



presents

Bad Faith in Insurance Claims

Strategies for Prosecuting and Defending Against Claims of Insurer Misconduct

A Live 90-Minute Webinar/Audio Conference with Interactive Q&A

Today's panel features:

Paul R. Koepff, Partner, **O'Melveny & Myers**, New York

Jerold Oshinsky, Partner, **Gilbert Oshinsky**, Washington, D.C.

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Robert M. Horkovich, Shareholder, **Anderson Kill & Olick**, New York

Wednesday, July 15, 2009

The conference begins at:

1 pm Eastern

12 pm Central

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10 am Pacific

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Bad Faith Insurance Claims

Strategies for Prosecuting and
Defending Against Claims of
Insurer Misconduct

Jerold Oshinsky

A Live Interactive 90-Minute Teleconference Program
Wednesday, July 15, 2009 ■ 1:00 p.m. Eastern Time
Sponsored by Insurance Law & Litigation Reporter,
and the Legal Publishing Group of Strafford Publications

Bad Faith

- What constitutes bad faith?

Duty of Good Faith

- Claims arise out of the obligation of good faith implied in every policy. *Thompson v. Shelter Mut. Ins.*, 875 F.2d 1460, 1462 (10th Cir. 1989) (“ every insurance contract contains an implied duty of good faith and fair dealing”).
- The cornerstone of bad faith is unreasonable conduct, but the standard for finding bad faith varies widely among jurisdictions. *Cf. Pavia v. State Farm Mut. Auto Ins. Co.*, 82 N.Y.2d 445 (1993) (gross disregard for the insured’s interests) and *Pickett v. Lloyd’s*, 131 N.J. 457 (1993) (no debatable reasons for denial of benefits).

Tort or Contract

- Bad faith may arise in tort or contract. Some states have found that there is no actionable tort for bad faith. See. e.g., *Johnson v. Federal Kemper Ins. Co.*, 72 Md. App. 243, 536 A.2d 1211 (Md. Ct. App.) (tort action does not exist), cert. denied, 542 A.2d 844 (1988); *Kewin v. Massachusetts Mut. Life Ins. Co.*, 295 N.W.2d 50 (Mich. 1980) (bad faith breach of contract is not an independent and separate actionable tort).

First-Party Claims

- Insurer either failed to perform its obligation to pay money when it was due or improperly delayed the processing and payment of a valid claim. *Gruenberg v. Aetna Ins. Co.*, 9 Cal.3d 566 (1973) (insurer's duty to accept reasonable settlement in third-party case and duty not to withhold unreasonably payments due under a first-party policy "are merely two different aspects of the same duty").
- Not all states recognize first-party bad faith claims. *Talat Enterprises, Inc. v. Aetna Cas. and Sur. Co.*, 753 So.2d 1278, 1281 (Fla. 2000) (common law of Florida "did not recognize claims made by an insured against its own insurer for failing to act in good faith when settling a claim").

Third-Party Claims

- Insurer failed to properly defend insured in good faith or refused to settle underlying action against its insured.
- Focus is on the insurer's handling of the underlying claims brought by the third party against the policyholder.
- Policyholder may assign rights against the insurer to a third-party, typically the plaintiff bringing the underlying action.

Bad Faith Without Coverage

- Courts may not always require a finding of coverage to find bad faith. *Wilson v. 21st Cent. Ins. Co.*, 42 Cal. 4th 713 (2007) (even if coverage is debatable, and the insurer did not investigate, insurer could be liable for bad faith); *Avery Dennison Corp. v. Allendale Mutual Ins. Co.*, 310 F.3d 1114 (9th Cir. 2002) (“Except perhaps in highly extraordinary circumstances, California does not permit recovery on a bad faith claim unless insurance benefits are due under the policy.”).

Burden Of Proof – Standard

- The burden of proof varies among jurisdictions.
 - Preponderance of the evidence: *Lincoln Elec. Co. v. St. Paul Fire & Marine Co.*, 10 F. Supp. 2d 856, 873 (N.D. Ohio 1998) , *overruled on other grounds*, 210 F.3d 672 (6th Cir. 2000); *Rogers v. Hartford Accident & Indem. Co.*, 133 F. 3d 309 (5th Cir. 1998).
 - Clear and convincing evidence: *Bostick v. ITT Hartford Group, Inc.*, 56 F. Supp.2d 580 (E.D. Pa. 1999); *Polselli v. Nationwide Mut. Fire Ins. Co.*, 23 F.3d 747 (3d Cir. 1994); *State Farm Auto. Ins. Co. v Floyd*, 366 S.E.2d 93, 98 (Va. 1988).
 - Hybrid: *Independent Fire Ins. Co. v. Lunsford*, 621 So. 2d 977, 979 (Ala. 1992) (“substantial evidence” standard).

Statutes

- Prohibit insurer from misrepresenting facts or coverage, failing to timely disclaim, failing to attempt a good faith settlement, failing to settle claims promptly or to investigate or pay claims, or failing to promptly provide a reasonable explanation of its basis for denying coverage. Must show a general business practice.
- Remedies can include actual and consequential damages, costs and attorneys' fees, punitive and treble damages.
- Examples: Connecticut Unfair Insurance Practices Act, Conn. Gen. Stat. § 38a-816 (2008); Massachusetts Unfair Trade Practices Act, Mass. Gen. Laws Ann. Ch. 176D, § 3 (2008); North Carolina Insurance Unfair Trade Practices Act, N.C. Gen Stat. § 58-63-15 (2008).

Coverage Investigation

Insurer's Obligations

Policyholder's Obligations

- A policyholder may have an obligation of good faith. At least a few courts have begun to recognize a “reverse bad faith” claim brought by insurance companies against their insureds. *Cooper v. Equity Gen. Ins.*, 219 Cal. App. 3d 1252, 1258-59, 268 Cal. Rptr. 692, 695 (1st Dist. 1990).
- Document retention issues.

Does The Use Of Counsel Protect Investigative Materials?

- Investigative materials are not privileged merely because an insurer sends such materials to an attorney. *Spectrum Sys. Int'l Corp. v. Chemical Bank*, 78 N.Y.2d 371 (1991); see also *Mead Reinsurance Co. v. Superior Ct.*, 188 Cal. App. 3d 313 (1986) (documents in claims file reflecting advice of counsel are not privileged).
- Insurer may place privileged communications “in issue” by claiming advice of counsel defense.
- Insurer may not be permitted to benefit from protection against disclosure of “mental impressions, conclusions, opinions, or legal theories” even where it employs claims investigators who are attorneys because claims investigators do not function as attorneys. See *Fed. R. Civ. P. 26(3)(B)*; see also *Pete Rinaldi's Fast Foods, Inc. v. Great American Ins. Co.*, 123 F.R.D. 198 (M.D.N.C. 1988) (claims files not created in anticipation of litigation).

Proving A Bad Faith Claim

Pre-Suit Investigation

- Existence of insurance policy that provided coverage
- Justification for insurer's actions
- Nature and extent of injury or loss
- Conduct that may give rise to consequential and punitive damages
- Potential defenses suggested by the facts
- Injury to public generally

Useful Discovery

- Claim file is subject to discovery in bad faith cases. *Richardson v. Employers Liability Assur. Corp.*, 25 Cal. App.3d 232 (1972).
- Claim manuals. *Glenfed Development Corp. v. National Union Fire Ins. Co.*, 53 Cal. App. 4th 1113 (1997) (discovery of claims manuals proper); *Spray, Gould & Bowers v. Assoc. Int'l Ins. Co.*, 71 Cal. App. 4th 1260 (1999) (bad faith for insurer's failure to meet claims handling standards).
- Personnel files. *Zilisch v. State Farm Mut. Auto Ins. Co.*, 995 P.2d 276 (Ariz. 2000) (jury could find that salaries and bonuses paid to claims representatives were influenced by how much the representatives paid out on the claims).
- Prior similar claims. *Owens-Corning Fiberglass Corp. v. Allstate Ins. Co.*, 74 Ohio Misc.2d 174 (1993).
- *Jones v. Liberty Mut. Fire Ins. Co.*, No. 3:04-cv-137-MO, slip op. (W.D. Ky. Feb. 20, 2008) (discovery of post-litigation conduct).

Use Of Expert Witnesses

- Experts can testify on the standards and practices in the insurance industry for the handling of claims. *Hanson v. Prudential Co. of Am.*, 783 F.2d 762 (9th Cir. 1985).
- Anything shared with a testifying expert is discoverable.
- Some states have held that expert testimony is not necessary (AL, FL, NJ, PA).

Depositions: Useful Tips

- Obtain acknowledgment of insurer's duties and obligations.
- The insurer's claims representatives can be asked about standards in the insurance industry. *Lingener v. State Farm Mut. Auto. Ins. Co.*, 195 A.D.2d 838 (N.Y. App. Div. 1993).
- Assume insurer is experienced in bad faith litigation and prepare by obtaining all relevant document beforehand.
- Use insurance files as guide to questioning and as evidentiary support.
- Authenticate notes and materials created by the witness.

Summary Judgment

- Bad faith claims can sometimes be resolved on summary judgment. *Wiggington*, 964 F. 2d at 492 (“whether an insurer had an arguable reason to deny an insured’s claim is an issue of law”); *Colonial Foods, Inc. v. Aetna Casualty & Sur. Co.*, No. MON-L-3092-93, tr. of motion (N.J. Super. Ct. Law Div. Apr. 21, 1995) (holding on summary judgment that Aetna Casualty & Surety Company had breached its duty of good faith and fair dealing to the policyholder when it denied the policyholder’s claim for environmental contamination).
- Courts are more likely to find bad faith is a question of fact for trial. *Isaac v. State Farm Mut. Auto. Ins. Co.*, 522 N.W.2d 752, 758 (S.D. 1994) (“bad faith is a question of fact for the jury or other trier of fact”); *EOTT Energy Operating Ltd. P’shp. v. Certain Underwriters at Lloyd’s of London*, 59 F. Supp. 2d 1072, 1080 (D. Mont. 1999) (“whether an insurer had a reasonable basis to deny coverage is a factual issue not generally subject to disposition by summary judgment”).

Jury Trial

- Not all states allow bad faith claims to be heard by a jury. Pennsylvania courts are split over the question. Compare *Mishoe v. Erie Ins. Co.*, No. 1578 Harrisburg, 1998, 1999 Pa. Super. LEXIS 5160, and *Hamer v. Federal Kemper Ins. Co.*, No. 1988 Pittsburgh, 1998, 1999 Pa. Super. LEXIS 5126 (Pa. Super. Ct. Aug. 20, 1999) (court concludes that “Section 8371 permits a party to demand a jury trial on the issue of punitive damages,..”), with *Umstead v. Motorists Mut. Ins. Co.*, No. 92 CP 1739, slip op. at 2 (Pa. Ct. C. P. Nov. 24, 1997) (“in enacting the bad faith statute the legislature clearly directs judges, rather than juries, to be the sole factfinder in determining bad faith claims”); *Godak v. Nationwide Ins. Co.*, No. G.D. 96-10163 (Pa. Ct. C. P. Apr. 1, 1997) (striking jury demand).

Bifurcation

- A court may order a bifurcated trial on the issues of liability and damages. *White v. Western Title Co.*, 40 Cal.3d 870 (1985) (court determined the perceived legal question of liability and a jury determined the factual question of damages).
- Some states have statutes that mandate punitive damage claims be bifurcated. See Georgia (GA. 51-12-5.1); Nevada (N.R.S. 42. 005); Utah (U.C.A. 1953 § 78-18-1). Other states require bifurcation if one party requests it. See California (Cal. Civ. Code § 3295); Ohio (OH St. § 2315.21); Texas (Tex. Civ. Prac. & Rem. Code § 41.011).
- Discovery and trial on bad faith issues may be bifurcated from litigation of insurer's duties to defend and indemnify. *Lumbermen's Underwriting Alliance v. Federal Ins. Co.*, No. 2007 CA 019970 (Fla. Cir. Ct. Palm Beach County Nov. 7, 2007) (no discovery on bad faith until coverage established); cf. *Rohm & Haas Co. v. Utica Mut. Ins. Co.*, No. 07-584, 2008 U.S. Dist. LEXIS 48077 (E.D. Pa. June 23, 2008) (refusing to bifurcate discovery and trial of bad faith claims from duty to defend).

Defending Bad Faith Claims

Defending With Motions

Removal

Proper Parties

Coverage Issues

Declaratory Judgment

Motions In Limine

Motion To Disqualify Proposed Expert

Summary Judgment

Defenses

Policyholder's Error Or Fault

Bona Fide Issue Exists As To The Underlying Claim – Use Of Experts

Recoverable Damages

Compensatory Damages

- See judgment in *ABT Building Prods. Corp. v. National Union Fire Insurance Company of Pittsburgh, PA.*, No. 5:01CV100-V (W.D.N.C. Sept. 30, 2004) (attached) (party can choose between compensatory and punitive damages award and trebled damages).
- New York allows consequential damages in first-party bad faith cases. *Bi-Economy Market, Inc. v. Harleystville Ins. Co. of New York*, 10 N.Y.3d 187 (2008) (insurer should have foreseen that it would owe damages to the policyholder for additional business losses attributable to the insurer's failure to promptly act on claim); *Panasia Estates, Inc. v. Hudson Ins. Co.*, 10 N.Y.3d 200 (2008) (“consequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance contract context”) (see article attached).

Punitive Damages

- Punitive damage awards limited by *State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003) (“courts must ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered”).
- A number of states have statutory limits on punitive damages. Colo. Rev. Stat. § 13-21-102 (exemplary damages cannot exceed actual damages); Fla. Stat. § 768.73 (punitive damages cannot exceed three times compensatory damages unless claimant demonstrates by clear and convincing evidence that award is not excessive); N.J. Stat. § 2A: 15-5.14 (capping punitive damages at the greater of five times actual damages or \$350,000).

Punitive Damages *(continued)*

- Some states require an additional showing of ill-will or gross misconduct. *Alberici v. Safeguard Ins. Co.*, 664 A.2d 110 (Pa. Super. Ct. 1995) (must show insurer's conduct was malicious, wanton, reckless, willful or oppressive); *Erie Ins. Co. v. Hickman*, 622 N.E.2d 515 (Ind. 1993) (insurer must have acted with malice, fraud, gross negligence or oppressiveness).
- Punitive damages may be permitted under exceptional circumstances where bad faith arises out of contract. *Rocanova v. Equitable Life Assur. Soc'y*, 634 N.E.2d 940 (N.Y. 1994) (punitive damages only available where conduct is of an egregious nature and directed to public generally).

Amended Judgment ABTCo

Strafford Publications Teleconference

BAD FAITH IN INSURANCE CLAIMS

Wednesday, July 15, 2009
1:00 PM – 2:30 PM EDT

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COVERAGE INVESTIGATION

- Insurer's obligations
- Policyholder's obligations
- Does the use of counsel protect investigative materials?

INSURER'S OBLIGATIONS

- First-party bad faith claims often center on adequacy of insurer's factual investigation.
- In some states, insurer's failure to properly investigate, in itself, constitutes bad faith. See, e.g., Egan v. Mutual of Omaha Ins. Co., 24 Cal. 3d 809, 819 (1979); CACI 2332 ("insurer acts unreasonably or without proper cause if it fails to conduct a full, fair, and thorough investigation of all of the bases of the claim").
 - Insurer still should be required to prove that adequate investigation would have made a difference. *But see* CACI 2331, 2332 (recently amended to eliminate causation requirement).



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INSURER'S OBLIGATIONS (Cont.)

In states that predicate bad faith on the insurer's knowledge or reckless disregard of the lack of a reasonable basis to deny coverage, knowledge or reckless disregard may be inferred where the coverage investigation is inadequate.

See, e.g., Stahl v. Preston Mut. Ins. Ass'n, 517 N.W. 2d 201 (Iowa 1994).

INSURER'S OBLIGATIONS (Cont.)

- Adequacy of investigation will turn on:
 - Whether investigators are competent;
 - How investigation is carried out.
- Insurer must “fully inquire into possible bases that might support the insured’s claim.” Egan, 24 Cal. 3d at 819.
- No duty to investigate further when insurer discovers reasonable debatable basis for denying the claim. See, e.g., National Sec. Fire & Cas. Co. v. Vintson, 454 So. 2d 942, 945 (Ala. 1984).



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INSURER'S OBLIGATIONS (Cont.)

Tips for investigating insured's claim:

- Obtain all relevant facts and information
 - from insured;
 - from within the company (e.g., underwriting);
 - from other appropriate sources.
- Obtain sworn statements.
- Document any need to clarify uncertain facts.
- Ask questions.

INSURER'S OBLIGATIONS (Cont.)

Tips for investigating insured's claim (Cont.):

- Employ necessary experts.
- Communicate regularly with insured.
- Carefully evaluate policy provisions in light of potentially applicable law. Consult counsel if necessary.
- Treat insured with courtesy and professionalism.
- Give due consideration to insured's position.

INSURER'S OBLIGATIONS (Cont.)

Tips for investigating insured's claim (Cont.):

- Conduct investigation with no predetermined outcome.
- Thoroughly document the investigation, communications and coverage analysis.
- Adhere to internal claims handling procedures.
 - Document reasons for any deviation.
- Make a timely coverage decision.

INSURER'S OBLIGATIONS (Cont.)

Tips for investigating insured's claim (Cont.):

- Before denying any claim:
 - Obtain management approval of coverage position.
 - Consult counsel on policy interpretation questions.
 - Consider whether to get a coverage opinion.
 - Understand company precedent.
- Invite insured to provide contrary facts and present contrary positions.

POLICYHOLDER'S OBLIGATIONS

- Provide timely notice/ proof of loss.
- Cooperate with insurer.
- Provide necessary information to insurer.
 - Access to documents.
 - Examination under oath.
- Duty not to enter into unauthorized settlements.
- Some states recognize insured owes duty of good faith and fair dealing. See, e.g., Commercial Union Assurance Co. v. Safeway Stores, 26 Cal. 3d 912, 918 (1980).



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PRE-DISCLAIMER CONDUCT

- Failure to conduct a reasonable investigation. Egan v. Mutual of Omaha Ins. Co., 620 P. 2d 141 (Cal. 1979), appeal dismissed and cert. denied, 445 U.S. 912 (1980).
- Failure to investigate claim with objectivity. Example: Conducting investigation solely to uncover additional grounds for denial. State Farm Fire & Cas. v. Simmons, 857 SW 2d 126 (Tex. Ct. App. 1993) (“ Outcome-oriented” investigation of fire, which ignored evidence favorable to policyholder, constitutes a breach of the insurance company’s duty of good faith).
- Failure to disclose facts or theories supporting coverage. Dercoli v. Pennsylvania Nat. Mut. Ins., 554 A. 2d 906 (Pa. 1989).



[C]ourts have held that the cause of action against the insurer arises “where there is no reasonable basis for denial of a claim or when the insurer fails to determine or delays in the determination of whether there is any reasonable basis for a denial of the claim...In order to sustain a claim for breach of good faith, the insured must establish:

- (1) the absence of a reasonable basis for denying or delaying payment of the claim, and
- (2) that the insurer knew, or should have known, that there existed no reasonable basis for denying or delaying payment of the claim.”

Dixon v. State Farm Fire and Casualty Co., 1993
C.C.H. (Fire and Cas.) 4023 (U.S.D.C., S.D.Tx.).



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DOES THE USE OF COUNSEL PROTECT INVESTIGATIVE MATERIALS?

- Attorney-client communications generally are protected from discovery by attorney-client privilege.
- Work product protection not afforded unless materials prepared in anticipation of litigation.
- Attorney directly responsible for handling a claim is not acting as an attorney and what she says or does is not privileged.

WAIVER OF PRIVILEGE

- Insurer may waive privilege by placing privileged communications at issue. Typically occurs through reliance on “advice of counsel” defense.
- Generally no waiver simply because insurer’s “state of mind may be in issue.” See Rhone-Poulenc Rorer, Inc. v. Home Indemnity Co., 32 F. 3d 851, 863 (3d Cir. 1994) (PA) (“advice of counsel is placed in issue [only] where the client asserts a claim or defense, and attempts to prove that claim or defense by disclosing or describing an attorney-client communication”).
- Raising subjective good faith as a defense may result in waiver in some states. See State Farm Mut. Auto. Ins. Co. v. Lee, 13 P. 3d 1169, 1174 (Ariz. 2000) (State Farm asserted its actions were reasonable based what it knew about the law, thereby putting communications with counsel at issue).



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RECOVERABLE DAMAGES

- Compensatory
- Punitives

DAMAGES FOR BREACH OF DUTY OF GOOD FAITH

Causes of Action:

Breach of Contract

- Limited to Benefit-of-the-Bargain
- Some states allow extra-contractual damages

Tort

- Enhanced damages
- Not limited by policy limits
- Can get punitive damages



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TORT VS. BREACH OF CONTRACT

House burns down, insurance company refuses to pay, policyholder rents room:

- Breach of contract: get only cost of rebuilding
- Tort: get cost of rebuilding and cost of rent, maybe even punitive damages

COMPENSATORY DAMAGES

- See judgment in ABT Building Prods. Corp. v. National Union Fire Insurance Company of Pittsburgh, PA, No. 5:01CV100-V (W.D.N.C. Sept. 30, 2004) (party can choose between compensatory and punitive damages award and trebled damages).
- New York allows consequential damages in first-party bad faith cases. Bi-Economy Market, Inc. v. Harleysville Ins. Co. of New York, 10 N.Y. 3d 187 (2008) (insurer should have foreseen that it would owe damages to the policyholder for additional business losses attributable to the insurer's failure to promptly act on claim); Panasia Estates, Inc. v. Hudson Ins. Co., 10 N.Y. 3d 200 (2008) ("consequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance contract context").



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PUNITIVE DAMAGES

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- Punitive damage awards limited by State Farm Mut. Auto. Ins. Co. v. Campbell, 538 U.S. 408 (2003) (“courts must ensure that the measure of punishment is both reasonable and proportionate to the amount of harm to the plaintiff and to the general damages recovered”).
- A number of states have statutory limits on punitive damages. Colo. Rev. Stat. §13-21-102 (exemplary damages cannot exceed actual damages); Fla. Stat. §768.73 (punitive damages cannot exceed three times compensatory damages unless claimant demonstrates by clear and convincing evidence that award is not excessive); N.J. Stat. §2A:15-5.14 (capping punitive damages at the greater of five times actual damages or \$350,000).



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QUESTIONS & ANSWERS



Bad Faith Insurance Claims: Strategies for Prosecuting and Defending Against Claims of Insurer Misconduct

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I. What is Bad Faith?

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An insurer's failure to act with due care toward the rights and interests of its insured

Common Bad Faith Claims

First Party and Third Party Claims

Common Bad Faith Claims

A. Bad Faith Refusal to Pay a Covered Claim (First Party Claims)

defined as a:

- frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent.

For purposes of an action against an insurer for failure to pay a claim, **such conduct imparts a dishonest purpose and means a breach of a known duty** (i.e., good faith and fair dealing) **through some motive of self interest or ill-will.**

Terletsky v. Prudential Property & Cas. Ins. Co., 649 A.2d 680, 688 (Pa. Super. Ct., 1994), quoting Black's Law Dictionary at 139 (6th Ed., 1990)

Common Bad Faith Claims

B. Bad Faith Refusal to Settle Within Policy Limits (Third Party Claims)

- Occurs when there is an opportunity to settle a covered claim within limits that is rejected or ignored by the carrier
- Can result in liability for the full verdict rendered against the insured, even if that verdict is *in excess of policy limits*
- Derived from the principle that the insurer cannot gamble with the insured's money
- Often the result of a "Set Up"

Common Bad Faith Claims

Bad Faith Refusal to Settle Within Policy Limits (Third Party Claims)

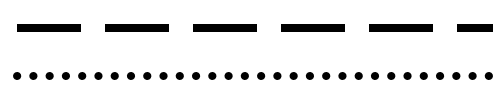
Components of a resulting “Set-Up”:
We now have a Dilemma



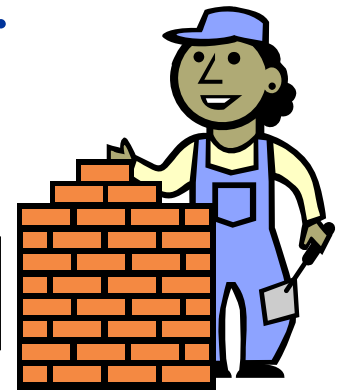
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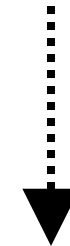
sues



Defendant



\$ Demands \$
\$ Policy Limits \$



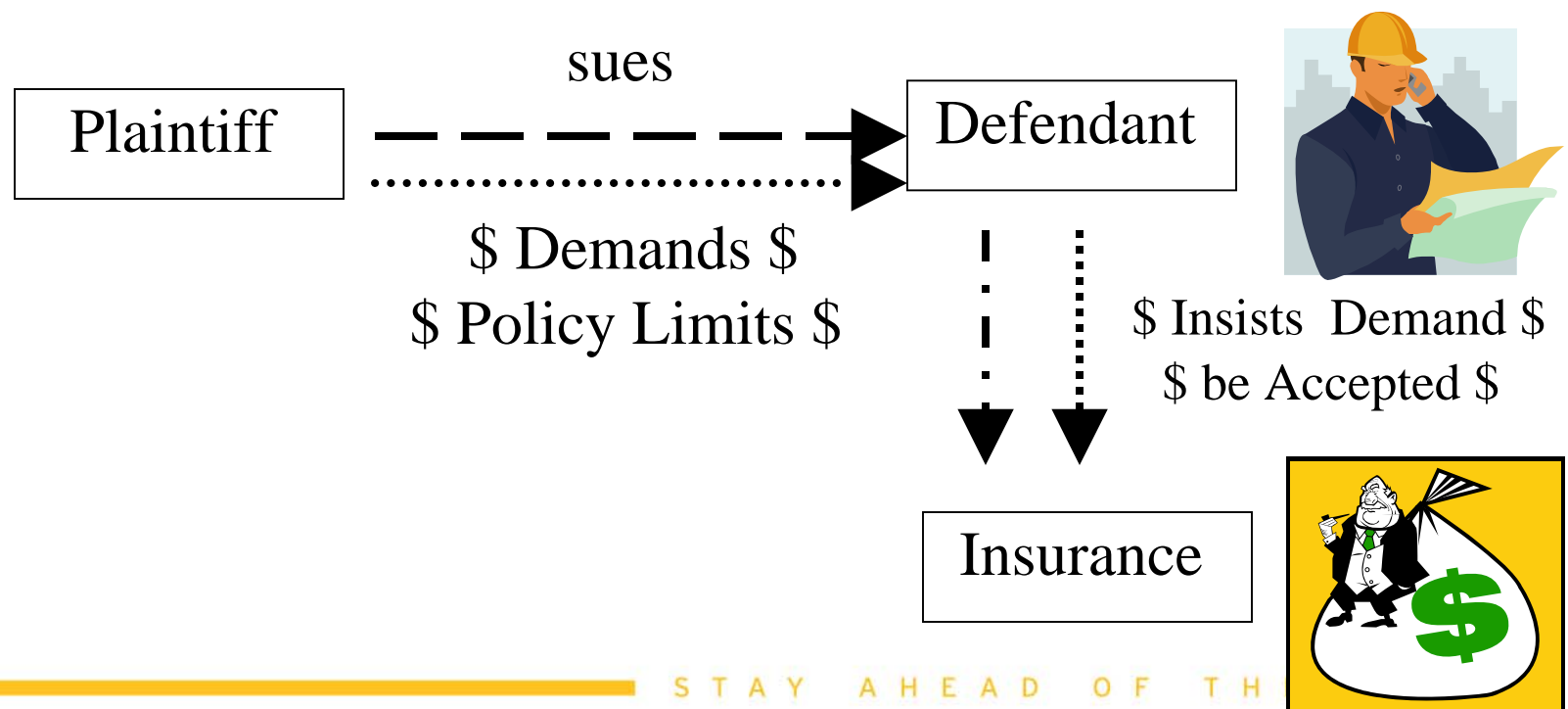
Insurance



Common Bad Faith Claims

Bad Faith Refusal to Settle Within Policy Limits (Third Party Claims)

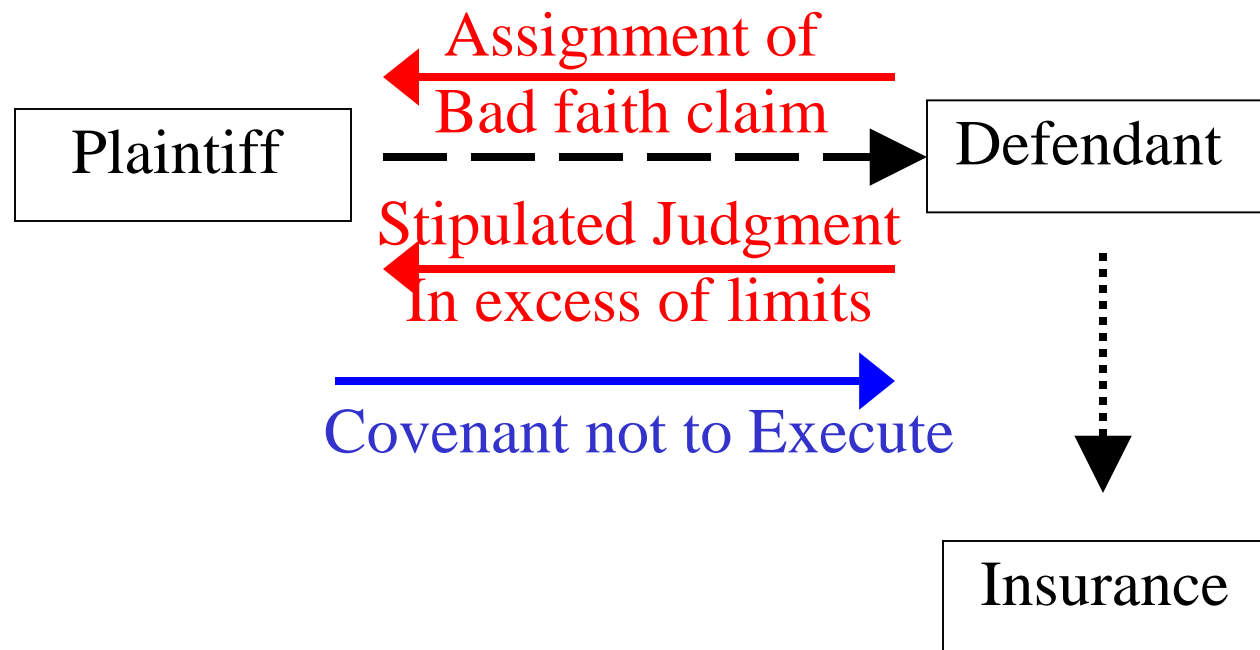
Components of a resulting “Set-Up”:



Common Bad Faith Claims

Bad Faith Refusal to Settle Within Policy Limits (Third Party Claims)

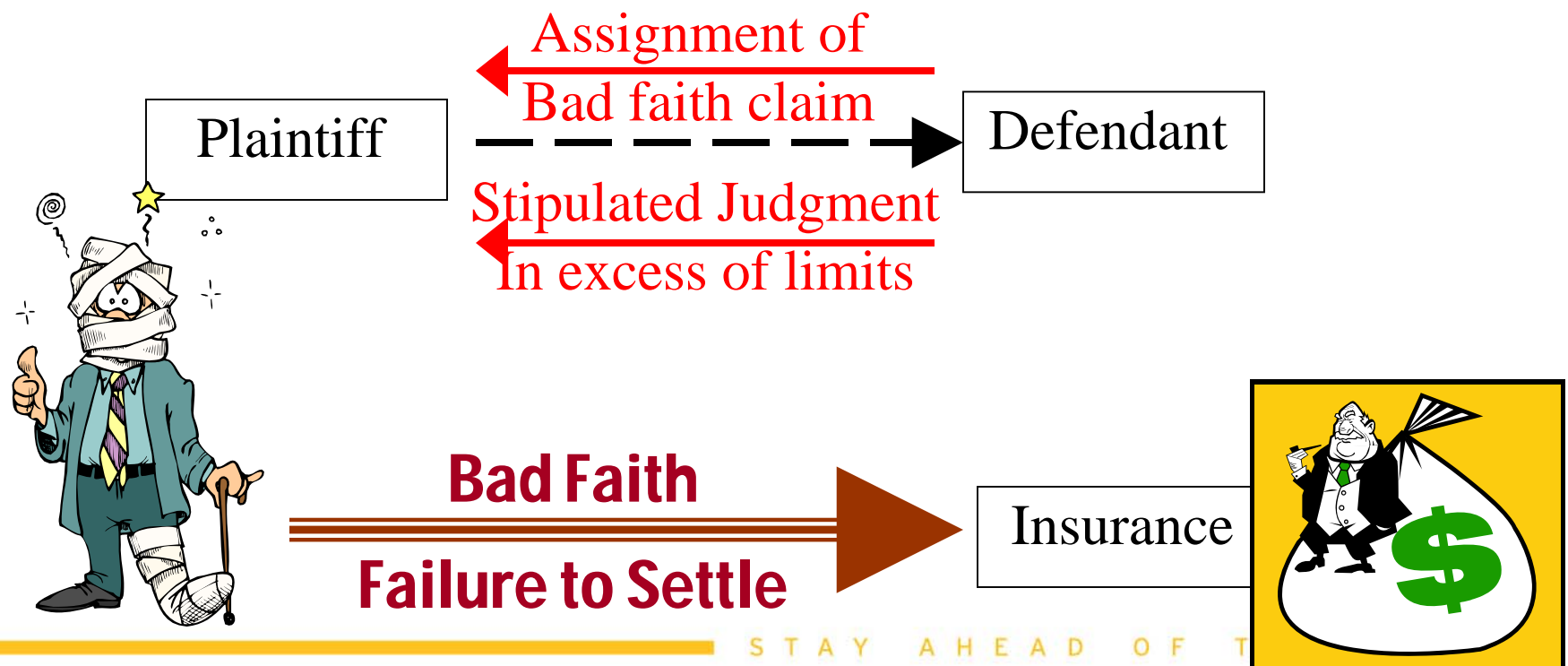
Components of a resulting “Set-Up”:



Common Bad Faith Claims

Bad Faith Refusal to Settle Within Policy Limits (Third Party Claims)

Components of a resulting “Set-Up”:



Emerging Bad Faith Claims

Litigation Bad Faith

- Seeks to hold an insurer liable for conduct that occurs during the litigation of a coverage dispute; an emerging cause of action in some states
 - Even if NO COVERAGE ULTIMATELY EXISTS, if conduct during litigation rises above mere discovery abuse, that conduct can be used to establish bad faith on the part of the carrier
 - Routine discovery disputes not likely to support a litigation bad faith claim
 - Conduct which amounts to an attempt to conceal true facts from the insured can establish litigation bad faith

Common Bad Faith Claims

C. Burden of Proof

- Threshold Issues: Generally, an insurance bad faith case starts with the insurance policy.
 - As a foundational matter, it is the **insured's** burden of proof to establish that there is coverage for the insurance claim presented.
 - The burden then shifts to the **insurer** to prove that there is a valid coverage defense applicable to the claim, which defeats coverage.
 - Exclusions: if coverage exists but for the application of an exclusion, the insurer bears the burden of proving the applicability of such an exclusion.
 - If the insurer denied the insured's claim, the insured's bad faith lawyers must be able to analyze and confirm whether that denial was proper and supportable.

Common Bad Faith Claims

C. Burden of Proof

- Jurisdiction Matters:
 - **In Pennsylvania:**
 - A bad-faith plaintiff does not enjoy the relatively low burden of proof of preponderance of the evidence. Rather, the bad-faith plaintiff must prove the defendant's bad-faith conduct by "clear and convincing evidence."
 - Statutory bad faith claim can survive even if breach of contract claim is dismissed (e.g., statute of limitations).

Common Bad Faith Claims

D. Statutory Bad Faith

Claims can arise from the violation of State Unfair Claims provisions which typically prohibit the following:

1. Misrepresenting facts or policy provisions;
2. Failing to acknowledge and act promptly on communications;
3. Failing to adopt and implement reasonable standards for investigation of claims;
4. Refusing to pay claims without conducting a reasonable investigation based on all available information;
5. Failing to affirm or deny coverage within a reasonable time;
6. Not attempting to settle when liability has become reasonably clear;
7. Compelling insureds to sue by offering substantially less than the amount ultimately recovered by such insureds;
8. Attempting to settle claims on the basis of an application which was altered without notice to or knowledge or consent of the insured;
9. Making payment without a specifying the coverage under which the payment is made;
10. Threatening to appeal an arbitration award to encourage settlement for less than the amount awarded;
11. Delaying claims by requiring multiple submission of substantially the same information;
12. Failing to settle claims under one part of a policy to influence settlement under other parts; and
13. Failing to give a reasonable explanation of the basis in the insurance policy for denial of a claim or for an offer of a compromise settlement.

IV. Defending Bad Faith Claims

A. Defending with Motions

1. Removal: when a state court action is initiated by a policyholder, the insurer may wish to remove to federal court.
 - Advantages: quality of judiciary, more predictable schedules, trial availability
 - Timing: within 30 days of notice to defendant that case is removable
 - Requirement: complete diversity of parties
 - Removal motion may prompt a motion to remand by the insured or a motion to amend to add additional parties to the case (one possible way to defeat diversity jurisdiction)

A. Defending with Motions

2. Proper parties: from the insurer's perspective, tactical decision whether to name agent, broker, third party claimants, and/or policyholder as defendant(s) in declaratory relief suit
 - Competing Concerns: obtaining some preclusive effect to judgment obtained in coverage litigation v. complicating suit by addition of parties with potentially adverse interests
 - Consideration as to whether adding parties might create hostile witnesses

A. Defending with Motions

2. Proper parties: insured may seek to add parties for various reasons, including with respect to destroying diversity jurisdiction
 - Policyholder may also seek to add insurer's parent and/or other affiliated companies for tactical reasons, increasing possible recovery, etc.
 - Insurer may argue defense of lack of contractual privity

A. Defending with Motions

3. Coverage issues: in at least one jurisdiction (FL), bad faith claims may not be pursued until coverage is established.
 - Policyholder's tort claims will be stayed /dismissed pending determination of declaratory relief/coverage aspects of case. (See *Allstate Indemnity Co. v. Ruiz*, 899 So.2d 1121, 1130 (Fla. 2005) (ordering trial court to "dismiss" or abate bad faith claim pending resolution of coverage issues); *but see Coregis Ins. Co. v. McCollum*, 961 F. Supp. 1572 (N.D. Fla. 1997) (suggesting that insured could obtain damages for bad faith in the absence of coverage)
 - In the absence of a statute or case authority requiring separate prosecution of coverage and bad faith claims, insurer may wish to bifurcate or sever coverage issues for early determination

Advantage: potentially narrow issues for determination/scope of discovery

A. Defending with Motions

See Maryland Cas. Co. v. Alicia Diagnostic, Inc.,
2007 WL 2140598 (Fla. App. Ct. 2007)

- Affirming rule that under FL law, bad faith claim must not be litigated until after first party coverage claim is resolved in insured's favor.
- Rationale: (1) there can be no bad faith in the absence of coverage for the insured; (2) insurer could be prejudiced if required to litigate coverage and bad faith concurrently (e.g., evidence of latter could prejudice jury's view of former)

A. Defending with Motions

In Washington:

- As a result of the holding in *St. Paul Fire & Marine Ins. Co. v. Onvia, Inc.* (Wash. S. Ct., Nov. 2008), a liability insured may claim bad faith even in the absence of any contractual duty, but harm will not be presumed.

A. Defending with Motions

4. Declaratory Judgment: when a claim is denied, the policyholder most often files suit, but this option might also make sense from the insurer's perspective
 - If defending a claim under a ROR, insurer may seek declaration that no defense obligation exists
 - Early dispositive motion may clarify this issue, narrow scope of discovery and potential insurer obligation(s)

A. Defending with Motions

4. Declaratory Judgment: other advantages include
 - Choice of venue
 - Defining legal issues
 - Choosing parties to include
 - Obtaining necessary information from policyholder that has been difficult to obtain

A. Defending with Motions

5. Motions in Limine: used to define scope of evidence admissible at trial; can be critical to presentation of case.
 - Insurer perspective: may be useful in effectively narrowing issues and addressing evidence such as financial condition or “other claims” evidence deemed irrelevant / inadmissible

A. Defending with Motions

6. Motion to Disqualify Proposed Expert:

- Policyholders and claimants often seek to rely upon “experts” to establish standards of conduct / opine that an insurer has acted outside of such standards.
- State and federal evidentiary standards may present strong arguments for excluding expert testimony.

A. Defending with Motions

6. Motion to Disqualify Proposed Expert:

- *Jensen-Kelly Corp. v. Allianz Ins. Co.*, No. BC-069-018 (Calif. Super. Ct. 1999) (excluding purported bad faith expert testimony where policyholder proposed expert to testify primarily about the meaning of supposedly ambiguous terms in insurance contract).
- *Minasian v. Standard Chartered Bank, PLC*, 109 F.3d 1212 (7th Cir. 1997) (affirming exclusion of proposed expert witness, under federal rules, who was offered to testify about commercial reasonableness of defendant's banking practices, where expert offered essentially legal analysis)

A. Defending with Motions

6. Motion to Disqualify Proposed Expert:
Important to lay foundation during discovery, e.g.,
- Does expert possess relevant background/qualifications?
 - Has expert analyzed case specific issues?
 - Has expert applied correct legal standard?
 - Is expert rendering opinion on ultimate question?

A. Defending with Motions

7. Summary Judgment: Consequences of failure to challenge / remove meritless claims include:
 - Broadening scope of discovery (relevance standard)
 - Possibly complicating possible settlement (e.g., policyholder may have unrealistic settlement expectation if bad faith or punitive claim remains)

A. Defending with Motions

7. Summary Judgment: Duty to defend
 - Because of “four corners” or “eight corners” rule in many jurisdictions, may be possible to resolve this issue early
 - Example: *The Premcor Refining Group, Inc. v. Maryland Cas. Co. et al.* (Del. Super. Ct. Mar. 2009) (dismissing duty to defend and bad faith claims on summary judgment)

A. Defending with Motions

7. Summary Judgment: other coverage limitations
 - Insurers may seek summary disposition of claims for certain types of coverage, thereby establishing duty to defend / indemnify only certain claims

B. Defenses

1. Policyholder's error or fault:

- A policyholder's own bad faith may constitute a defense to a bad faith claim against the insurer (see *Calif. Cas. Gen. Ins. Co. v. Super. Ct.*, 173 Cal. App. 3d 274; *Safeco Inc. Co. of Am. v. Tholen*, 117 Cal. App. 3d 685; *Comparative and Reverse Bad Faith: Insured's Breach of Implied Covenant of Good Faith and Fair Dealing as Affirmative Defense or Counterclaim*, 23 Tort & Ins. Law. J. 215 (1988))

B. Defenses

2. Bona fide issue exists as to the underlying claim:
 - Lack of legal precedent (See *First Fin. Ins. Co. v. Rarmey*, 195 Ga. App. 655 (1990) (lack of legal precedent no defense to bad faith failure to settle))
 - Claim was “fairly debatable” so no liability in tort See *Pressman v. Aetna Cas. & Sur. Co.*, 574 A.2d 757 (R.I. 1990) (no liability in tort arises if claim is fairly debatable); *St. Paul Fire & Marine Ins. Co. v. Tinney*, 920 F.2d 861 (11th Cir. 1991) (reasonably legitimate or arguable reason for denying coverage defense to bad faith action); see also *Premcor, supra* (same).

V. Consequences of Bad Faith: Recoverable Damages

Consequences of Bad Faith (Damages)

- If found to have acted in bad faith:
Insurer can be held liable for all damages that flow from the breach, even in excess of limits
 - Consequential damages
 - Emotional distress
 - Attorneys fees and litigation costs
 - Whatever else a jury sees fit to award (loss of consortium, health affects, etc.)

Consequences of Bad Faith (Damages)

- Jurisdiction dependent:
 - New York is one example that tends to be more insurer friendly (*but see BI Economy Market and Panasia Estates* cases, N.Y. Ct. App. 2008, ruling that under appropriate circumstances policyholders may seek not only payment of policy proceeds but also pursue consequential damages in cases where the insurer has acted in bad faith)
 - Many jurisdictions (not NY) also permit recovery of punitive damages.

Consequences of Bad Faith (Punitive Damages)

- Pursuant to the Supreme Court's Ruling in State Farm v. Campbell, 538 U.S. 408, 123 S.Ct. 1513, 155 L.Ed.2d 585 (2003), punitive damages can be challenged if they are excessive under due process analysis.

The three guideposts that must be examined to determine whether an award violates due process are:

1. the degree of reprehensibility of the defendant's misconduct;
2. the disparity between the actual harm suffered by the plaintiff and the punitive damage award; and
3. the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases

Consequences of Bad Faith (Damages)

- Nevertheless, punitive damage awards can still be severe and in no way relative to the policy limits originally at issue

Consequences of Bad Faith

Examples

- Nardell v. Metlife, Superior Ct. of Arizona, Mar. 20, 2009
 - An Arizona jury ordered MetLife to pay **\$55 million** for refusing to cover a \$30,400 claim from a couple whose SUV was stolen and vandalized
 - Couple wanted car totaled; insurer agreed to pay \$10,759 for repairs
 - Jury awarded \$155,000 in compensatory damages and \$55 million in punitives

Consequences of Bad Faith

Examples

- Broussard v. State Farm Fire & Cas. Co., No. 1:06-CV-6 (S.D. Miss. 2006), rev'd, 523 F.3d 618 (5th Cir. 2008)
 - \$223,000 coverage award to a couple whose home was destroyed by Katrina; jury awarded **\$2.5 million** in punitive damages (12-1 ratio).
 - Rationale: because coverage was undisputed, insurer was unreasonable in attempting to shift burden of proof to plaintiffs to establish the portion of their losses caused by wind.
 - Because the only injury was economic, judge ruled a **\$1 million** award (4-1 ratio) was appropriate.
 - 5th Circuit reversed punitive damages award; remanded for jury to determine consequential damages.

Consequences of Bad Faith

Examples

- Gallatin Fuels Inc. v. Westchester Fire Ins. Co.,
(W.D.Pa. 2006)
 - Award of \$1.325 million in compensatory damages on breach of contract claim (loss of mining equipment) and **\$20 million** in punitive damages on the bad faith claim (20 to 1 ratio)
 - The presiding judge subsequently reduced the punitive award to **\$4.5 million** (4 to 1 ratio)
 - Court reduced award based on fact that harm was economic only and did not directly concern the health or safety of others, although he ultimately found the insurer's conduct to be sufficiently "reprehensible" to support punitive damages

Consequences of Bad Faith

Examples

- Century Surety Co. v. Polisso, 139 Cal. App. 4th 922 (2006)
 - CGL policy with special endorsement that covered glass damage up to \$15,000
 - Coverage dispute arose in which insurer failed to timely pay for the insured's defense to a 3rd party claim
 - Ultimately, the 3rd party claim against the insured failed, but costs of litigation and emotional effects damaged the insured
 - INSURER filed declaratory judgment action seeking recoupment of defense costs and insured counterclaimed for bad faith

Consequences of Bad Faith Examples

- Century Surety Co. v. Polisso, 139 Cal. App. 4th 922 (2006)
 - Jury awards insured:
 - \$15,000 in contract damages (i.e. policy limits)
 - \$622,911 in compensatory tort damages
 - \$2,015,000 in punitive damages
 - Award affirmed under State Farm guide posts
 - Court considered the ratio of compensatory tort damage to punitive damages, (the proper analysis under State Farm) which it found to be a constitutionally permissible 3.2 to 1
 - In contrast, note that the ratio of contract damage to punitive damages is 134.3 to 1

Consequences of Bad Faith

Examples

- Hollock v. Erie Ins. Exchange, 842 A.2d 409, 415-16 (Pa. Super 2004).
 - \$500,000 policy limit
 - Insured awarded
 - \$500,000 policy limit
 - \$278,825 in compensatory damages; and
 - **\$2.8 million in punitive damages**
 - Plaintiff used litigation conduct to establish bad faith

Consequences of Bad Faith Examples

- Jurinko v. The Medical Protective Co. 2006
U.S. Dist. LEXIS 13601 (E.D. Pa.)
 - Medical malpractice insurer refuses \$200,000 policy limit demand to settle 3rd party plaintiff's claim
 - Case proceeds to trial and a \$2.5 million verdict
 - Insured assigns his bad faith claim to the plaintiff in exchange for a covenant not to execute against his personal assets

Consequences of Bad Faith Examples

- Jurinko v. The Medical Protective Co. 2006
U.S. Dist. LEXIS 13601 (E.D. Pa.)
 - Resulting bad faith suit alleges causes of action for failure to settle and for failure to properly defend the insured (appointed attorney represented multiple defendants)
 - Jury returned a verdict for the plaintiff
 - \$1,658,345 in compensatory damages
 - \$6.25 million in punitive damages
 - Insurer's post trial motions were denied and the verdict was upheld after a consideration of the State Farm factors

FILED
STATESVILLE, N.C.
2004 SEP 30 PM 4:06
W. DIST. OF N.C.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
STATESVILLE DIVISION

ABT BUILDING PRODUCTS)
CORP. and ABTco, INC.,)
)
Plaintiffs,)
)
vs.)
)
NATIONAL UNION FIRE)
INSURANCE COMPANY OF)
PITTSBURGH, PA.,)
)
Defendant.)

Civil Action No. 5:01CV100-V

AMENDED JUDGMENT

THIS CAUSE came to be heard before the Honorable Richard L. Voorhees, United States District Judge, and a duly impaneled Jury at the June 15, 2004 Special Term of the United States District Court for the Western District of North Carolina, Statesville Division. The trial of this case began on June 15, 2004 and concluded with a verdict on June 25, 2004. The Jury's verdict was entered on the Verdict Form that is attached hereto as Exhibit A.

1. The duly impaneled Jury unanimously answered the questions submitted as follows:

PART A: NATIONAL UNION'S PRESENT PAYMENT OBLIGATION, IF ANY

(1) Under the contract of insurance, did National Union breach its duty to defend ABTco?

Yes X No _____

(2) In what amount of damages, if any, has ABTco been damaged by National Union's breach?

\$2,500,000.00

PART B: UNFAIR BUSINESS PRACTICES STATUTE

(1) Did National Union commit any one of the following acts:

Did National Union misrepresent the terms of its 1997 policy for the purposes of changing National Union's insurance coverage obligations in 1998-2000 and did ABTco rely upon this misrepresentation to its detriment?

Yes X No _____

Did National Union fail to make a reasonable investigation of the damages claimed in the homeowner lawsuits against ABTco or the coverage provided for those claims under the National Union policy?

Yes _____ No X

Did National Union fail to attempt in good faith to effectuate a prompt, fair and equitable settlement with ABTco when National Union's liability to pay for a part of the Foster claims became reasonably clear?

Yes X No _____

(2) If you answered "Yes" to sections (a) or (b) or (c) of Question B(1) above, what is the amount of damages sustained by ABTco as a proximate result of National Union's conduct?

\$3,900,000.00

PART C: BAD FAITH ISSUE

(1) Was National Union's conduct of such an arbitrary and reprehensible nature as to constitute bad faith, meaning conscious doing of wrong, or breaching a known duty through some motive or interest or ill will?

Yes X No _____

(2) What is the amount of damages, if any, were sustained by ABTco as a result of National Union's bad faith conduct?

\$3,900,000.00

PART D: PUNITIVE DAMAGES

(1) If you answered "Yes" to Question C(1) above, was the conduct of National Union accompanied by some element of aggravated conduct, such as malice, fraud or oppression to a degree that indicates a reckless indifference to the consequences?

Yes X No _____

(2) If you answered "Yes" to Question D(1) above, what amount of punitive damages, if any, do you, in your discretion, award to ABTco?

\$7,500,000.00

PART E: NATIONAL UNION'S FUTURE PAYMENT OBLIGATIONS

(1) Was all of the damage alleged in the homeowners' lawsuits the result of a single "Occurrence," that is, alleged defects in the ABTco hardboard siding?

Yes X No _____

(2) Does National Union's policy cover the Foster settlement claims arising from property damage between the period of January 1, 1997 and January 31, 2000?

Yes X No _____

(3) What is National Union's share, if any, of the amount already paid under the Foster Settlement for Class Counsel Fees (for homeowners' attorneys), Notice Costs and Claims Administration Fees?

Homeowner Class Counsel Fees \$1,448,709.00

Notice Costs \$ 234,719.00

Claims Administration Fees \$ 177,312.00

(4) What percentage of the Foster payments to homeowners represents the costs of the replacement ABTco siding and what percentage represents the costs of all other materials and labor?

Costs of Siding 22.5%

All Other Costs 77.5%

(TOTAL 100%)

(5) What is the amount of administrative cost per claim that National Union is responsible to pay for claims in the future?

\$378.06

2. The Court concludes as a matter of law that the actions of Defendant National Union Fire Insurance Company of Pittsburgh, PA (“National Union”) — as found as a fact by the Jury in Part B of the Verdict Form — were in or affecting commerce and were unfair and deceptive trade practices in violation of N.C. Gen. Stat. § 75-16.

3. Upon the Jury’s findings that the conduct of National Union — as found as a fact by the Jury in Part B of the Verdict Form — proximately caused the Plaintiffs to be damaged in the amount of \$3,900,000, the Plaintiffs, as a matter of law, are entitled to have the said damages trebled to the amount of \$11,700,000, pursuant to N.C. Gen. Stat. § 75-16 (“Chapter 75”).

4. Based on the Jury’s findings in Parts C and D of the Verdict Form, and the Court’s own review of the evidence presented at trial, the Court concludes that National Union willfully engaged in the aforementioned unfair or deceptive acts or practices and there was an unwarranted refusal by National Union to fully resolve the matter which constitutes the basis of this suit.

BASED UPON THE JURY’S VERDICT, AND THE COURT’S CONCLUSIONS OF LAW, IT IS HEREBY ORDERED, ADJUDGED AND DECREED AS FOLLOWS:

1. Louisiana-Pacific Corporation (“Louisiana-Pacific”), the successor to Plaintiffs ABT Building Products Corp. and ABTco, Inc., shall be entitled to have and

recover from National Union as follows:

(a) \$2,500,000 for the breach of the duty to defend, together with interest at the statutory rate of 8% per annum from June 14, 2001 until the date this Judgment is entered and post-judgment interest as allowed by law; and

(b) \$11,700,000 in damages based on unfair or deceptive trade practices, together with interest on the sum of \$3,900,000 (the untrebled portion) at the statutory rate of 8% per annum from June 14, 2001 (the date this action was filed) until entry of the Judgment, and post-judgment interest on the entire award as allowed by law.

2. The Court recognizes that the jury also awarded \$3.9 million dollars in compensatory damages for National Union's bad-faith conduct and an additional \$7,500,000 in punitive damages, but the law requires that Louisiana-Pacific elect between these damages and the trebled damages awarded under Chapter 75. At this time, Louisiana-Pacific has elected to recover the treble damages. However, Louisiana-Pacific's election of its remedy shall be without prejudice to its right to move to amend this Judgment following a final determination by an appellate court, such that, if the Chapter 75 award is overturned, Louisiana-Pacific may instead elect to recover the compensatory and punitive damages awarded by the jury. Under such circumstances, Louisiana-Pacific shall be entitled to recover the sums set forth in Paragraph 1(a) above, plus \$3,900,000 in damages based on bad-faith conduct, with interest at the statutory rate of 8% per annum from June 14, 2001 until the entry of Judgment and post-judgment interest as allowed by law, and \$7,500,000 in punitive damages, with post-judgment interest as allowed by law.

3. Based on the Jury's findings in Part E of the Verdict Form, the Court issues the following Declaratory Judgment:

(a) Louisiana-Pacific is entitled to indemnification from National Union for Foster settlement claims arising from installations of ABTco siding occurring during the period from January 1, 1997 to January 31, 2000 ("the National Union coverage period").

(b) National Union's obligation to indemnify Louisiana-Pacific for future Foster settlement claims shall begin after Louisiana-Pacific has paid Foster settlement costs or Foster settlement claims attributable to installations during the National Union coverage period equal to the \$3,000,000 in underlying insurance coverage.

(c) As of the date of the verdict, Louisiana-Pacific had paid Foster settlement costs of \$1,860,740 and Foster settlement *claims* of \$275,598 (exclusive of the costs of siding).

(d) National Union shall be obligated to indemnify Louisiana-Pacific for 77.5% of the amount of each Foster settlement claim attributable to installations during the National Union coverage period.

(e) National Union shall be obligated to pay Louisiana-Pacific \$378.06 for each applicable Foster settlement claim to cover the administrative costs of handling such claims.

4. The costs of this action shall be, and hereby are, taxed as against National Union.

5. Pursuant to N.C. Gen. Stat. § 75-16.1, the costs so taxed shall include Plaintiffs' reasonable attorneys' fees. Plaintiffs shall file separate applications for

their costs and attorneys' fees pursuant to the rules of this Court.

6. The Court retains jurisdiction of this matter to enforce the terms of its declaratory judgment and to award such other or further relief as may be authorized by law.

IT IS SO ORDERED THIS 28th DAY OF SEPTEMBER, 2004.


RICHARD L. VOORHEES
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
STATESVILLE DIVISION
CIVIL DOCKET NO.: 5:01CV100-V

EXHIBIT A

FILED
IN COURT
STATESVILLE, N. C.
JUN 25 2004
U. S. DISTRICT COURT
W. DIST. OF N. C.

ABT BUILDING PRODUCTS CORP.)
and ABTco, INC.)

Plaintiffs)

v.)

NATIONAL UNION FIRE)
INSURANCE COMPANY OF)
PITTSBURGH, PA.)

Defendant.)

VERDICT FORM

PART A: NATIONAL UNION'S PRESENT PAYMENT OBLIGATION, IF ANY

(1) Under the contract of insurance, did National Union breach its duty to defend ABTco?

Yes No

If you answered "No", skip to **PART B**. If "Yes," go on to **Question A(2)** below

(2) In what amount of damages, if any, has ABTco been damaged by National Union's breach?

\$ 2,500,000.00

PART B: UNFAIR BUSINESS PRACTICES STATUTE

(1) Did National Union commit any one of the following acts:

(a) Did National Union misrepresent the terms of its 1997 policy for the purposes of changing the National Union's insurance coverage obligations in 1998-2000 and did ABTco rely upon this misrepresentation to its detriment?

Yes No

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(b) Did National Union fail to make a reasonable investigation of the damages claimed in the homeowner lawsuits against ABTco or the coverage provided for those claims under the National Union policy?

Yes _____ No

(c) Did National Union fail to attempt in good faith to effectuate a prompt, fair and equitable settlement with ABTco when National Union's liability to pay for a part of the Foster claims became reasonably clear?

Yes No _____

(2) If you answered "Yes" to sections (a) or (b) or (c) of Question B(1) above, what is the amount of damages sustained by ABTco as a proximate result of National Union's conduct?

\$3,900,000.00

PART C: BAD FAITH ISSUE

(1) Was National Union's conduct of such an arbitrary and reprehensible nature so as to constitute bad faith, meaning conscious doing of wrong, or breaching a known duty through some motive or interest or ill will?

Yes No _____

If you answered "No," skip to **Question E(1)**. If "Yes," go on to **Question C(2)** below

(2) What is the amount of damages, if any, were sustained by ABTco as a result of National Union's bad faith conduct?

\$3,900,000.00

PART D: PUNITIVE DAMAGES

- (1) If you answered "Yes" to **Question C(1)** above, was the conduct of National Union accompanied by some element of aggravated conduct, such as malice, fraud or oppression to a degree that indicates a reckless indifference to the consequences?

Yes No

- (2) If you answered "Yes" to **Question D(1)** above, what amount of punitive damages, if any, do you, in your discretion, award to ABTco?

\$ 7,500,000.00

PART E: NATIONAL UNION'S FUTURE PAYMENT OBLIGATIONS

Your answers to the following questions will be used by the Court to determine the amount, if any, that National Union must pay for claims filed by homeowners during the 25 years of the Foster Settlement Program

- (1) Was all of the damage alleged in the homeowners' lawsuits the result of a single "Occurrence," that is, alleged defects in the ABTco hardboard siding?

Yes No

- (2) Does National Union's policy cover the Foster Settlement claims arising from property damage between the period of January 1, 1997 and January 31, 2000?

Yes No

- (3) What is National Union's share, if any, of the amount already paid under the Foster Settlement for Class Counsel Fees (for homeowners' attorneys), Notice Costs and Claims Administration Fees?

Homeowner Class Counsel Fees	\$ <u>1,448,709.00</u>
Notice Costs	\$ <u>234,719.00</u>
Claims Administration Fees	\$ <u>177,312.00</u>

- (4) What percentage of the Foster payments to homeowners represent the cost of the replacement of ABTco siding and what percentage represents the costs of all other materials and labor?

Costs of Siding	<u>22.5</u> %
All Other Costs	<u>77.5</u> %

(TOTAL 100%)

- (5) What is the amount of administrative cost per claim that National Union is responsible to pay for claims in the future?

\$378.06

You may end your deliberations and return to the courtroom.

So say we all, this the 25 day of June, 2004

Stella S. Chapman
FOREPERSON

United States District Court
for the
Western District of North Carolina
September 30, 2004

* * MAILING CERTIFICATE OF CLERK * *

Re: 5:01-cv-00100

True and correct copies of the attached were mailed by the clerk to the following:

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cc:
Judge ()
Magistrate Judge ()
U.S. Marshal ()
Probation ()
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Defendant ()
Warden ()
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Date: 9-30-04

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Deputy Clerk



Bi-Economy Market, Inc. v. Harleystown
Ins. Co. of New York
10 N.Y.3d 187, 856 N.Y.S.2d 505
NY,2008.

10 N.Y.3d 187886 N.E.2d 127, 856 N.Y.S.2d 505,
2008 WL 423451, 2008 N.Y. Slip Op. 01418

Bi-Economy Market, Inc., Appellant
v
Harleystown Insurance Company of New York et al.,
Respondents.
Court of Appeals of New York

Argued January 9, 2008
Decided February 19, 2008

CITE TITLE AS: Bi-Economy Mkt., Inc. v Harleystown
Ins. Co. of N.Y.

SUMMARY

Appeal, by permission of the Appellate Division of the Supreme Court in the Fourth Judicial Department, from an order of that Court, entered February 2, 2007. The Appellate Division affirmed, insofar as appealed from, so much of an order of the Supreme Court, Monroe County (David D. Egan, J.), as had granted defendants' motion for leave to amend their answer to raise the defense of contractual exclusion for consequential damages and for partial summary judgment dismissing plaintiff's second cause of action of the first amended complaint and denied plaintiff's cross motion for partial summary judgment on the first cause of action. The following question was certified by the Appellate Division: "Was the order of this Court, entered February 2, 2007, properly

made?"

[Bi-Economy Mkt., Inc. v Harleystown Ins. Co. of N.Y., 37 AD3d 1184](#), reversed.

HEADNOTE

Damages
Consequential Damages
Business Interruption Insurance-Liability of Commercial Insurer

It was error to dismiss plaintiff's claim for consequential damages resulting from defendant insurer's failure to fulfill its obligations under a commercial property contract of insurance that included business interruption insurance. In light of the nature and purpose of the insurance contract at issue, as well as plaintiff's allegations that defendant breached its duty to act in good faith by improperly delaying payment for plaintiff's building and contents damage and failed to timely pay the full amount of plaintiff's lost business income claim, plaintiff's claim for consequential damages, including the demise of its business, was reasonably foreseeable and contemplated by the parties. Limiting plaintiff's damages to the amount of the policy, i.e., money which should have been paid by the insurer in the first place, plus interest, would not have placed plaintiff in the position it would have been in had the contract been performed. The contractual exclusions for certain consequential "losses" did not demonstrate that the parties contemplated, and rejected, the recoverability of consequential "damages" in the event of a contract breach.

RESEARCH REFERENCES

[Am Jur 2d, Insurance §§ 1533, 1734.](#)

*188 [Couch on Insurance \(3d ed\) §§ 1:61, 167:9, 167:11, 205:64-205:66.](#)

[NY Jur 2d, Insurance §§ 539, 1989, 2139.](#)

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ANNOTATION REFERENCE

[Business interruption insurance. 37 ALR5th 41.](#)

FIND SIMILAR CASES ON WESTLAW

Database: NY-ORCS

Query: business /2 interruption /2 insurance & consequential /2 damage

POINTS OF COUNSEL

Lipsitz & Ponterio, LLC, Buffalo (Kathleen A. Burr and John Ned Lipsitz of counsel), for appellant.

I. A consequential “loss” exclusion in an insurance policy does not preclude recovery of consequential “damages” caused by an insurance company’s breach. (*Korona v State Wide Ins. Co.*, 122 AD2d 120; *O’Dell v New York Prop. Ins. Underwriting Assn.*, 145 AD2d 791; *Davis v Mutual of Omaha Ins. Co.*, 167 AD2d 714; *Manolis v International Life Ins. Co. of Buffalo*, 83 AD2d 784; *Metropolitan Life Ins. Co. v Noble Lowndes Intl.*, 84 NY2d 430; *United States Trust Co. of N.Y. v O’Brien*, 143 NY 284; *Kenford Co. v County of Erie*, 73 NY2d 312; *Ashland Mgt. v Janien*, 82 NY2d 395; *Lava Trading Inc. v Hartford Fire Ins. Co.*, 326 F Supp 2d 434; *Panasia Estates, Inc. v Hudson Ins. Co.*, 39 AD3d 343.) II. New York law recognizes Bi-Economy Market, Inc.’s claim for consequential damages for the death of its business as a remedy for the Harleysville defendants’ breach. (*Kenford Co. v County of Erie*, 73 NY2d 312; *Sabbeth Indus. v Pennsylvania Lumbermens Mut. Ins. Co.*, 238 AD2d 767; *Hold Bros., Inc. v Hartford Cas. Ins. Co.*, 357 F Supp 2d 651; *J.R. Adirondack Enters. v Hartford Cas. Ins. Co.*, 292 AD2d 771; *Royal Coll. Shop, Inc. v Northern Ins. Co. of N.Y.*, 895 F2d 670; *Kosierowski v Madison Life Ins. Co.*, 31 AD2d 930, 25 NY2d 737; *Great Canal Realty Corp. v Seneca Ins. Co., Inc.*, 13 AD3d 227, 5 NY3d 742; *Rocanova v Equitable Life Assur. Socy. of U.S.*, 83 NY2d 603; *New York Univ. v Continental Ins. Co.*, 87 NY2d 308; *American List Corp. v U.S. News & World Report*, 75 NY2d 38.)

Chelus, Herdzik, Speyer & Monte, P.C., Buffalo (Michael F. Chelus and Christopher R. Poole of counsel), for respondents.

I. In a breach of contract action, a nonbreaching party may only recover damages that were within the contemplation of the parties*189 at the time of contracting. (*Kenford Co. v County of Erie*, 73 NY2d 312; *Kenford Co. v County of Erie*, 67 NY2d

257; *Globe Refining Co. v Landa Cotton Oil Co.*, 190 US 540; *Martin v Metropolitan Prop. & Cas. Ins. Co.*, 238 AD2d 389; *Crawford Furniture Mfg. Corp. v Pennsylvania Lumbermens Mut. Ins. Co.*, 244 AD2d 881; *Rocanova v Equitable Life Assur. Socy. of U.S.*, 83 NY2d 603; *New York Univ. v Continental Ins. Co.*, 87 NY2d 308; *LTS Contrs. v Hartford Ins. Co.*, 99 AD2d 644; *Brody Truck Rental v Country Wide Ins. Co.*, 277 AD2d 125; *J.R. Adirondack Enters. v Hartford Cas. Ins. Co.*, 292 AD2d 771.) II. Appellant improperly relies upon case law outside of the Fourth Department that is unchallenged, speculative or inapplicable. (*Acquista v New York Life Ins. Co.*, 285 AD2d 73; *Panasia Estates, Inc. v Hudson Ins. Co.*, 39 AD3d 343; *Sabbeth Indus. v Pennsylvania Lumbermens Mut. Ins. Co.*, 238 AD2d 767; *USAlliance Fed. Credit Union v CUMIS Ins. Socy., Inc.*, 346 F Supp 2d 468; *Crawford Furniture Mfg. Corp. v Pennsylvania Lumbermens Mut. Ins. Co.*, 244 AD2d 881; *J.R. Adirondack Enters. v Hartford Cas. Ins. Co.*, 292 AD2d 771; *Lava Trading Inc. v Hartford Fire Ins. Co.*, 326 F Supp 2d 434; *Hold Bros., Inc. v Hartford Cas. Ins. Co.*, 357 F Supp 2d 651.) III. Bi-Economy Market, Inc. improperly seeks expansion of unrelated issues pertaining to rights and remedies of insured. IV. The New York Public Adjusters Association represents the interests of insureds and attempts to influence the Court of Appeals as such. (*Acquista v New York Life Ins. Co.*, 285 AD2d 73; *Batas v Prudential Ins. Co. of Am.*, 281 AD2d 260.)

Wilkofsky, Friedman, Karel & Cummins, New York City (Mark L. Friedman of counsel), for New York Public Adjusters Association, amicus curiae.

I. The damages suffered by Bi-Economy Market, Inc. constitute general damages which are the natural and probable consequences of the Harleysville defendants’ breach of contract. (*Archer Daniels Midland Co. v Hartford Fire Ins. Co.*, 243 F3d 369; *American List Corp. v U.S. News & World Report*, 75 NY2d 38; *Kenford Co. v County of Erie*, 73 NY2d 312; *Massi’s Greenhouses v Farm Family Mut. Ins. Co.*, 233 AD2d 844.) II. Consequential damages have always been a permitted remedy in a breach of contract cause of action. (*Acquista v New York Life Ins. Co.*, 285 AD2d 73; *Sabbeth Indus. v Pennsylvania Lumbermens Mut. Ins. Co.*, 238 AD2d 767; *Mortimer v Otto*, 206 NY 89; *Globe Refining Co. v Landa Cotton Oil Co.*, 190 US 540; *Kenford Co. v County of Erie*, 67 NY2d 257; *Fleming v Allstate Ins. Co.*, 106 AD2d 426; *Korona v State Wide Ins. Co.*, 122 AD2d 120; *Batas v Prudential Ins. Co. of Am.*, 281 AD2d 260; *New*190 York Univ. v Continental Ins. Co.*, 87

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[NY2d 308;Rocanova v Equitable Life Assur. Socy. of U.S.](#), 83 NY2d 603.) III. “Consequential loss” is not synonymous with “consequential damages.”

Anderson Kill & Olick, P.C., New York City (*Eugene R. Anderson* and *Richard P. Lewis* of counsel), and *Amy Bach*, Mill Valley, California, for United Policyholders, amicus curiae.

I. Whether the insurance companies acted in bad faith is irrelevant to Bi-Economy Market, Inc.'s recovery of consequential damages. ([Sabbeth Indus. v Pennsylvania Lumbermens Mut. Ins. Co.](#), 238 AD2d 767;[Kenford Co. v County of Erie](#), 73 NY2d 312;[Hold Bros., Inc. v Hartford Cas. Ins. Co.](#), 357 F Supp 2d 651;[Lava Trading Inc. v Hartford Fire Ins. Co.](#), 326 F Supp 2d 434;[Carney v Memorial Hosp. & Nursing Home of Greene County](#), 101 AD2d 990;[New York Univ. v Continental Ins. Co.](#), 87 NY2d 308.) II. Exclusion of consequential loss under an insurance policy does not bar recovery of consequential damages. ([Lava Trading Inc. v Hartford Fire Ins. Co.](#), 326 F Supp 2d 434;[Panasia Estates, Inc. v Hudson Ins. Co.](#), 39 AD3d 343;[Hold Bros., Inc. v Hartford Cas. Ins. Co.](#), 357 F Supp 2d 651;[Royal Coll. Shop, Inc. v Northern Ins. Co. of N.Y.](#), 895 F2d 670.) *Rivkin Radler LLP*, Uniondale (*Evan H. Krinick*, *Michael A. Troisi* and *Michael P. Versichelli* of counsel), for New York Insurance Association and others, amici curiae.

Public policy militates against exposing carriers to liability beyond the bargained-for policy limits. ([Lava Trading Inc. v Hartford Fire Ins. Co.](#), 326 F Supp 2d 434;[DiBlasi v Aetna Life & Cas. Ins. Co.](#), 147 AD2d 93;[Pavia v State Farm Mut. Auto. Ins. Co.](#), 82 NY2d 445;[St. Paul Fire & Mar. Ins. Co. v United States Fid. & Guar. Co.](#), 43 NY2d 977;[Asahi Glass Co., Ltd. v Pentech Pharms., Inc.](#), 289 F Supp 2d 986.)

OPINION OF THE COURT

Pigott, J.

In this action brought by an insured against an insurer for breach of a commercial property insurance contract, the principal issue presented is whether the insured can assert a **2 claim for consequential damages. Under the circumstances of this case, we hold that it can.^{FN*}

I.

Bi-Economy Market, a family-owned wholesale and retail meat market located in Rochester, New York,

suffered a major *191 fire in October 2002, resulting in the complete loss of food inventory and heavy structural damage to the building and business-related equipment. At the time of the fire, Bi-Economy was insured by defendant Harleysville Insurance Company under a “Deluxe Business Owners” policy that provided replacement cost coverage on the building as well as business property or “contents” loss coverage.

The policy also provided coverage for lost business income, what is commonly referred to as “business interruption insurance,” for up to one year from the date of the fire. Specifically, the contract stated that Harleysville would “pay for the actual loss of Business Income . . . sustain[ed] due to . . . the necessary suspension of [Bi-Economy’s] ‘operations’ during the ‘period of restoration.’ ” Business income is defined as the “(1) Net Income (Net Profit *or Loss* before income taxes) that would have been earned or incurred; and (2) Continuing normal operating expenses incurred, including payroll.” “Period of restoration” is defined as the period of time that “[b]egins with the date of direct physical loss or damage” and “[e]nds on the date when the property . . . should be repaired, rebuilt or replaced with reasonable speed and similar quality.”

Following the fire, Bi-Economy submitted a claim to Harleysville pursuant to the terms of the contract. Harleysville disputed Bi-Economy’s claim for actual damages, and advanced only the sum of \$163,161.92. More than a year later, following submission of their dispute to alternative dispute resolution, Bi-Economy was awarded the additional sum of \$244,019.88. During all this time, Harleysville offered to pay only seven months of Bi-Economy’s claim for lost business income, despite the fact that the policy provided for a full 12 months. Bi-Economy never resumed business operations.

In October 2004, Bi-Economy commenced this action against Harleysville, asserting causes of action for bad faith claims handling, tortious interference with business relations and breach of contract, seeking consequential damages for “the complete demise of its business operation in an amount to be proved at trial.” Bi-Economy alleged that Harleysville improperly delayed payment for its building and contents damage and failed to timely pay the full amount of its lost business income claim. Bi-Economy further al-

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leged that, as a result of Harleysville's breach of contract, its business collapsed, and that liability for such consequential **3 damages was reasonably foreseeable and contemplated by the parties at the time of contracting.

*192 Harleysville answered, and subsequently moved for leave to amend its answer to raise the defense that the contract excluded consequential damages and for partial summary judgment dismissing Bi-Economy's breach of contract cause of action. In support of its motion, Harleysville cited several contractual provisions excluding coverage for "consequential loss."

Supreme Court granted the motion and the Appellate Division affirmed, holding that "the insurance policy expressly exclude[d] coverage for consequential losses, and thus it cannot be said that [consequential] damages were contemplated by the parties when the contract was formed" (37 AD3d 1184, 1185 [2007] [internal quotation marks and citations omitted]). The Appellate Division granted Bi-Economy leave to appeal and certified the following question: "Was the order of this Court, entered February 2, 2007, properly made?" We conclude that it was not.

II.

Bi-Economy contends that the courts below erred in dismissing its breach of contract claim seeking consequential damages for the collapse of its business resulting from Harleysville's failure to fulfill its obligations under the contract of insurance. We agree and therefore reverse the order of the Appellate Division and reinstate that cause of action.

It is well settled that in breach of contract actions "the nonbreaching party may recover general damages which are the natural and probable consequence of the breach" (*Kenford Co. v County of Erie*, 73 NY2d 312, 319 [1989]). Special, or consequential damages, which "do not so directly flow from the breach," are also recoverable in limited circumstances (*American List Corp. v U.S. News & World Report*, 75 NY2d 38, 43 [1989]). In *Kenford*, we stated that "[i]n order to impose on the defaulting party a further liability than for damages [which] naturally and directly [flow from the breach], i.e., in the ordinary course of things, arising from a breach of contract, such unusual or extraordinary damages must have

been brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting" (73 NY2d at 319 [internal quotation marks and citations omitted]).

We later explained that "[t]he party breaching the contract is liable*193 for those risks foreseen or which should have been foreseen at the time the contract was made" (*Ashland Mgt. v Janien*, 82 NY2d 395, 403 [1993]). It is not necessary for the breaching party to have foreseen the breach itself or the particular way the loss occurred, rather, "[i]t is only necessary that loss from a breach is foreseeable and probable" (*id.*, citing Restatement [Second] of Contracts § 351; 3 Farnsworth, Contracts § 12.14 [2d ed 1990]).

To determine whether consequential damages were reasonably contemplated by the parties, courts must look to "the nature, purpose and particular circumstances of the contract known by the parties . . . as well as 'what liability the defendant fairly may be supposed to have **4 assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made' " (*Kenford*, 73 NY2d at 319, quoting *Globe Refining Co. v Landa Cotton Oil Co.*, 190 US 540, 544 [1903]). Of course, proof of consequential damages cannot be speculative or conjectural (*see Ashland Mgt.*, 82 NY2d at 403 [damages for the loss of future profits must be proven with reasonable certainty and "be capable of measurement based upon known reliable factors without undue speculation"]; *see also Kenford Co. v County of Erie*, 67 NY2d 257, 261 [1986]).

The dissent seeks to distinguish this case from the *Kenford* line of reasoning by grouping it with that separate class of contract actions involving pure "agreements to pay"-contracts for money only-where the only recoverable damage for breach is interest. This distinction is without basis. With agreements to pay money-for example, an agreement to pay sales commissions or a contract to pay a lender \$12 tomorrow for \$10 given today, the sole purpose of the contract is to pay for something given in exchange. In such cases, what the payee plans to do with the money is external and irrelevant to the contract itself. In the present case, however, the purpose of the agreement-what the insured planned to do with its payment-was at the very core of the contract itself.

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The dissent also blurs the significant distinction between consequential and punitive damages. The two types of damages serve different purposes and are evidenced by different facts. Consequential damages, designed to compensate a party for reasonably foreseeable damages, “must be proximately caused by the breach” and must be proven by the party seeking them (24 Lord, Williston on Contracts § 64:12, at 125 [4th ed]). Punitive damages, by contrast, “are not measured by the pecuniary loss *194 or injury of the plaintiff as a compensation” but are “assessed by way of punishment to the wrongdoer and example to others” (11 Perillo, Corbin on Contracts § 59.2, at 550 [rev ed]). Unlike consequential damages, which are quantifiable, “[t]here is no rigid formula by which the amount of punitive damages is fixed, although they should bear some reasonable relation to the harm done and the flagrancy of the conduct causing it” (*L. H. P. Corp. v 210 Cent. Park S. Corp.*, 16 AD2d 461, 467 [1st Dept 1962], *affd* 12 NY2d 329 [1963]).

As in all contracts, implicit in contracts of insurance is a covenant of good faith and fair dealing, such that “a reasonable insured would understand that the insurer promises to investigate in good faith and pay covered claims” (*New York Univ. v Continental Ins. Co.*, 87 NY2d 308, 318 [1995]). An insured may also bargain for the peace of mind, or comfort, of knowing that it will be protected in the event of a catastrophe (see e.g. *Beck v Farmers Ins. Exch.*, 701 P2d 795, 802 [Utah 1985] [(I)t is axiomatic that insurance frequently is purchased not only to provide funds in case of loss, but to provide peace of mind for the insured or his beneficiaries”]; *Best Place, Inc. v Penn Am. Ins. Co.*, 82 Haw 120, 128, 920 P2d 334, 342 [1996], quoting *Noble v National Am. Life Ins. Co.*, 128 Ariz 188, 189, 624 P2d 866, 867 [1981] [“An insurance policy is not obtained for commercial advantage; it is obtained as protection against calamity”]; *Andrew Jackson Life Ins. Co. v Williams*, 566 So 2d 1172, 1179 n 9 [Miss 1990] [(A)n insured bargains for more than mere eventual monetary proceeds of a policy; insureds bargain for such intangibles as risk aversion, peace of mind, and certain and prompt payment of the policy proceeds upon submission of a valid claim”]; *Ainsworth v Combined Ins. Co. of Am.*, 104 Nev 587, 592, 763 P2d 673, 676 [1988] [“A consumer buys insurance for security, protection, and peace of mind”]).

III.

The purpose served by business interruption coverage cannot be clearer—to ensure that Bi-Economy had the financial support necessary to sustain its business operation in the event disaster occurred (see *Howard Stores Corp. v Foremost Ins. Co.*, 82 AD2d 398, 400 [1st Dept 1981] [“The purpose of business interruption insurance is to indemnify the insured against losses arising from inability to continue normal business operation and functions due to the damage sustained as a result of the hazard insured against”], *affd* 56 NY2d 991 [1982]; 3-36 Bender’s*195 New York Insurance Law § 36.06). Certainly, many business policyholders, such as Bi-Economy, lack the resources to continue business operations without insurance proceeds. Accordingly, limiting an insured’s damages to the amount of the policy, i.e., money which should have been paid by the insurer in the first place, plus interest, does not place the insured in the position it would have been in had the contract been performed (see generally *Brushston-Moira Cent. School Dist. v Thomas Assoc.*, 91 NY2d 256, 261 [1998] [“Damages are intended to return the parties to the point at which the breach arose and to place the nonbreaching party in as good a position as it would have been had the contract been performed”]; *Goodstein Constr. Corp. v City of New York*, 80 NY2d 366, 373 [1992], citing Restatement [Second] of Contracts § 347, Comment a; § 344 [“Contract damages are ordinarily intended to give the injured party the benefit of the bargain by awarding a sum of money that will, to the extent possible, put that party in as good a position as it would have been in had the contract been performed”]).

Thus, the very 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 (see *Sabbeth Indus. v Pennsylvania Lumbermens Mut. Ins. Co.*, 238 AD2d 767, 769 [3d Dept 1997]).

Furthermore, contrary to the dissent’s view, the purpose of the contract was not just to receive money, but to receive it promptly so that in the aftermath of a calamitous event, as Bi-Economy experienced here, the business could avoid collapse and get back on its feet as soon as possible. Thus, this insurance contract included an additional performance-based compo-

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ment: **5 the insurer agreed to evaluate a claim, and to do so honestly, adequately, and-most importantly-promptly. The insurer certainly knew that failure to perform would (a) undercut the very purpose of the agreement and (b) cause additional damages that the policy was purchased to protect against in the first place. Here, the claim is that Harleysville failed to promptly adjust and pay the loss, resulting in the collapse of the business. When an insured in such a situation suffers additional damages as a result of an insurer's excessive delay or improper denial, the insurance company should stand liable for these damages. This is not to punish the insurer, but to give the insured its bargained-for benefit.

*196 Nor do we read the contractual exclusions for certain consequential "losses" as demonstrating that the parties contemplated, and rejected, the recoverability of consequential "damages" in the event of a contract breach. The consequential "losses" clearly refer to delay caused by third-party actors or by the "[s]uspension, lapse or cancellation of any license, lease or contract." Consequential "damages," on the other hand, are in addition to the losses caused by a calamitous event (i.e., fire or rain), and include those additional damages caused by a carrier's injurious conduct-in this case, the insurer's failure to timely investigate, adjust and pay the claim.

Therefore, in light of the nature and purpose of the insurance contract at issue, as well as Bi-Economy's allegations that Harleysville breached its duty to act in good faith, we hold that Bi-Economy's claim for consequential damages including the demise of its business, was reasonably foreseeable and contemplated by the parties, and thus cannot be dismissed on summary judgment.

Accordingly, the order of the Appellate Division, insofar as appealed from, should be reversed, with costs, defendants' motion for leave to amend their answer to raise the defense of contractual exclusion for consequential damages and partial summary judgment dismissing the plaintiff's second cause of action denied, and the certified question answered in the negative.

Smith, J. (dissenting in this case and in [Panasia Estates, Inc. v Hudson Ins. Co.](#) [10 NY3d 200 (2008)]). In [Rocanova v Equitable Life Assur. Socy. of U.S.](#) (83 NY2d 603 [1994]) and [New York Univ. v Continental](#)

[Ins. Co.](#) (87 NY2d 308 [1995] [NYU]), we rejected the argument that a bad faith failure by an insurer to pay a claim could, without more, justify a punitive damages award. We held that punitive damages are not available for breach of an insurance contract unless the plaintiff shows both "egregious tortious conduct" directed at the insured claimant and "a pattern of similar conduct directed at the public generally" ([Rocanova](#), 83 NY2d at 613; see [NYU](#), 87 NY2d at 316). Today, the majority abandons this rule, without discussing it and without acknowledging that it has done so. The majority achieves this simply by changing labels: Punitive damages are now called "consequential" damages, and a bad faith failure to pay a **6 claim is called a breach of the "covenant of good faith and fair dealing."

I think that *Rocanova* and *NYU* were correctly decided, and *197 that the majority makes a mistake in largely nullifying their holdings.

Underlying our refusal in *Rocanova* and *NYU* to open the door to awards of punitive damages was a recognition of the serious harm such awards can do. Punitive damages will sometimes serve to deter insurer wrongdoing and thus protect insureds from injustice, but they will do so at too great a cost. Insurers will fear that juries will view even legitimate claim denials unsympathetically, and that insurers will thus be exposed to damages without any predictable limit. This fear will inevitably lead insurers to increase their premiums-and so will inflict a burden on every New Yorker who buys insurance.

This policy judgment was implicit in *Rocanova* and *NYU*. Not everyone agreed with it. The Appellate Division majority in [Acquista v New York Life Ins. Co.](#) (285 AD2d 73, 78 [1st Dept 2001]) hardly concealed its disagreement: "It is correct that, to date, this State has maintained the traditional view . . . [citing *Rocanova* and *NYU*]. Yet, for some time, courts and commentators around the country have increasingly acknowledged that a fundamental injustice may result . . ." The *Acquista* court found a way to avoid what it thought an injustice: award "consequential," not punitive damages. *Acquista* adopted the rule of some sister-state decisions, notably [Beck v Farmers Ins. Exch.](#) (701 P2d 795 [Utah 1985]), that an insurer that denies a claim in bad faith becomes liable for consequential damages beyond the policy limits (285 AD2d at 80-81). With less frankness than the *Ac-*

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quista court-indeed, without even citing *Rocanova* or discussing *Acquista*-the majority here reaches the same result.

The “consequential” damages authorized by the majority, though remedial in form, are obviously punitive in fact. They are not triggered, as true consequential damages are, simply by a breach of contract, but only by a breach committed in bad faith. The majority never explains why this should be true, but the explanation is self-evident: the purpose of the damages the majority authorizes can only be to punish wrongdoers and deter future wrongdoing. They have nothing to do with consequential damages, or with the covenant of good faith and fair dealing, as those terms are ordinarily understood.

The whole idea of “consequential damages” is out of place in a suit against an insurer that has failed to pay a claim-or, indeed, in any case where the obligation breached is merely one to pay money. Consequential damages are a means of measuring *198 the harm done when a party fails in some nonmonetary performance-say, the transportation of a broken mill shaft (*Hadley v Baxendale*, 9 Exch 341 [1854]) or the construction of a football stadium (*Kenford Co. v County of Erie*, 73 NY2d 312 [1989]). In such cases, where there is no agreement on what money will be paid in the event of a breach, a court must try to decide what damages the parties contemplated-what damages they would have agreed to had they considered the question when **7 the contract was signed (*Kenford*, 73 NY2d at 320). But in insurance contracts or other contracts for the payment of money, the parties have already told us what damages they contemplated; in the case of insurance, it is payment equal to the losses covered by the policy, up to the policy limits. There is no occasion for a *Kenford* analysis.

Nor could such an analysis, done in the way *Kenford* requires, support the results the majority reaches in these two cases. Under *Kenford*, the premise of consequential damages awards is that they effectuate the parties' presumed intentions at the time of contracting: “the commonsense rule to apply is to consider what the parties would have concluded had they considered the subject” (*Kenford*, 73 NY2d at 320). Can anyone seriously believe that the parties in these cases would, if they had “considered the subject,” have contracted for the results reached here? Imagine

the dialogue. Applicant for insurance: “Suppose you refuse, in bad faith, to pay a claim. Will you agree to be liable for the consequences, including lost business, without regard to the policy limits?” Insurance company: “Oh, sure. Sorry, we forgot to put that in the policy.”

The majority also departs from the established understanding of the “covenant of good faith and fair dealing”-thus obscuring the fact that the predicate for “consequential” damages here is exactly the same conduct, bad faith failure to pay claims, that we refused to make a predicate for punitive damages in *Rocanova* and *NYU*. Ordinarily, the covenant of good faith and fair dealing is breached where a party has complied with the literal terms of the contract, but has done so in a way that undermines the purpose of the contract and deprives the other party of the benefit of the bargain (e.g. 511 W. 232nd Owners Corp. v Jennifer Realty Co., 98 NY2d 144 [2002]). Here, plaintiffs allege that defendants breached, in bad faith, the express terms of the policies, by refusing to pay for the losses the policies covered. There is no need for resort to the implied covenant of good faith, and this is the first time, as far as I *199 know, that we have relied on that implied covenant to condemn the bad faith breach of an express promise.

These two conceptual errors-the misuse of the terms “consequential damages” and “covenant of good faith”-are not the only ones in the majority opinions. The *Bi-Economy* opinion seems fundamentally to misunderstand the purpose of business interruption insurance-which is to compensate the insured for a business interruption that has already occurred, not to prevent one from occurring (see majority op at 194-195). If the insured's business is never interrupted, there can be no claim under a business interruption policy. This error seems unimportant, however, for the majority's discussion of business interruption insurance is apparently extraneous to its holding. The *Panasia* case involves no business interruption coverage-yet the majority upholds the legal sufficiency of *Panasia*'s claim for consequential damages on the basis of a simple citation to *Bi-Economy* (*Panasia Estates, Inc. v Hudson Ins. Co.*, 10 NY3d 200, 203 [2008]). **8

The majority's bad policy choice is more important than the flaws in its reasoning. This attempt to punish unscrupulous insurers will undoubtedly lead to the

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punishment of many honest ones. Under today's opinions, juries will decide whether claims should have been paid more promptly, or in larger amounts; whether an insurer who failed to pay a claim did so to put pressure on the insured, or from legitimate motives, or from simple inefficiency; and whether, and to what extent, the insurer's slowness and stinginess had consequences harmful to the insured. All these very difficult, often nearly unanswerable, questions will be put to jurors who will usually know little of the realities of either the insured's or the insurer's business. The jurors will no doubt do their best, but it is not hard to predict where their sympathies will lie.

The result of the uncertainty and error that the majority's opinions will generate can only be an increase in insurance premiums. That is the real "consequential damage" flowing from today's holdings.

Chief Judge Kaye and Judges Ciparick, Graffeo and Jones concur with Judge Pigott; Judge Smith dissents in a separate opinion in which Judge Read concurs.

Order, insofar as appealed from, reversed, etc.

FOOTNOTES

[FN*](#) This being an appeal from the grant of partial summary judgment to the insurer, we view the facts in the light most favorable to the insured.

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BI-ECONOMY v HARLEYSVILLE

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Panasia Estates, Inc. v. Hudson Ins. Co.
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NY,2008.

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2008 WL 420014, 2008 N.Y. Slip Op. 01419

Panasia Estates, Inc., Respondent
v
Hudson Insurance Company, Appellant.
Court of Appeals of New York

Argued January 9, 2008
Decided February 19, 2008

CITE TITLE AS: Panasia Estates, Inc. v Hudson Ins.
Co.

SUMMARY

Appeal, by permission of the Appellate Division of the Supreme Court in the First Judicial Department, from an order of that Court, entered April 17, 2007. The Appellate Division affirmed an order of the Supreme Court, New York County (Karen S. Smith, J.; op [2006 NY Slip Op 30352](#)[U]), which had granted defendant's motion for summary judgment only to the extent of precluding plaintiff from asserting any claims for legal fees incurred in the prosecution of the action. The following question was certified by the Appellate Division: "Was the order of the Supreme Court, as affirmed by this Court, properly made?"

[Panasia Estates, Inc. v Hudson Ins. Co., 39 AD3d 343](#), affirmed.

HEADNOTE

Damages
Consequential Damages
Liability of Commercial Insurer

In an action alleging that defendant insurer breached the parties' insurance contract by failing to properly investigate plaintiff's loss and denying the loss as not covered under the policy, defendant's motion to dismiss plaintiff's claims for consequential damages was properly denied. 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. Here, consideration of whether the specific damages sought by plaintiff were foreseeable damages as the result of defendant's breach was required. The contractual exclusion for consequential loss did not bar the recovery of consequential damages.

RESEARCH REFERENCES

[Am Jur 2d, Insurance §§ 1407, 1734.](#)

[Couch on Insurance \(3d ed\) §§ 205:64-205:67.](#)

[NY Jur 2d, Insurance §§ 1910, 1915.](#)

ANNOTATION REFERENCE

[Insurer's liability for consequential or punitive damages for wrongful delay or refusal to make payments due under contracts. 47 ALR3d 314.](#)

*201 FIND SIMILAR CASES ON WESTLAW
Database: NY-ORCS

Query: breach /4 insurance /s consequential /2 damage

POINTS OF COUNSEL

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White Fleischer & Fino, LLP, New York City (Janet P. Ford and Nancy Davis Lyness of counsel), for appellant.

I. Consequential/extracontractual damages based upon an insurer's alleged bad faith breach of its contractual obligations under a policy of insurance are not recoverable by an insured. (*Rocanova v Equitable Life Assur. Socy. of U.S.*, 83 NY2d 603;*New York Univ. v Continental Ins. Co.*, 87 NY2d 308;*Brody Truck Rental v Country Wide Ins. Co.*, 277 AD2d 125;*High Fashions Hair Cutters v Commercial Union Ins. Co.*, 145 AD2d 465;*Sweazey v Merchants Mut. Ins. Co.*, 169 AD2d 43;*Martin v Metropolitan Prop. & Cas. Ins. Co.*, 238 AD2d 389;*Acquista v New York Life Ins. Co.*, 285 AD2d 73;*Polidoro v Chubb Corp.*, 354 F Supp 2d 349;*USAlliance Fed. Credit Union v CUMIS Ins. Socy., Inc.*, 346 F Supp 2d 468.) II. *Acquista v New York Life Ins. Co.* (285 AD2d 73 [2001]) is critically distinguishable from the instant matter in that the Hudson Insurance Company policy contains an explicit exclusion for consequential losses. (*J.R. Adirondack Enters. v Hartford Cas. Ins. Co.*, 292 AD2d 771;*Crawford Furniture Mfg. Corp. v Pennsylvania Lumbermens Mut. Ins. Co.*, 244 AD2d 881;*Bretton v Mutual of Omaha Ins. Co.*, 110 AD2d 46, 66 NY2d 1020;*Adorable Coat Co. v Connecticut Indem. Co.*, 157 AD2d 366;*Pergament Distribs. v Old Republic Ins. Co.*, 128 AD2d 760, 70 NY2d 607;*CBS, Inc. v Continental Cas. Co.*, 753 F Supp 525;*Harris v Provident Life & Acc. Ins. Co.*, 310 F3d 73;*Kenford Co. v County of Erie*, 73 NY2d 312;*Martin v Metropolitan Prop. & Cas. Ins. Co.*, 238 AD2d 389.) III. The First Department erroneously concluded that the terms "consequential damages" and "consequential losses" are not synonymous. (*J.R. Adirondack Enters. v Hartford Cas. Ins. Co.*, 292 AD2d 771;*Crawford Furniture Mfg. Corp. v Pennsylvania Lumbermens Mut. Ins. Co.*, 244 AD2d 881;*Bi-Economy Mkt., Inc. v Harleysville Ins. Co. of N.Y.*, 37 AD3d 1184.)

Peckar & Abramson, P.C., New York City (Michael S. Zicherman of counsel), for respondent.

I. Panasia Estates, Inc. is entitled to assert a claim for consequential damages against Hudson Insurance Company arising out of Hudson's breach of the insurance contract. (*202*Hold Bros., Inc. v Hartford Cas. Ins. Co.*, 357 F Supp 2d 651;*Lava Trading Inc. v Hartford Fire Ins. Co.*, 326 F Supp 2d 434;*511 W. 232nd Owners Corp. v Jennifer Realty Co.*, 98 NY2d 144;*Pavia v State Farm Mut. Auto. Ins. Co.*, 82 NY2d 445;*Rocanova v Equitable Life Assur. Socy. of*

U.S., 83 NY2d 603;*Acquista v New York Life Ins. Co.*, 285 AD2d 73;*Koloski v Metropolitan Life Ins. Co.*, 5 Misc 3d 1028[A], 2004 NY Slip Op 51596[U]; *Weisel v Provident Life & Cas. Ins. Co.*, 11 Misc 3d 1062 [A], 2006 NY Slip Op 50360[U]; *Fleming v Allstate Ins. Co.*, 106 AD2d 426, 66 NY2d 838, 475 US 1096; *Korona v State Wide Ins. Co.*, 122 AD2d 120.) II. Public policy considerations favor an insured's right to claim consequential damages. (*Hold Bros., Inc. v Hartford Cas. Ins. Co.*, 357 F Supp 2d 651.) III. The insurance policy issued to Panasia Estates, Inc. does not exclude consequential damages that arise from Hudson Insurance Company's breach of contract. (*Hold Bros., Inc. v Hartford Cas. Ins. Co.*, 357 F Supp 2d 651;*Lava Trading Inc. v Hartford Fire Ins. Co.*, 326 F Supp 2d 434.)

OPINION OF THE COURT

Pigott, J.

Panasia Estates is the owner of commercial rental property located at 33 West 19th Street in Manhattan. Panasia had a commercial property insurance policy with Hudson Insurance Company, which included "Builders' Risk Coverage," covering damage to its property **2 while undergoing renovation. During the policy period, the roof of its building was opened in order to perform construction work. Inclement weather caused rain to enter the building through the roof opening, resulting in extensive damage to the property.^{FN*}

Shortly after the occurrence, Panasia claimed it promptly notified Hudson of the loss. According to Panasia, however, Hudson failed to investigate or adjust the claim until several weeks later. Hudson then denied the claim three months after that, stating that Panasia's loss was the result of repeated water infiltration over time and wear and tear rather than from a risk covered under the builders risk policy provision.

Panasia commenced this action against Hudson, alleging that it breached the insurance contract by failing to properly investigate the loss and denying the loss as not covered under the policy. Panasia sought both direct and consequential damages that it claimed stemmed from Hudson's breach.

*203 Hudson moved for partial summary judgment "dismissing all of [Panasia's] bad faith allegations

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and all prayers for consequential, extra-contractual, or incidental damages or attorneys [*sic*] fees.” Hudson argued, among other things, that a contractual exclusion for “[a]ny other consequential loss” precluded Panasia’s request for consequential damages.

As pertinent here, Supreme Court denied that part of Hudson’s motion to dismiss Panasia’s claims for consequential damages. The Appellate Division affirmed, stating that “[a]n insured may recover foreseeable damages, beyond the limits of its policy, for breach of a duty to investigate, bargain for and settle claims in good faith” (39 AD3d 343 [2007], citing *Acquista v New York Life Ins. Co.*, 285 AD2d 73 [1st Dept 2001]). In addition, the court concluded that Hudson failed to show that the contractual exclusion for “‘consequential loss’” applied to Panasia’s claim, rejecting Hudson’s argument that “consequential loss” and “consequential damages” were synonymous (*id.*).

The Appellate Division granted Hudson leave to appeal to this Court, certifying the question: “Was the order of the Supreme Court, as affirmed by this Court, properly made?” We conclude that it was.

The courts below properly rejected Hudson’s contention that it was entitled to judgment as a matter of law because consequential damages are not recoverable in a claim for breach of an insurance contract. As we explained in *Bi-Economy Mkt., Inc. v Harleysville Ins. Co. of N.Y.* (10 NY3d 187 [2008] [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 ****3** “‘within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting’ ” (at 192, quoting *Kenford Co. v County of Erie*, 73 NY2d 312, 319 [1989]). Here, the courts below failed to consider whether the specific damages sought by Panasia were foreseeable damages as the result of Hudson’s breach. Because the record before us is not fully developed on that issue, such claim must be considered by Supreme Court.

Lastly, as the Appellate Division correctly concluded, the contractual exclusion for consequential loss does not bar the recovery of consequential damages (*see Bi-Economy* at 196).

***204** Accordingly, the order of the Appellate Division should be affirmed, with costs, and certified question answered in the affirmative.

Smith, J. (dissenting [For the dissenting opinion of Judge Smith, see *Bi-Economy Mkt., Inc. v Harleysville Ins. Co. of N.Y.* (10 NY3d 187, 196 [2008]).]).

Chief Judge Kaye and Judges Ciparick, Graffeo and Jones concur with Judge Pigott; Judge Smith dissents in a separate opinion in which Judge Read concurs.

Order affirmed, etc.

FOOTNOTES

FN* As this is an appeal from a summary judgment motion, we view the facts in the light most favorable to Panasia, the nonmoving party.

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