



NEW YORK STATE HIGH COURT HOLDS INSURERS LIABLE FOR "CONSEQUENTIAL DAMAGES"

In two strongly-worded, decisions, each with a sharp dissent, the New York Court of Appeals on February 19, 2008 effectively expanded the scope of damages recoverable under a commercial property insurance policy. The 5-2 majority opinion, written by Judge Eugene F. Pigott, Jr., ruled that owners of commercial property insurance policies may seek damages from their insurers in excess of the stated policy limits if those damages are a "natural and probable consequence" of a breach of the insurance contract. These rulings came in two separate decisions, in appeals from two different lower appellate courts, and based on distinct factual and insurance policy issues.

In ¹[*Bi-Economy Market, Inc. v. Harleystown Insurance Company of New York*](#), the Court reversed, with costs, a ruling by the Appellate Division, Fourth Department, in a case involving a claim for business interruption coverage following a disastrous fire. In ²[*Panasia Estates, Inc. v. Hudson Insurance Company*](#), the Court upheld, with costs, a First Department decision in a claim of significant water damage under a builder's risk policy. The majority concluded in both cases that the "insurance contract included an additional performance-based component: the insurer agreed to evaluate a claim, and to do so honestly, adequately, and – most importantly – promptly." The Court went on to conclude that an insured who suffers "additional damages as a result of an insurer's excessive delay or improper denial" may seek compensation, irrespective of the limits of coverage, for loss of this "bargained for benefit."

In *Bi-Economy*, a family-owned food market suffered a major fire resulting in heavy structural damage and complete loss of its inventory. Its insurance policy provided coverage for, among other losses, lost business income up to one year from the date of the fire "... due to the necessary suspension of [its] 'operations' during the 'period of restoration.'" Harleystown disputed the claim for actual damages and offered to pay only seven months of the business interruption claim. *Bi-Economy* never resumed business operations and claimed that it was forced to go out of business because of Harleystown's payment of less than the full policy limits.

In the second case decided by the Court at the same time, *Panasia Estates* was the owner of a commercial rental property in Manhattan which suffered extensive water damage from rain which entered a roof opening during construction work. Hudson Insurance, *Panasia's* property insurer, did not investigate or adjust the claim for several weeks after notification of the loss; it then denied the claim three months later, citing the applicability of express policy exclusions for wear and tear, and repeated water infiltration over time.

1. <http://www.nycourts.gov/ctapps/decisions/feb08/14opn08.pdf>

2. <http://www.nycourts.gov/ctapps/decisions/feb08/15opn08.pdf>

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ADMISSIONS INFORMATION

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In both cases, the Court applied traditional contract principles, holding that the damages which flowed from the insurers' failure to promptly pay the coverage resulted in losses which exceeded the policy limits, for which the insurers were liable. The majority found in *Bi-Economy* that "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 had the contract been performed." In *Panasia*, Judge Pigott wrote further that "when an insured ... suffers additional damages [here, interest on loans taken out to complete rejected repair costs] as a result of an insurer's excessive delay or improper denial, the insurance company should stand liable for these damages."

In a harshly worded dissent, Judge Robert S. Smith equated the majority decision to an award of punitive damages, which had explicitly been rejected by the Court in *Rocanova v. Equitable Life Assurance Society of U.S.* (83 N.Y.2d 603 [1994]) and *New York University v. Continental Insurance Co.* (87 N.Y.2d 308 [1995]). The dissent argued that the decisions in *Bi-Economy* and *Panasia* effectively nullify the established "egregious tortious conduct" standard established in *Rocanova* and *NYU*, and now permits extra-contractual claims under the guise of "consequential damages." Although the majority purports to hold these damages remedial in nature – to "place the insured in the position it would have been in had the contract been performed" – the dissent opined that the ruling was obviously punitive in effect because such damages are not recoverable for a simple breach of contract, but are awarded only for "a breach committed in bad faith." The dissent concluded that "the purpose of the damages ... can only be to punish wrongdoers and deter future wrongdoing ... [] and have nothing to do with consequential damages, or the covenant of good faith and fair dealing ..." The dissent in these cases is unusual, in part because the rulings are the result of a relatively one-sided split (5 to 2), rather than a close call (4 to 3), where one would normally expect to find such strong language. It is also unusual in that the same dissent is repeated, verbatim, in both decisions.

Ultimately the rulings expand a business insurer's risks when failing to promptly adjust claims or pay full policy benefits. The decisions also further the placement of these issues in the hands of a trial jury to determine damages based on their own, and often slanted, view of the facts. While the decisions in *Bi-Economy* and *Panasia* pertain only to certain business policy coverages, it is not difficult to envision that similar claims will soon be raised under personal policies as well, including homeowner's and automobile insurance. The rulings may lead to a flood of insurance claims and lawsuits seeking "bargained for benefits" in excess of the policy limits notwithstanding a legitimate basis for denying, or limiting, coverage under the terms of the insurance policy. For more information regarding how these rulings may effect your business, contact David G. Brock at dbrock@jaeckle.com or 716.843.3811 or Mitchell J. Banas, Jr. at mbanas@jaeckle.com or 716.843.3803.