*To be Argued by:*
MICHAEL S. ZICHERMAN
*(Time Requested: 10 Minutes)*

New York County Clerk's Index No. 602472/05

# Court of Appeals

*of the*

# State of New York



PANASIA ESTATES, INC.,

*Plaintiff-Respondent,*

– against –

HUDSON INSURANCE COMPANY,

*Defendant-Appellant.*

## BRIEF FOR PLAINTIFF-RESPONDENT

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## STATEMENT PURSUANT TO RULE 500.5(e)

Panasia Estates, Inc., is a privately owned corporation, and has no parent company, affiliates, or subsidiaries.

## COUNTERSTATEMENT OF QUESTIONS PRESENTED

1. Whether an insured, in the context of a first-party claim, may recover consequential damages for its insurer's breach of the parties' insurance contract?

2. Whether the Appellate Division correctly held that the parties' insurance contract did not exclude consequential damages related to Defendant-Appellant's breach of the agreement?

3. Whether the Appellate Division correctly held that the term "consequential losses," as found in a business income exclusion of a commercial property insurance policy is not synonymous with "consequential damages" related to the breach of an insurance contract?

## PRELIMINARY STATEMENT

The issues before the Court on this appeal are far simpler than one would be led to believe from the appellate brief by Defendant-Appellant, Hudson Insurance Company ("Hudson"). Contrary to the misguided arguments asserted by Hudson and the litany of inapposite cases it cited, Plaintiff-Respondent, Panasia Estates, Inc. ("Panasia") has not asserted a cause of action for deceptive trade practices, pursuant to General Business Law § 349, or a private cause of action for unfair claim settlement practices under New York Insurance Law § 2601. Panasia concedes that, to date, the Court of Appeals has not recognized such causes of action. Likewise, Panasia has not sought punitive damages to redress Hudson's wrongful conduct, nor has it asserted a separate cause of action for bad faith or a separate cause of action for breach of the covenant of good faith and fair dealing. Instead, Panasia merely has asserted a simple, single cause of action for breach of contract for which it seeks an award of consequential damages, in addition to its general damages.

Claims for consequential damages arising out of an insurer's breach of its insurance contract have been allowed by the decisions of the courts of this state, as well as the federal courts in New York, and have not been proscribed by any decision of this Court. Nevertheless, because this issue has not directly been addressed by the Court, there is a sharp divide amongst the state and federal courts

in New York, as to whether policyholders have the right to seek such damages. It is respectfully submitted that this Court should settle the conflict by ruling, as a matter of public policy and based upon the existing law of this state, that insureds have the right to obtain reasonably foreseeable consequential damages for an insurance company's breach of the policy. Accordingly, the order of the First Department should be affirmed.

## COUNTERSTATEMENT OF FACTS

Panasia commenced this action to recover damages it incurred as a direct result of Hudson's breach of its insurance contract by wrongfully delaying and then denying the insurance claim that Panasia made under its commercial property and builder's risk insurance policy issued by Hudson (the "Policy"). (R. 100).

Panasia procured the insurance from Hudson to cover damage that might occur to certain occupied commercial rental property that it owned, which was in the process of undergoing extensive renovations and construction. (R. 21-22). During the Policy period, in the summer of 2003, part of the roof of the Property was opened in order to perform some of the construction work. (R. 22). The contractor performing the renovations and construction temporarily protected the roof opening when work was not being performed. (R. 22).

Between July 9-11, 2003, there was severe inclement weather with high winds and significant rainfall. (R. 22). Despite the temporary protection of the roof, the inclement weather caused rain to enter the building through the roof opening (R. 22), resulting in nearly $1.5 million in damage to the property (R. 101). Upon discovery of the water damage, Panasia promptly notified Hudson of the loss and its claim. (R. 22). However, Hudson did not send anyone to investigate or adjust the claim until several weeks later. (R. 22).

Hudson's agent, UTC Risk Management Services ("UTC"), investigated Panasia's claim on or about July 31, 2003. (R. 22). As alleged by Panasia in its Complaint, UTC's investigation of the loss and the cause of loss at the Property lasted no more than 30 minutes, with most of that time being spent on the roof where the water had infiltrated the building, and conducted little to no investigation of the interior of the building and the resulting damage caused by the water. (R. 24-25, R. 101). At no time before, during, or after UTC's investigation did Hudson or UTC ever ask Panasia to provide any documentation in connection with their determination of the existence of coverage or any documentation to estimate the value of the loss sustained. (R. 101).

It was clear from the superficial nature of the investigation, the complete lack of time spent determining the cause and extent of the damage, and the failure to develop an estimate of the cost to repair/replace the damage, that Hudson never

had any intention of compensating Panasia's claim under the Policy, but instead was working to develop a basis to deny the claim. (R. 24-25, R. 101). Eventually, three months after UTC investigated the claim, it sent a letter to Panasia, on behalf of Hudson, summarily denying the claim on several baseless, pro-forma Policy exclusions, including, (1) wear and tear; (2) continuous or repeated seepage or leakage of water, or the presence or condensation of humidity, moisture or vapor, that occurs over a period of fourteen days or more; (3) the insured's failure to use all reasonable means to save and preserve property from further damage at and after the time of loss; and (4) faulty, inadequate or defective workmanship, repair, construction, renovation, materials, and maintenance, unless they result in a covered cause of loss. (R. 18-20, R. 23). Here, the cause of loss was from water infiltration through the opening in the roof, which is a covered cause of loss under the policy. (R. 24, R. 25).

Apparently, Hudson/UTC routinely send out many denial letters for water infiltration with these very same policy exclusions cited as the bases for the denial because the letter of denial that Hudson/UTC sent to Panasia referred to a policy section/endorsement that was not part of Panasia's Policy, making it reasonably evident that the denial letter was merely a standard form letter that Hudson/UTC sends out without regard to the factual applicability of the exclusions. (R. 25). Further, there was absolutely no factual substantiation or findings reported to

Panasia to support the bases for denial asserted by Hudson. (R. 25).

Due to Hudson's inexcusable and extensive delay in processing the claim and then its baseless denial of the claim, Panasia was caused to incur damages beyond the direct loss sustained from the inclement weather, including the payment of significant interest on several loans taken out to pay for the repair and replacement costs for the property damage that Hudson refused to cover, as well as payment of higher interest rates and closing costs on the conversion of Panasia's construction financing into permanent financing. (R. 101-102). In addition, Panasia lost rents due to its inability to more expeditiously complete the repair work, which too resulted from Hudson's delay in processing the claim and ultimate wrongful disclaimer of coverage. (R. 101-102).

Thereafter, Panasia commenced this action against Hudson, asserting a single cause of action for breach of contract for the wrongful bad faith disclaimer of coverage under the Policy.[1] (R. 21-26). In order to make itself whole, Panasia sought both general damages and consequential damages. (R. 26). Hudson filed a motion for partial summary judgment to dismiss the allegations of bad faith and the claim for consequential damages, among other things. Relying on the First

[1] While Panasia alleged bad faith against Hudson, it did so to make its claim for consequential damages consonant with the requirements of *Acquista v. New York Life*, which governs an insured's right to consequential damages in the First Department. Notwithstanding, Panasia respectfully submits that, under general principles of New York law, "bad faith" should not be a threshold requirement for an insured's right to obtain consequential damages for the breach of an insurance agreement and that this Court ought to modify the holding in *Acquista* to so reflect. *See* Point I, subpart B, *infra*.

Department's binding precedent in *Acquista v. New York Life Ins. Co.*, 285 A.D.2d 73 (1st Dept. 2001), the trial court entered an Order and Decision on July 24, 2006, denying the motion, except to the extent that Panasia sought attorney's fees in connection with the pending action. (R. 8-12). That Order was affirmed on appeal to the First Department (R. 173-174), which then granted Hudson leave to appeal the subject issues to this Court (R. 172).

## LEGAL ARGUMENT

### POINT I

### PANASIA IS ENTITLED TO ASSERT A CLAIM FOR CONSEQUENTIAL DAMAGES AGAINST HUDSON ARISING OUT OF HUDSON'S BREACH OF THE INSURANCE CONTRACT.

In short, the primary issue presented to this Court on appeal is whether, and under what circumstances, an insured, on a first-party claim, should have the right to seek damages (such as consequential damages), against an insurance company, beyond the money to which the insured would have been entitled had the insurer fully and properly performed under the policy. As noted by several judges in the Southern District of New York, this issue remains one of first impression before this Court. *See Hold Brothers, Inc. v. Hartford Casualty Insurance Co.*, 357 F.Supp.2d 651, 656 (S.D.N.Y. 2005); *Lava Trading Inc. v. Hartford Fire Ins. Co.*, 326 F.Supp.2d 434, 439 (S.D.N.Y. 2004). Notwithstanding, this issue and the

relief sought by Panasia is not new and was first addressed and allowed by the California Supreme Court nearly 35 years ago, in *Gruenberg v. Aetna Ins. Co.*, 9 Cal. 3d 566, 108 Cal. Rptr. 480, 510 P.2d 1032 (1973).

Based upon the decisions in other jurisdictions, as well as the state and federal courts in New York, there essentially are three theories / circumstances under which this Court may permit the pursuit of claims for consequential damages. The first theory, adopted by the majority of states, is a tort-based cause of action stemming from the insurer's bad faith claim settlement practices, which gives rise to not only ordinary damages, but also punitive damages, consequential damages (including damages for emotional distress), and attorney's fees. *See Acquista*, 285 A.D.2d at 79-80. The second theory follows traditional contract principles by allowing consequential damages that were reasonably foreseeable and which arose out of the insurer's ordinary breach of the contract. *See id.* at 80-81. The third and final theory is a hybrid of the prior two, which was adopted by the First Department in *Acquista*, and allows the insured to obtain consequential damages arising from the insurer's breach of its duty to investigate, bargain, and settle claims in good faith under the contract. *See id.* at 81.

## A. The *Acquista* Standard.

Pursuant to the law of this state, all contracts contain an implied covenant of good faith and fair dealing in the course of their performance. *See 511 West 232nd Owens Corp. v. Jennifer Realty Co.*, 98 N.Y.2d 144 (2002). This covenant to act in good faith even extends to insurance contracts. *See Smith v. General Acc. Ins. Co.*, 91 N.Y.2d 648 (1998). When an insurance carrier has breached its duty to act in good faith, the courts of this state have ruled that the insurer may be liable for damages beyond the policy limits (*see, e.g., Pavia v. State Farm Ins. Co.*, 82 N.Y.2d 445, 453 (1993)) and where the insurer's bad faith rises to the level of egregious patterns of tortious conduct directed at the public at large, as well as the individual claimant, the insured even may be entitled to recover punitive damages as well (*see Rocanova v. Equitable Life Ass. Soc.*, 83 N.Y.2d 603, 615 (1994)).

In affirming the denial of Hudson's motion for partial summary judgment, the First Department correctly relied upon its decision in *Acquista v. New York Life Ins. Co.*, holding that in the context of a first-party insurance claim, Hudson's alleged breach of its insurance contract gives rise to a right of action for consequential damages. In *Acquista*, the First Department reversed the dismissal of the plaintiff's bad faith claim and held that while New York law does not recognize an independent tort cause of action for an insurer's alleged failure to perform its contractual obligations under an insurance policy, the insurer's failure

to make payment of benefits under the policy is a breach of contract for which contract damages (including consequential damages) should be awarded. 285 A.D.2d at 78.

The *Acquista* court noted that commentators have recognized that a fundamental injustice may result if an insured's damages are limited solely to an amount equal to what the insurer was otherwise obligated to pay under the policy plus interest (i.e., benefit-of-the-bargain damages), since it presumes that the plaintiff has access to alternative funding sources from which to pay the moneys that the insurer refused to pay and ignores further damages that the insured might incur from being denied the money to which it was entitled. *Id.* 78-79. The court explained that the difficulty with limiting an insured's remedy is that it does not necessarily achieve the goal of contract damages, which is to place the plaintiff in the position he would have been in had the contract been performed. *Id.* at 79.

In redressing this problem, the First Department acknowledged that the majority of jurisdictions throughout the country have adopted a tort cause of action for the insurer's bad faith in handling a policyholder's claim and that other courts have merely expanded the scope of contract remedies to encompass more than just the policy limits, so as to include foreseeable money damages beyond the policy limits, consequential damages (even for mental distress and inconvenience), as well as other economic losses. *Id.* at 79-81.

The First Department declined to adopt a tort-based cause of action, as has been done by numerous other states, because it believed that to adopt such an approach "would constitute an extreme change in the law of this State." *Id.* at 81. Instead, it employed a contract-based approach, adopting the reasoning and rationale of the Utah Supreme Court in *Beck v. Farmers Ins. Exchange*, 701 P.2d 795 (1985), which held that:

> [T]here is no reason to limit damages recoverable for breach of a duty to investigate, bargain, and settle claims in good faith to the amount specified in the insurance policy. Nothing inherent in the contract law approach mandates this narrow definition of recoverable damages. Although the policy limits define the amount for which the insurer may be held responsible in performing the contract, they do not define the amount for which it may be liable upon a breach.

*Id.* at 81. Accordingly, the *Acquista* court allowed consequential damages where the insured's claim was delayed or denied in bad faith.

Since *Acquista*, the courts in the First Department have consistently cited to the holding in that case with approval and followed it as binding precedent to permit a claim of consequential damages. *See Koloski v. Metropolitan Life Ins. Co.*, 5 Misc.3d 1028(A), 799 N.Y.S.2d 161, 2004 WL 2903626 at *8 (Sup. Ct. 2004) (unpublished disposition)[2] (citing *Acquista* with approval for the proposition that where a showing of bad faith is made, a plaintiff can recover "consequential

[2] Copy of decision contained in the Record at pages 105 – 105.6.

damages beyond the limits of the policy for the claimed breach of contract"); *Weisel v. Provident Life and Cas. Ins. Co.*, 11 Misc.3d 1062(A), 2006 WL 624900 at *4 (Sup. Ct. 2006) (unpublished disposition)[3] (Denying the defendant-insurer's motion to dismiss the insured's claim for consequential damages for the bad faith denial of his disability insurance claim).

The decision in *Acquista* is consistent with the case law from the other departments, which have long held that claims for consequential damages are permissible (although without the added showing of bad faith). *See Fleming v. Allstate Ins. Co.*, 106 A.D.2d 426, 426, (2d Dept. 1984), *aff'd* 66 N.Y.2d 838 (1985), *cert. denied* 475 U.S. 1096, 106 S.Ct. 1493, 89 L.Ed.2d 894 (1986) (Affirming the denial of the insurer's motion to dismiss the complaint, the court held that the "complaint alleges a cause of action for breach of contract and, if plaintiffs ultimately prevail, they may recover consequential damages resulting from said breach"); *Korona v. State Wide Ins. Co.*, 122 A.D.2d 120, 121 (2d Dept. 1986) (Holding that the plaintiff pled a cause of action for breach of contract for which "he may recover consequential damages as resulted from the breach of the insurance contract"); *Porter v. Allstate Ins. Co.*, 184 A.D.2d 685, 686 (2d Dept. 1992) (Holding that the factual allegations in the complaint set out a cause of action for breach of contract and consequential damages arising from a breach);

[3] Copy of decision contained in the Record at pages 105.6 – 105.11.

*Sabbeth Industries Ltd. v. Pennsylvania Lumbermens Mut. Ins. Co.*, 238 A.D.2d 767, 769 (3rd Dept. 1997) (Reversing the dismissal of Plaintiff's claim for consequential damages arising out of the defendant-insurer's breach of contract).

Hudson has gone to great lengths to argue that *Acquista* was wrongly decided by this Court, relying upon the Court of Appeals' decisions in *Rocanova v. Equitable Life Ass. Soc.*, 83 N.Y.2d 603 (1994) and *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308 (1995), as well as a line of non-binding, non-precedential federal district court decisions (mostly unpublished) that have criticized *Acquista* as being contrary to New York law as set out in *Rocanova* and *New York University*. However, its reliance on *Rocanova* and *New York University* for the proposition that an insured cannot obtain consequential damages for the insured's breach of an insurance contract is gravely misplaced. The Court of Appeals in those cases solely ruled that an insured may not assert: (1) an independent tort cause of action for bad faith claim settlement practices; (2) a cause of action for deceptive trade practices, pursuant to General Business Law § 349; (3) a private cause of action for unfair claim settlement practices under New York Insurance Law § 2601; or (4) a claim for punitive damages (absent exceptional circumstances).

Nowhere in either *Rocanova* or *New York University* did this Court address the issue of consequential damages or breach of contract claims. It does not even

appear that the plaintiffs in those cases asserted claims for consequential damages, which would explain why the issue was never raised. However, while the Court of Appeals did not expressly address this issue in *Rocanova* and *New York University*, or any other published decision, it did do so inferentially via its affirmance of the Second Department's decision in *Fleming v. Allstate Ins. Co.*, *supra*, which allowed claims for consequential damages arising out of an insurance carrier's breach of its insurance contract.

Panasia's bad faith allegations are merely supportive of its general breach of contract claim and are consonant with the holding in *Acquista*. If Panasia establishes Hudson's bad faith at trial, it will be entitled to recover consequential damages under the rationale of *Acquista*. However, as discussed in subpart B below, Panasia should be entitled to recover consequential damages, even absent a showing of bad faith. Regardless, Panasia merely seeks to be made whole by recovering those costs it would not have incurred but for Hudson's breach of the contract. Accordingly, Panasia's claim for consequential damages states a viable remedy for breach of an insurance contract in New York and should not be dismissed.

**B. The Tort-Based and Pure Contract-Based Standards.**

The *Acquista* court never rejected the merits of the tort-based approach, nor did it reject the merits of the contract-based approaches in the other cases it cited. By not doing so, and adopting a "more conservative approach," it implicitly left to this Court the ultimate decision as to the appropriate basis for the remedy that ought to be afforded to insureds (tort or contract), the burden that must be established (bad faith, simple breach of contract, or negligence), and the remedies that ought to be available (consequential damages, a right to attorney's fees, punitive damages, etc.). *See Acquista*, 285 A.D.2d at 81.

While the tort-based approach adopted by the majority of states is a perfectly reasonable mechanism to afford an insured the right to seek consequential damages and other extra contractual damages, Panasia advocates that this Court should adopt a pure contract-based approach, without the necessity of establishing bad faith, since it would be more in accord with the existing law in New York. Indeed, after analyzing the decisions of the courts in this state and predicting what this Court would likely do if faced with the question on the availability of consequential damages for the breach of an insurance agreement, two judges in the Southern District of New York, have come to the same conclusion and opined that this Court would follow the established rule of consequential damages laid down in *Kenford Co. v. County of Erie*, 73 N.Y.2d 312 (1989), and its progeny. *See Hold*

*Brothers, Inc. v. Hartford Casualty Insurance Co.*, 357 F.Supp.2d 651, 656-658 (S.D.N.Y. 2005); *Lava Trading Inc. v. Hartford Fire Ins. Co.*, 326 F.Supp.2d 434, 439-441 (S.D.N.Y. 2004).

In *Hold Brothers*, the plaintiff's offices in the World Trade Center were destroyed on 9/11. It filed an insurance claim under the policies issued by the defendant, for the physical damage to the property, loss of business income due to the suspension of operations resulting from the damage, and extra expenses incurred as a result of the suspension. 357 F.Supp.2d at 651. The policies provided that within 30 days of receiving a sworn statement of loss from the plaintiff, the defendant would notify the plaintiff of its intentions respecting coverage, and if the parties agreed to an amount of the loss, payment would be made within 30 days thereafter. *Id.* at 654-655. The defendant delayed its coverage determination and refused to pay any money for the interruption of business. *Id.* at 655.

The plaintiff filed an action against the defendant-insurer claiming consequential damages for lost business, lost market share to competitors, and increased costs, all due to the defendant's breach of its obligations under the policies. *Id.* at 656. The defendant moved to dismiss on the grounds that New York law does not allow such damages for failure to pay a policyholder's claims

and that the policies expressly exclude recovery of consequential damages.[4] *Id.* The defendant argued that based on various appellate division cases, a policyholder cannot obtain consequential damages resulting from an insurer's breach of an insurance policy unless a contractual provision specifically authorizes such damages. *Id.* The court, though, found that the appellate cases cited were almost entirely devoid of analysis, either predated or ignored this Court's decision in *Kenford*, contained a provision that expressly excluded analysis, or actually supported the opposite proposition that a specific provision permitting such damages is not a prerequisite.[5] *Id.* at 656-657.

Moreover, the District Court found that, according to *Kenford*, an express contractual term allowing consequential damages is not required as a condition of the right to recover such damages. *Id.* at 657. Instead, it found that the Third Department's holding in *Sabbeth*, *supra*, 238 A.D.2d 767, closely adhered to the text of *Kenford*, that it was more consonant with this Court's holding in that case, and thus, was a good predictor of how the Court would rule on this issue. *Id.* Accordingly, in keeping with *Kenford*, the District Court ruled that to recover consequential damages for an insurer's breach of an insurance policy, New York

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[4] The District Court's analysis of this latter point will be addressed at Point III, infra, wherein Panasia addresses the identical argument raised by Hudson.

[5] It is worth noting that many of the cases rejected by the District Court as allegedly standing for the proposition that New York law does not allow consequential damages for the breach of an insurance agreement are the same cases cited by Hudson in support of its appeal to dismiss Panasia's claim.

law only requires the policy to show that such damages "were within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting," and that an express contractual provision authorizing recovery of such damages was not required. *Id.* at 658 (*quoting Kenford*, 73 N.Y.2d at 319).

Similarly, in *Lava Trading*, in the absence of any holding from this Court, the District Court followed the rationale of *Kenford*, as the leading New York case on the availability of consequential damages in a breach of contract action, and ruled that such damages are available for the breach of an insurance policy where the damages were brought within the contemplation of parties. *See Lava Trading*, 326 F.Supp.2d at 439-440. Also, like *Hold Brothers*, the District Court cited the Third Department's decision is *Sabbeth* in support of its holding. *Id.* at 440-441.

While Hudson likely will argue that neither of these federal district court cases are binding on this Court and that they conflict with the decisions of other judges out of the same court, these decisions to allow consequential damages, without a showing of bad faith, not only are consistent with *Sabbeth*, but more importantly, are consistent with the Second Department's decision in *Fleming v. Allstate Ins. Co.*, *supra*, which this Court affirmed on appeal.

Accordingly, applying the *Kenford* rationale to insurance agreements, insureds, such as Panasia, may claim consequential damages for the insurance

company's breach of contract to the extent they establish that the consequential damage was "brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting." *Kenford*, 73 N.Y.2d at 319. In *Ashland Management Inc. v. Janien*, this Court further explained this rule as follows:

> The party breaching the contract is liable for those risks foreseen or which should have been foreseen at the time the contract was made. The breaching party need not have foreseen the breach itself, however, or the particular way the loss came about. It is only necessary that loss from a breach is foreseeable and probable (see, Restatement [Second] of Contracts § 351; 3 Farnsworth, Contracts § 12.14 [2d ed. 1990]).

82 N.Y.2d 395, 403 (1993).[6]

This standard for the foreseeability of consequential damages, as articulated by the Court in *Ashland*, comports with the general black letter law on the issue as

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[6] It should be noted that the issue of whether the damages claimed by Panasia are general or consequential, or if consequential, whether those damages were reasonably foreseeable, are not before the Court on this appeal as those issues have not yet been addressed by the trial court. However, to the extent that the Court generally decides to addresses the circumstances under which an insurance company may be deemed to have foreseen such damages, it is Panasia's position that the finder of fact should be permitted to consider the type of insurance procured, the types of risks that are contemplated under the policy (whether covered or excluded), and the subject matter of the insurance (commercial property, personal property, etc.). *See Kenford*, 73 N.Y.2d at 319 ("In determining the reasonable contemplation of the parties, the nature, purpose and particular circumstances of the contract known by the parties should be considered …"); *See, e.g.*, *Sabbeth Industries Ltd. v. Pennsylvania Lumbermens Mut. Ins. Co.*, 238 A.D.2d 767, 769 (3rd Dept. 1997) (Citing *Kenford* and finding that the very nature of a business interruption policy made consequential damages reasonably foreseeable and within the contemplation of the parties, since the existence of such coverage would make the insurer "aware that if it breached the policy it would be liable to plaintiffs for damages for the loss of their business as a consequence of its breach or made it possible for plaintiffs reasonably to suppose that defendant assume such damages when the contract was made.").

expressed in the Restatement of Contracts and other treatises. *See* Restatement (Second) of Contracts, § 351, Comment a. ("It is enough, however, that the loss was foreseeable as a probable, as distinguished from a necessary, result of his breach. Furthermore, the party in breach need not have made a "tacit agreement" to be liable for the loss. Nor must he have had the loss in mind when making the contract, for the test is an objective one based on what he had reason to foresee."); Arthur L. Corbin, Corbin on Contracts, Interim Edition, vol. 11, § 1009 (2002) ("The existing rule requires only reason to foresee, not actual foresight. It does not require that the defendant should have promised either impliedly or expressly to pay therefore in case of breach. It is erroneous, therefore, to refuse damages for an injury merely because its possibility was not in fact in the contemplation of the parties at the time they made the contract. … [I]n general, damages are awarded for a breach not because they were contemplated and promised to be paid, but to compensate the injured party for harm done that ought to have been foreseen whether it was or not.").

For the foregoing reasons it is respectfully requested that this Court affirm the Order of the First Department to the extent it allowed Panasia the right to seek consequential damages from Hudson, but narrowly modify that court's decision by eliminating the requirement for establishing bad faith.

## POINT II

## PUBLIC POLICY CONSIDERATIONS FAVOR AN INSURED'S RIGHT TO CLAIM CONSEQUENTIAL DAMAGES.

There is no valid reason why an insured's breach of contract damages should be limited solely to the amount that the insurance company would have been obligated to pay had it performed in the first instance, or why the insurer's bad faith would need to be established as a prerequisite to obtaining consequential damages.

The general theory for denying consequential damages to an insured for the insurer's breach of the insurance contract is derived from the perspective that an insurance contract is simply an agreement to pay money, and therefore, recovery is limited to the amount due under the contract plus interest. *See* George J. Kenny and John H. Denton, 2 Law and Practice of Insurance Coverage Litigation, § 27:2. However, such notions are outdated, do not accurately reflect the nature of the relationship between the parties, and should not be followed. An insurance contract is not just an agreement to pay money, like the implied agreement between a casino and patron that has just won a hand of Blackjack. Rather, insurance contracts are ordinary performance-based agreements, whereby the insurance company is charged with the specific obligation under the policy to evaluate the occurrence of a loss, assess the quantum of the loss, determine

whether the occurrence and/or the loss are covered under the policy, to pay the assessed loss if covered, and to do all this within either a prescribed or reasonable period of time.

Essentially, what Hudson and the insurance industry *amici curiae* in *Bi-Economy Market Inc v. Harleysville Insurance Company of New York*[7] are urging this Court to do is to single out insurance companies for specialized treatment, by exempting them from consequential damages as a matter of law, and place them in a better position than every other company that enters into contracts. Their argument for special treatment is based on public policy reasons due to theoretical societal consequence of their being held accountable for consequential damages and their professed need to be free to make good faith decisions. *Amici Curiae* Br. at 17-19. However, contrary to their arguments, insurance policies are contracts, just like any other contract, and insurance companies are profit driven organizations, just like other companies, and therefore, the same rules should apply to both.[8]

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[7] The New York Insurance Association, National Association of Mutual Insurance Companies, American Insurance Association, Property Casualty Insurers Association of America filed a joint *amici curiae* brief in *Bi-Economy*, which is scheduled for argument before this Court on the same date as the within action due to the identity of issues in the two cases. Thus, while the insurance industry *amici curiae* brief was filed in the *Bi-Economy* case only, because the issues raised in that brief may be viewed as applying equally to this action, it is necessary for Panasia to briefly address some of the issues raised therein.

[8] As noted by Judge Scheindlin, in *Hold Brothers*, there is no apparent reason why the Court of Appeals would create a rule for insurance policies with regard to consequential damages different from the rule for all other types of contracts. *See* 357 F.Supp.2d at 657.

In this regard, many companies make good faith contractual decisions based on what they believe their rights to be under their contract. Sometimes they are right and sometimes they are wrong. However, when they are wrong, and that decision results in a breach of the contract that causes damages to the other party, their having acted in good faith is no defense and the law allows the non-breaching party to recover reasonably foreseeable consequential damages. Once one gets past the incorrect notion that insurance contracts are just agreements for the payment of money, the insured's right to seek consequential damages flows naturally as an ordinary remedy for the breach of contract, without the necessity of overcoming special, arbitrary burdens of bad faith that are not a prerequisite for other contracts.

There is, however, one significant difference between ordinary contractees and insurance companies, but that difference only further militates in favor of the an insured's right to seek consequential damages. Typically, a company enters into a contract because it believes that doing so will be profitable (monetarily or otherwise) and performs that contract to realize its profit. Insurance companies, like these other companies, also enter into contracts to obtain a profit. However, unlike these companies, because of the nature of the insurance business, insurance companies make money by not performing their contracts; that is, by not paying or delaying payments that are due. The less that is paid, the more profitable the

insurance company becomes. Thus, there is a conflict between the interests of the insurer and that of the insured, and it takes no great leap of faith to conclude that an insurance company will favor its own profitability over the full and complete payment of a claim to an insured.

Presently, in New York, there is no real consequence or disincentive for a carrier to wrongfully deny coverage, and in fact, it has every incentive to do so, leaving an insured in a completely vulnerable position. Once the insured has paid the premiums that are due under the policy, it is left to hope that the insurer will pay the moneys that are due and owing. It has no leverage to compel the insurer to pay what is due, particularly if the only remedy available to it is the payment of what was actually due under the policy if it had been performed. The only arguable leverage is the threat of statutory interest, assuming that the insured has the fortitude and financial resources to even commence a lawsuit and ultimately is successful in its suit several years later. However, insurers certainly realize that most insureds will not commence a suit for coverage because the suits are not economically feasible, in that the amount of the typical claim is disproportionate to costs to pursue the claim. Nonetheless, on the off chance that a claim was brought and was successful, the interest that the insurer earns on the continued investment of the policy premiums likely will exceed the 9% statutory interest it ultimately may be required to pay anyway.

Lastly, as might be expected, the insurance industry paints quite a bleak picture of the tragedies that would befall society if this Court were to adopt a policy that would allow consequential and other types of damages beyond the limits of the policy, resulting from their erroneous decision to deny or delay coverage. *See Amici Curiae* Br. at 14-19. One may think that the sky would start falling. However, as previously stated, these types of extra contractual damages have been available to insureds in numerous other jurisdictions for more than 35 years, and yet the sky is still intact. People still are able to obtain insurance and from all accounts, insurance companies are turning record profits. Thus, the unrealistic doomsday scenario portrayed by the insurance industry should not impede this Court from officially bringing New York law in line with that of the rest of the country.

For the foregoing reasons, public policy mandates that an insured receive more than just its benefit-of-the-bargain damages plus statutory interest. The insured needs to be made whole and the insurer needs to be disincentivized from advancing its own self-interests over that of the insured. However, to the extent that there is any arguable public policy for immunizing insurance carriers from consequential damages, such a policy must be established by the legislature, not the courts.

Regardless of the theory ultimately adopted by this Court to be the law in New York, insureds, such as Panasia, should be accorded the basic right to be made whole for all of the real damages sustained from an insurance company's wrongful delay and/or denial of coverage, as has been permitted in the vast majority of states throughout the country over the last 35 years. And even if this Court elects to adopt a tort-based cause of action, this additional cause of action should not limit an insured's right to obtaining traditional contract damages, including consequential damages, arising from the insurer's breach of contract.

## POINT III

## THE INSURANCE POLICY ISSUED TO PANASIA DOES NOT EXCLUDE CONSEQUENTIAL DAMAGES THAT ARISE FROM HUDSON'S BREACH OF CONTRACT.

Hudson's final argument that Panasia is not entitled to consequential damages because of an "explicit" exclusion in the Policy is flawed on several grounds.

First, there is no exclusion in Panasia's policy that bars consequential damages attributable to Hudson's breach of contract. Hudson argues that the Policy contains an exclusion against "any other consequential loss" and that this exclusion precludes the damages sought by Panasia. The exclusion is contained at section B.4.a. of the Causes of Loss – Special form (R. 106) and states in pertinent part as follows:

> 4. Special Exclusions
>
> The following provisions apply *only* to the specified Coverage Forms.
>
> a. Business Income (And Extra Expenses) Coverage Forms, Business Income (Without Extra Expense) Coverage Form, Or Extra Expense Coverage Form
>
> We will not pay for:
>
> * * *
>
> (6) Any other consequential loss.

(R. 54) (Emphasis added).[9]

It is clear that the exclusion upon which Hudson relies is taken out of context and does not apply to Panasia's claim, since the exclusion pertains *solely* to claims made under the specified forms and none of those forms are part of Panasia's Policy, as evidenced by the Policy's Forms and Endorsement List (R. 29). Further, there is no other provision in the policy that deals with consequential losses and there is no provision that refers to consequential damages. Thus, the Policy exclusion for "any other consequential loss" cannot serve as a basis to dismiss Panasia's claim of consequential damages.

Second, even assuming, *arguendo*, that the "any other consequential loss" exclusion was applicable to the Policy, it still would not preclude Panasia's claim for consequential damages because the terms "consequential losses" and "consequential damages" are not synonymous. The exclusion only applies to claims for "consequential losses" and Panasia is asserting a claim for "consequential damages," not consequential losses.

As the First Department correctly held below, these two terms are not synonymous. (R. 173). The court's holding in this regard is supported by Black's Law Dictionary, which defines "Consequential Loss" as "Losses not directly

[9] It is rather telling that Hudson failed to quote the relevant portion of the Policy for the alleged exclusion or even provide the Record citation for this Court to review the purported exclusion in context. The only policy exclusion quoted by Hudson appears at pages 25-26 of its brief, which is not from the Policy that is the subject of this appeal, but rather was from the policy at issue in *Streamline Capital, LLC v. Hartford Cas. Ins. Co.*, 2003 WL 22004888, *5-6 (S.D.N.Y.).

caused by damage, but rather arising from results of such damage" and defines "Consequential Damage" as "Such damage, loss or injury as does not flow directly and immediately from the act of the party, but only from some of the consequences or results of such act." Black's Law Dictionary 390 (6th ed. 1990).

As is evident from the above definitions, the significant distinction between the two concepts is that the former is a consequence of damages that were sustained and the other is the consequence of a party's actions. For example, if a historic home is damaged by fire, a claim by the insured for the lost business opportunity to use the home as an income producing property by giving tours would be a consequential loss, since the lost business opportunity resulted from the fire damage. However, if the lost business opportunity was caused by the insurer's failure to adjust and pay for the fire damage that was covered under the policy (i.e., the business opportunity would not have been lost if the claim was timely and fully paid), this would be a consequential damage, since the lost business opportunity was not caused by the fire *per se*, but was a consequence of the insurer's actions or inactions.

Here, Panasia is not seeking any consequential losses arising out of the damage from the water infiltration, only the additional costs it was forced to incur as a result of Hudson's wrongful delay and disclaimer of coverage.

Lastly, even if the terms "consequential losses" and "consequential damages" were deemed synonymous, the exclusion still is inapplicable, or at a minimum – ambiguous, thereby precluding the dismissal of Panasia's claim. This final point was addressed directly by the Southern District in *Hold Brothers* and *Lava Trading*, which found that a policy exclusion for "any other consequential loss" does not necessarily preclude consequential damages from a breach of contract and is, at least, ambiguous.[10]

Like Hudson, the defendant-insurer in *Hold Brothers* argued that the "any other consequential loss" exclusion found in the subject policy's Business Income and Extra Expense Exclusions, expressly excluded recovery of the consequential losses claimed from its breach of the insurance policy. 357 F.Supp.2d at 658-659. Rejecting the insurer's argument, and finding the existence of a question of fact, the District Court held that for purposes of the motion, it was sufficient that the cited provision does not "unambiguously exclude the recovery of consequential damages resulting from a breach" of the policy, since it appears as an exclusion of coverage to certain losses and does not reference losses or damages resulting from a breach. *Id.* at 659.

[10] Panasia acknowledges that this issue also has been addressed by various state courts and New York federal district courts, which have come to the contrary conclusion. Notwithstanding, it is submitted that those cases generally provided an incomplete or fleeting explanation for their decision, or provided a summary conclusion with no explanation at all. Unlike those cases, *Hold Brothers* and *Lava Trading* provide a sensible, cogent argument that the alleged exclusion may not pertain to consequential damages for a breach of contract, and thus, cannot serve as a basis to dismiss a claim of consequential damages.

The District Court, in *Lava Trading*, likewise rejected the argument raised by the defendant-insurer that the exclusion of "any other consequential loss" should be applied to consequential damages for a breach of insurance contract. 326 F.Supp.2d at 441-442. However, the court in *Lava Trading* correctly took the analysis one step further by directly holding that the exclusion is inapposite to damages claimed for a breach of an insurance policy and did not preclude the consequential damages claimed. As such, the District Court held:

> [A] policy exclusion speaks only to what constitutes a covered loss under a policy of insurance, and not to what remedies are available for breach of a policy. The scope of a policy's coverage and the damages that are recoverable if the insurer breaches the policy are, of course, distinct concepts. Payment to an insured for a covered and non-excluded loss is performance under the contract of insurance. Breach of the contract of insurance is an entirely different matter …

Id. at 442. Thus, Hudson's "any other consequential loss" exclusion fails to preclude Panasia's claim for consequential damages

As a final point, it is significant to note that despite the numerous provisions setting out the rights and obligations of the parties in connection with asserting a claim and paying claims under the Policy (see, e.g., R. 71-73), the Policy is completely devoid of any provision that expressly excludes claims of consequential damages arising out of a breach of the contract. If Hudson truly sought to avoid potential liability for consequential damages arising out of its

breach of its insurance contract, it could have attempted to do so by adding a simple clause in the Policy, as is often found in many commercial contracts, that specifically states it shall not be liable for any consequential damages arising out of or related to its breach of the terms of the policy. Certainly, the inclusion of such a clause would not be an onerous task and the glaring lack of such a provision can only signify that Hudson agreed to be liable for all foreseeable damages arising out its breach of the contract. *See Lava Trading*, 326 F.Supp.2d at 442-443 (Positing, in *dicta*, that "by specifically addressing consequential losses and then expressly excluding them from policy coverage, consequential damages were a type of injury that the parties recognized might arise," and would be compensable for a breach of contract.).

## CONCLUSION

For all of the foregoing reasons, it is respectfully submitted that the First Department's April 17, 2007 Decision and Order should be affirmed.

Respectfully submitted,

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November 28, 2007.

STATE OF NEW YORK )
) ss.:
COUNTY OF NEW YORK )

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I, , being duly sworn, depose and say that deponent is not a party to the action, is over 18 years of age and resides at the address shown above or at

NOV 28 2007

**On**

deponent served the within: **Brief for Plaintiff-Respondent**

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the address(es) designated by said attorney(s) for that purpose by depositing **3** true copy(ies) of same, enclosed in a properly addressed wrapper in an Overnight Next Day Air Federal Express Official Depository, under the exclusive custody and care of Federal Express, within the State of New York.

Sworn to before me on NOV 28 2007

**Mariana Braylovskaya**
Notary Public State of New York
No. 01BR6004935
Qualified in Richmond County
Commission Expires March 30, 2010

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