

NY's Evolving Acceptance Of Policyholder Bad Faith Claims

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The availability of extracontractual remedies for policyholders denied full and prompt payment of their claims is a crucial means of leveling the playing field between policyholders and the insurance industry. When a policyholder's damages are limited to the value of the contract, insurance companies can leverage their financial clout to extract favorable settlements from policyholders who cannot bear the cost of litigation, knowing that they will never be forced to pay more than policy limits.

New York, however, has not statutorily enacted rules which would allow policyholders to seek extracontractual damages. Recently, though, New York courts and the New York State Legislature have taken up this issue. In addition to the recent court decisions discussed below, the Legislature is considering the New York Policyholders' Protection Act. The impetus for such developments appears to be the handling (or perhaps mishandling) of claims related to Superstorm Sandy.

Before Bi-Economy

Prior to 2008, New York courts held that Section 2601 of the New York Insurance Law, which prohibits insurance companies from engaging in bad faith claims handling practices, did not provide policyholders with a private cause of action. See *Rocanova v. Equitable Life Assurance Society*, 83 N.Y.2d 603 (N.Y. 1994). Relatedly, New York courts held that there is no statutory cause of action for bad faith.

Through the development of the common law, policyholders were permitted to maintain a bad faith action against an insurance company where the insurance company unreasonably refused to settle with an underlying plaintiff within policy limits and the underlying plaintiff subsequently obtained a judgment in excess of policy limits against the policyholder. See, e.g., *Pavia v. State Farm Mutual Automobile Insurance Co.*, 82 N.Y.2d 445 (N.Y. 1993).

Although not couched in bad faith, New York courts also provided policyholders with a means of recovering extracontractual damages against an insurance company when an insurance company's actions, such as filing a lawsuit against its policyholder, placed the policyholder in "a defensive posture." See *Mighty Midgets Inc. v. Centennial Insurance Co.*, 47 N.Y.2d 12 (N.Y. 1979). In such situations, the policyholder can recover attorneys' fees in addition to any amounts due under the insurance policy.

Bi-Economy Clarifies the Recovery of Consequential Damages



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The common law truly changed following the Court of Appeals decision in *Bi-Economy Markets Inc. v. Harleysville Insurance Co. of N.Y.*, 10 N.Y.3d 187 (N.Y. 2008). In *Bi-Economy*, the Court of Appeals held that a policyholder could recover consequential damages for an insurance company's breach of an insurance policy.

The policyholder, a family-owned meat market, suffered a fire loss and sought recovery from its insurance company for lost business income. The insurance company delayed paying the claim and then only made payment for seven months of lost income even though the policy provided coverage for 12. Due to the insurance company's actions, the policyholder went bankrupt and was unable to reopen.

The Court of Appeals held that the bankruptcy and closure were foreseeable consequences of the insurance company's breach of its contractual obligation to "evaluate a claim, and to do so honestly, adequately and — most importantly — promptly." Accordingly, *Bi-Economy* was permitted to recover the damages it suffered as a consequence of the insurance company's breach of contract, above policy limits, such as the lost business income the policyholder incurred for having to permanently.

In the companion case, *Panasia Estates Inc. v. Hudson Insurance Co.*, 10 N.Y.3d 200 (N.Y. 2008), decided the same day as *Bi-Economy*, the Court of Appeals held that a policyholder could recover consequential damages, including attorneys' fees, from an insurance company for its breach of the policy.

In *Panasia Estates*, the policyholder bought a builders' risk policy to cover damage to a property while the property underwent renovations. During the construction, the roof of the building was open, allowing rain to enter the building and damage the property. The insurance company delayed investigating the loss and subsequently denied the claim. As with *Bi-Economy*, the Court of Appeals permitted the policyholder to recover consequential damages against the insurance company due to the breach.

Following these decisions, New York courts have reinforced the view that attorneys' fees may be recoverable as consequential damages in breach of contract actions against insurance companies. For example, in *Richman v. Harleysville Worcester Insurance Co.*, No. 600467/06, 2010 N.Y. Misc. LEXIS 6832, at *3 (N.Y. Sup. Ct. Nov. 1, 2010), Justice Emily Goodman held:

Contrary to Harleysville's argument, consequential damages, other than attorney's fees, have been sufficiently identified (e.g., plaintiff's costs of renting another home, which Harleysville allegedly approved). Further, attorney's fees could be recovered.

Comparing *Mighty Midgets Inc.* and *Panasia*, Judge Goodman concluded that "the 2008 Court of Appeals cases [*Bi-Economy* and *Panasia*] have ended the question of whether attorneys' fees may be recovered in the breach of insurance contract context, whether it is a first party or third party action." *Richman*, 2010 N.Y. Misc. LEXIS 6832, at *3.

In *National Railroad Passenger Corp. v. Arch Specialty Insurance Co.*, a case currently pending appeal on other grounds, Judge Jed Rakoff found that the policyholder could "demand attorneys' fees and costs and consequential damages in the form of unnecessary expenses imposed on [it] through the unduly protracted adjustment process." 14-cv-7510, at 2 (ECF No. 158, Feb. 17, 2015); see also order (ECF No. 260, dated June 29, 2015) ("den[ying] defendants' request to dismiss Amtrak's claims for breach of contract and consequential damages.")

Similarly, a state court in New York reached a similar decision in *Niesenbaum v. AXA/Equitable Life Insurance Co.*, Case No. 2013/600412 (N.Y. Sup. Ct., Nassau County). In the case, Judge Bruce Cozzens denied an insurance company's motion for summary judgment to dismiss a claim for consequential damages, concluding that the plaintiff policyholder could seek attorneys' fees and costs against her insurance company.

Sandy Litigation and Bad Faith

Predating the Amtrak decision, however, was a decision which may have been the precursor to the present legislative efforts.

In *Raimey v. Wright National Flood Insurance Co.* (In re Hurricane Sandy Cases), 303 F.R.D. 17 (E.D.N.Y. 2014), an insurance company and its counsel failed to produce engineering reports prepared by the insurance company's engineering firm. Upon the release of one such "draft" report, it became clear that the draft — which had found coverage — was jettisoned in favor of a draft which found no coverage. The former, however, had not been produced in discovery.

The court found that the failure to produce such a critical document "constitute[d] a severe injustice" and imposed sanctions on the insurance company and (monetary) sanctions on the insurance company's counsel for failing to abide by a discovery order and misleading the court about the nature of the draft engineering reports.

The court then ordered all parties to the Sandy cases to produce all draft engineering reports pursuant to the earlier discovery order. While the judge's order did not rely on a bad faith cause of action to support the issuance of sanctions, the notion that insurance companies and the engineering firms developed a system of altering reports to avoid paying claims led to the result.

Post-Sandy Legislation

In 2015, the New York State Senate and the New York General Assembly introduced the New York Policyholders' Protection Act, a set of identical bills entitled "An act to amend the insurance law, in relation to unfair claim settlement practices." Materials circulated in support of the bill, echoing Wright, noted that:

It has also been widely reported that some insurance company experts' opinions and reports have been falsified and conclusions changed to favor a claim denial to the prejudice of the premium paying public on a massive scale. This activity was so widespread that it has resulted in reopening 144,000 Sandy claims.

The purpose of the legislation is to "allow holders of property and casualty insurance policies to recover damages when an insurance company's refusal to pay or unreasonable delay in paying a claim was not substantially justified." Thus, it aims to enshrine a statutory cause of action for bad faith conduct. Under the bill, a statutory remedy would be available to policyholders where an insurance company is not justified in refusing to pay a claim or unreasonably delays payment.

Conclusion

New York policyholders should stay abreast of these developments, both judicial and legislative, as they portend a future in which parties will be on a level playing field.

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DISCLAIMER: Anderson Kill represented National Railroad Passenger Corp. and Niesenbaum in the cases cited above.

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