



COUGHLIN DUFFY LLP

CASE ALERT, NO. 29

FEBRUARY 29, 2008



Justin N. Kinney, Esq.
Member

Wall Street Plaza
88 Pine Street, 5th Floor
New York, New York 10005
Tel (212) 612-4983
Fax (212) 480-3899

jkinney@coughlinduffy.com



Rebecca J. Foote, Esq.
Associate

Wall Street Plaza
88 Pine Street, 5th Floor
New York, New York 10005
Tel (212) 612-4981
Fax (212) 480-3899

rfoote@coughlinduffy.com

Offices also located at:

P.O. Box 1917
350 Mount Kemble Avenue
Morristown, New Jersey 07962
Tel (973) 267-0058
Fax (973) 267-6442

www.coughlinduffy.com

New York High Court Expands Insurer Liability for Extra-Contractual Damages

Last week the New York Court of Appeals dramatically altered the landscape of insurer bad faith law in New York. In two equally divided decisions, *Bi-Economy Market, Inc. v. Harleysville Insurance Co.* and *Panasia Estates, Inc. v. Hudson Insurance Co.*, the Court held that insureds may assert extra-contractual claims for consequential damages against insurers that allegedly breached their policies in bad faith. In a strongly worded, identical dissent in both cases, two justices criticized the majority for reversing prior Court precedent and for opening the door to increased premiums for all purchasers of insurance in New York. As a result of these decisions, the Court now has created a new avenue for insureds to pursue extra-contractual damages from insurers that undermines New York's long-standing reputation as a favorable jurisdiction for insureds on bad faith law.

In *Bi-Economy Market*, the Court reversed a grant of partial summary judgment to Harleysville Insurance Company ("Harleysville") dismissing plaintiff's breach of contract claim. The insured, Bi-Economy Market ("Bi-Economy"), was a meat market located in Rochester, New York. A fire occurred on the Bi-Economy premises in October 2002 that resulted in

the complete loss of food inventory as well as heavy structural damage to the building and equipment. Bi-Economy was insured by Harleysville under a "Deluxe Business Owner's" policy that provided, among other things, business interruption coverage for up to one year from the date of the fire. Following the fire, Bi-Economy submitted a claim to Harleysville, however, Harleysville disputed Bi-Economy's damages and advanced only \$163,161.92. Over one year later, after the parties submitted to dispute resolution, Bi-Economy was awarded \$407,181. During the pendency of the dispute, Harleysville paid only seven months of Bi-Economy's business interruption claim. Bi-Economy never resumed its operations following the fire and claimed that Harleysville was responsible for consequential damages sustained by Bi-Economy, including damages due to the loss of its business.

In *Panasia Estates*, the Court upheld a denial of summary judgment to Hudson Insurance Company ("Hudson"). The insured, Panasia Estates, Inc. ("Panasia"), owned a commercial property located at 33 West 19th Street in New York City and had a commercial property insurance policy with Hudson that included "Builders

About Coughlin Duffy LLP

Coughlin Duffy LLP is one of the fastest growing law firms in the northeastern United States, servicing a sophisticated national and international clientele. We provide a full range of legal services including all types of litigation, arbitration and transactional work on behalf of corporate, institutional, governmental and individual clients. We have one of the largest groups of attorneys dedicated to representing insurers and reinsurers throughout the United States and internationally, and specialize in the representation of multi-national organizations faced with international disputes.

The materials presented herein are for information purposes only and are not offered as legal advice. No reader should act on the basis of these materials without seeking appropriate professional advice as to the particular facts and applicable law involved. Opinions presented herein are the opinions of the individual authors, and do not necessarily reflect the opinion of the firm of Coughlin Duffy LLP, or any of its attorneys or clients.

Risk Coverage” covering damage to its property while undergoing renovation. During the policy period, the roof of the building was opened in order to perform construction work and rain water entered the building, resulting in extensive damage to the property. Panasia allegedly notified Hudson of the loss shortly after it occurred, however, Panasia claimed that Hudson failed to investigate or adjust the claim until several weeks later. Thereafter, Hudson denied the claim stating that Panasia’s loss was the result of repeated water infiltration over time and wear and tear, rather than from a covered risk. Panasia sought both direct and consequential damages as a result of Hudson’s alleged breach of contract.

The majority in *Bi-Economy* premised its decision on the general rule that parties to a contract may recover consequential damages above and beyond general damages where the consequential damages were reasonably contemplated by the parties. The Court noted that the purpose of business interruption coverage “would have made Harleysville 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.” It therefore held “that *Bi-Economy*’s claim for consequential damages including the demise of its business, were reasonably foreseeable and contemplated by the parties, and thus cannot be dismissed on summary judgment.” In doing so the Court rejected Harleysville’s reliance on exclusions for “consequential loss”, holding that such exclusions did not apply to “additional damages caused by a carrier’s injurious conduct.”

In *Panasia Estates* the Court did not add much to the analysis, stating simply:

As we explained in *Bi-Economy Market v Harleysville Ins. Co.* [decided today], consequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance contract context, so long as the damages were within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting.

Unlike in *Bi-Economy*, the Court did not reach a conclusion as to whether the consequential damages sought in *Panasia Estates* were foreseeable as the courts below failed to consider that question. It did, however, conclude as in *Bi-Economy* that a “consequential loss” exclusion in the Hudson policy did not bar Panasia’s claims.

In an identical dissenting opinion in each case, two Justices accused the majority of legitimizing punitive damages in insurance breach-of-contract cases by renaming them “consequential” damages, contrary to the Court’s prior precedent, without any logical reasoning to support this departure. Specifically, the Court of Appeals previously had rejected claims for punitive damages based solely on an alleged bad faith failure to pay a claim. Instead, to justify punitive damages the insured had to prove both “egregious tortious conduct” directed at the insured claimant and “a pattern of similar conduct directed at the public generally.” The dissent concluded this rule effectively was eviscerated by the majority without even an acknowledgement that it was doing

so. Beyond dissatisfaction with the majority’s reasoning (or lack thereof), the dissent denounced the majority’s “bad policy choice”, which the dissent predicted will lead to higher premiums because “[i]nsurers will fear that juries will view even legitimate claim denials unsympathetically, and that insurers will thus be exposed to damages without any predictable limit.”

Though the *Bi-Economy* opinion on its face purports to rely on the purpose of business interruption coverage for its decision, such that it should be limited to cases involving such coverage, as the dissent correctly pointed out, the purpose of business interruption coverage “app[ears] extraneous to [the majority’s] holding” because *Panasia Estates* did not involve business interruption coverage. Indeed the majority in both cases used rather loose, broad language to describe its holding that could be construed to suggest that it applies to any insurance policy. In the first-party context, at least one Appellate panel, albeit divided, had already allowed a claim for extra-contractual damages for alleged bad faith denial of disability benefits in a decision that has been widely criticized. Though neither majority opinion mentioned this decision, the result in *Bi-Economy* and *Panasia Estates* vindicates it. In the third-party context, except in only limited circumstances the New York Courts have rejected claims for extra-contractual damages for bad faith denial of coverage principally because New York law does not recognize an independent tort claim for bad faith denial of coverage. Based on *Bi-Economy* and *Panasia Estates*, insurers now should expect that insureds will seek the very same extra-contractual damages under the guise of “consequential damages” based on bad faith breach of contract. Insurers do, however, have strong arguments available to them to defeat the extension of *Bi-Economy* and *Panasia Estates* to third-party policies.

If you have any questions concerning the Court of Appeals’ decisions, please call Justin Kinney or Rebecca Foote in our New York office.