for an assault claim under general, business owners and homeowners liability policies. The trial court dismissed plaintiffs’ claim for punitive damages, but allowed them to amend their complaint to seek consequential damages, noting that such a claim is available if the failure to provide coverage flows from a breach of the covenant of good faith and fair dealing. The court also noted that defendants could still move to dismiss the claim after discovery.

In *Handy & Harman v. AIG*,<sup>14</sup> the insured sought consequential damages as part of its claim for breach of an environmental pollution liability policy, which provided coverage for cleanup costs and third party liability. The court noted that the nature of that policy was to ensure that the insured had the finances to conduct the remediation and pay third party claims, and that the insured had purchased the policy when it agreed to remediate its property in conjunction with its sale to avoid the financial pressure of remediation on its on-going business. Thus, the court found that “the particular circumstances” of the case and the nature and purpose of the policy supported the foreseeability of consequential damages. Significantly, the court required that there be allegations of breach of the covenant of good faith in plaintiff’s breach of contract claim to support the request for consequential damages.

## Conclusion

*Bi-Economy* and *Panasia* have provided insureds with a means to seek extra-contractual damage where there is foreseeable and quantifiable damage proximately resulting from an insurer’s improper conduct.

To date, decisions have focused on an insured’s right to plead consequential damages, rather than on upholding a recovery. It remains to be seen whether courts will continue to limit the right to plead consequential damages to those situations in which there are allegations of improper insurer conduct beyond simple breach of contract, and whether they will limit the right to recover by enforcing the burden of proof on insureds to demonstrate that such damages are quantifiable rather than speculative, and were foreseeable at the time the insurance was placed.

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<sup>1</sup> 10 N.Y.3d 187 (2008) and 10 N.Y.3d 200 (2008), respectively.

<sup>2</sup> The 2001 decision by an intermediate appellate court in *Acquista v. N.Y. Life Ins. Co.*, 285 A.D.2d 73 (1st Dept. 2001) opened the door for policyholders to seek consequential damages apart from policy proceeds as a result of an insurer’s breach of an insurance contract, at least in the first party disability insurance context. The court (with a strong dissent) rejected the traditional view of New York courts up to that point that the remedy for an insurer’s breach of contract was limited to recovery of policy proceeds. The court’s reference to consequential damages being available was in the context of the insurer’s denial or dilatory payment being without a reasonable basis. The ruling in *Acquista*, however, was generally rebuffed by New York courts. See, *Eurospark Indus. v. Mass. Bay Ins. Co.*, 288 B.R. 177, 186 (E.D.N.Y. 2003) (acknowledging that “[t]he *Acquista* decision has been met with disapproval”).

<sup>3</sup> See *Rocanova v. Equitable Life Assur. Soc.*, 83 N.Y.2d 603, 615 (1994) (holding that insured may recover contractual damages for insurer’s breach, but not punitive damages unless insured could show “egregious tortious conduct” directed at the insured demonstrating a “pattern of similar conduct directed at the public generally.”); see also *New York Univ. v. Continental Ins. Co.*, 87 N.Y.2d 308, 316 (1995).

<sup>4</sup> This article does not address the issue of an insured’s right to recover excess of policy limits when its liability insurer improperly fails to settle a claim within policy limits in gross disregard of the insured’s interests. See, e.g., *Pavia v. State Farm Mut. Ins. Co.*, 82 N.Y. 2d 445 (1993).

<sup>5</sup> *Bi-Economy*, 10 N.Y. 3d 187, 193 (2008).

<sup>6</sup> *Id.* at 195.

<sup>7</sup> *Id.* at 193 (citations and quotations omitted).

<sup>8</sup> *Id.* at 195.

<sup>9</sup> *Id.* at 198.

<sup>10</sup> In both *Bi-Economy* and *Panasia*, and in a recent decision by the Fourth Department in *Stern v. Charter Oak Fire Ins. Co.*, 2009 NY Slip. Op. 00729 (N.Y. App. Div. Feb. 6, 2009) (reversing its prior holding issued before the Court of Appeals decided *Bi-Economy*), the courts also rejected the insurers’ attempt to rely on a policy’s “consequential loss” exclusion to bar an insured’s “consequential damages” claim against its insurer. *Bi-Economy* determined that the term “consequential loss” as used in the exclusion refers to loss stemming from the conduct of the insured or third parties, while “consequential damages” concerns damages incurred by the insured as a result of the insurer’s misconduct. *Bi-Economy*, 10 N.Y. 3d 187, 195.

<sup>11</sup> 857 N.Y.S.2d 680 (App. Div., 2nd Dep’t 2008).

<sup>12</sup> 2008 WL 4426620 (N.D.N.Y. 2008).

<sup>13</sup> 867 N.Y.S.2d 881 (N.Y. Sup. Ct. 2008).

<sup>14</sup> 2008 NY Slip. Op. 32366 (N.Y. Sup. Ct. 2008).