

OPENING STATEMENT

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Until recently, insurers issuing first party policies in New York were secure in the knowledge that, unlike in many States, New York's courts did not permit the recovery of punitive damages or damages in excess of policy limits based upon an insurer's incorrect declination of coverage. However, the Court of Appeals has changed everything for insurers. Now, insurers can be held liable for extra contractual damages and damages in excess of policy limits for consequential loss suffered by an insured as a result of an insurer's improper denial of coverage. Although the Court has not expressly said that an insurer can be held liable for punitive damages, at least one Justice of the Court of Appeals sees the majority's decision as an "end run" around the bar of granting punitive damages to insureds for breach of contract.

Foreseen and Forearmed: Consequential Damages Permitted for Claims of Breach of Contract in First Party Insurance Policies By: Thomas R. Maeglin

Fire sweeps through the premises of a business, and the owner suffers a devastating loss. When the smoke and confusion clear, the owner submits a claim to an insurer. The insurer does not adjust the claim to the owner's satisfaction and—coincidentally or not—the business fails. What does the insurer now owe the owner?

Until fairly recently, most courts in New York have held that the owner's recovery would be limited, generally speaking, to the value of the losses covered by the policy, up to the policy limits. In a pair of recent decisions, the New York Court of Appeals has cleared the way for policy-holders to assert claims for damages in excess of those limits.

The two cases, Bi-Economy Market, Inc. v. Harleysville Insurance Company of New York, et al., ___ N.Y.3d ___; and Panasia Estates, Inc. v. Hudson Insurance Company, ___ N.Y.3d ___ (both decided February 19, 2008), are breach of contract actions brought against property insurers seeking, among other things, consequential damages.

Bi-Economy concerns claims made under a "Deluxe Business Owner's" policy following a major fire. The policy in question provided a variety of first party coverages, including replacement cost coverage for a building, business property ("content") loss coverage and—what was at issue in this litigation—coverage for lost business income—a form of "business interruption insurance." The insured submitted its claim

for twelve months of business income, but the insurer offered to pay only seven months and it advanced only a fraction of the total claim. A year passed and, through alternative dispute resolution, the insured was awarded over \$400,000; however, the insured never resumed business operations. Bi-Economy commenced an action for breach of contract, as well as bad faith claims handling and tortious interference with business relations.

Panasia Estates also concerned commercial property insurance, but in that case, "Builders Risk Coverage" intended to cover damage to property occurring during renovation. The insured made a claim for water damage that resulted when it opened the roof of its premises in order to perform construction work. Several weeks later, the insurer began its investigation but it denied the claim three months after that on the grounds that the loss was due to repeated water infiltration and wear and tear. Panasia sued for breach of contract, alleging that the insurer failed to properly investigate the loss.

In both cases, the insurers made motions to dismiss the policy-holders' claims for consequential damages. The motion to dismiss was granted in Bi-Economy, but denied in Panasia because an earlier decision of the Appellate Division, First Department, had held that an 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. See Acquista v. New York Life Ins. Co., 285 A.D.2d 73 (1st Dep't 2001)(ongoing pattern of avoiding

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claim, by multiple requests for documents and transferals to different claims examiners, supported claim for breach of disability policy). The Court of Appeals thus needed to resolve a split between departments of the Appellate Division.

The Court of Appeals did the heavy lifting in the Bi-Economy decision. There, the Court of Appeals discussed the rules of damages in breach of contract actions, distinguishing general damages—the “natural and probable consequence” of a breach—from special or consequential damages, which “do not so directly flow from the breach” and are recoverable if they had been “brought within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting.” Thus, there are two essential elements for consequential damages for a breach of contract: the loss must have been foreseen or foreseeable; and foreseeability is determined as of the time that the contract was made. Courts then 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 assumed consciously or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made.”

Insurance contracts, in particular, contain the implied covenant of good faith and fair dealing (unstated, but understood to be part of any contract) that obligates it to “investigate in good faith and pay covered claims.” They are also, the Court said, agreements to give the insured “peace of mind, or comfort, or knowing that it will be protected in the event of a catastrophe.”

What of the particular kinds of policies at issue in the Bi-Economy and Panasia matters? What proof was there that the property insurers in those matters had contemplated—at the time of contracting—consequential damages if they failed to promptly investigate, adjust and pay the insureds’ losses? With respect to the business interruption policy at issue in Bi-Economy, the answer was almost self-evident. Its very purpose was to ensure that the insured “had the financial support necessary to sustain its business operation in the event disaster occurred.” Many businesses, the Court announced, “lack the resources to continue business operations without insurance proceeds.” Paying only the policy limits, plus interest, would not return an insured to the position the insured would have been in had the contract been performed. In short, the very nature of the insurance contract itself made the insurer liable for consequential damages. The Bi-Economy court stated:

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.

Clear enough when the policy pays for lost business income. But could the same thing be said of the Builder’s Risk Coverage

in the Panasia matter? The Court couldn’t say, because the record had not been fully developed. Consequently, it remanded the case to the lower court to determine whether the insured’s damages were foreseeable.

Suppose, however, an insurance policy specifically excludes consequential damages. Would that not be very clear evidence of foreseeability at the time of contracting? Perhaps—but not in these cases. In Bi-Economy, the policy referred to different types of consequential losses (those caused by third-party actors, or by the suspension, lapse or cancellation of any license, lease or contract), but not to those damages caused by an insurer’s injurious conduct. It was the same in Panasia.

The central holding of Bi-Economy and Panasia did not sit well with one justice (Smith), who, in a detailed dissent, said that the Court had effectively abandoned a rule that punitive damages are not available for breach of an insurance contract unless the plaintiff shows both egregious tortious conduct directed at the insured and a pattern of similar conduct directed at the public, generally. All the court had done, according to the dissent, was to recast punitive damages as “consequential damages” and re-characterize a bad faith failure to pay a claim as a “breach of the covenant of good faith and fair dealing.” The underlying wrongful conduct is the same in either case, but only a pretense for consequential damages. Such damages were out of place in this setting, as with other cases concerning contracts for the payment of money only, because the parties have expressed the damages that they have contemplated.

The purpose of business interruption insurance, Justice Smith opined, was not to *prevent* a business interruption from occurring, but to compensate the insured for an interruption *that has already occurred*. Moreover, the majority had departed from sound public policy, as well: it had chosen a rule aimed at avoiding an injustice (i.e., denying an insured damages in excess of the loss amount), but at the cost of a burdensome increase in the average premium. The result, in Justice Smith’s estimation, would likely be the punishment of many “honest insurers” at the hands of juries who are called to “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.”

Should this “parade of horrors” from Justice Smith’s dissent concern insurers as much as he suggests? The majority opinion directly responded to some of the issues raised in the dissent, but probably not enough to reassure insurers. What is to prevent courts from applying Bi-Economy and Panasia in, say, third-party contexts, where an insurer denies a defense to its insured in a liability case? If the insured is bankrupted by a judgment against it, would that give it a cause of action against its general liability carrier? Similar thoughts have occurred to policy-holders already. See Tortoso v. Metlife Auto, 2004 WL 5488404 (Sup. Ct. N.Y.Cty. 2004).

An indication of what is to come may be gathered from what has happened in the First Department since it rendered the Aquista decision in 2001. Aquista, it should be noted, was a disability insurance case, and it appears that until recently many of the cases applying it have also been in the fields of disability and life insurance. Unlike disability insurance and business interruption, other forms of insurance do not aim to replace lost income, or in cases where the insured has not lost an important alternative source of funds, consequential damages may be more difficult to establish. Also, there are several reported cases in which claims for bad faith breach of contract have been dismissed on a motion for summary judgment, proving that not all such cases will end up before a jury.

Further, the Aquista court saw its holding as a middle path, between New York's traditional analysis that could produce "fundamental injustice," and the adoption of a tort cause of action. It viewed "foreseeability" of damages as a key control upon these policy-holders' claims. Thus, as Justice Smith observed in Bi-Economy, the consequential damages authorized "are not triggered ... simply by a breach of contract, but only by a breach committed *in bad faith*." Surely not every thorough investigation or aggressive adjustment or claim denial based upon plain policy language is wrongful under that standard. However, where suits for recovery of consequential damages based upon insurers' bad faith previously could be expected to be dismissed on motion, the likelihood that such claims will be decided by a jury, have now been greatly increased.

RECENT DECISIONS OF INTEREST

New York's Labor Law continues to be a fertile source of appellate decisions concerning in both tort liability and contract interpretation. The following are brief summaries of but a few of the significant Labor Law appellate decisions in the first quarter of 2008.

- In Kwang Ho Kim v. D&W Shin Realty Corp. and ACP Sea Food Corp., 47 A.D.3d 616 (2nd Dept. 2008), decided on January 8, ACP Sea Food Corp. contracted with the employer of the plaintiff, Kim, to perform siding work at the building owned and leased to it by defendant, D&W.

Plaintiff claims that he was working alone, standing on the fifth or sixth rung of an unsecured 12 foot ladder when it slipped out from underneath him causing him to fall to the ground and break his feet.

According to the president of ACP, prior to plaintiff's fall, Shin had asked or told him to stop working because the plaintiff was alone and it was raining.

After suit was commenced, D&W cross-claimed against ACP for common law and contractual indemnification and to recover damages for breach of provision of the lease requiring ACP to procure liability insurance naming D&W as an additional insured.

On appeal, the Second Department found that the Court below had erred in granting ACP's motion for summary judgment dismissing the claims against it under Labor Law §240(1) and §241(6) on the ground that ACP was not an "owner" of the property. In reversing, the Appellate Division found that the meaning of "owner" under those sections of the Labor Law is not limited to title holders but has been extended to "encompass a person who has an interest in the property and who fulfilled the role of owner by contracting to have work performed for his benefit." Thus, the Second Department found that ACP was acting as a "owner" within the meaning of the statute when it hired the plaintiff's employer pursuant to an oral contract to perform the siding work on the building, from which it derived a benefit in the operation of its business.

Furthermore, the Court rejected ACP's contention that it was entitled to summary judgment dismissing the Labor Law §240(1) cause of action against it because ACP failed to satisfy its burden of establishing that the latter provided "proper protection" to the plaintiff or that plaintiff's actions were the sole proximate cause of his injuries.

In doing so, the Second Department noted that the fact that the plaintiff was not holding on to the ladder when he fell did not obviate the statutory requirement to provide proper protection where the plaintiff's work requires the use of both hands. Furthermore, the Court found that ACP did not establish, as a matter of law, that the plaintiff's failure to heed Shin's instructions to stop work was the sole proximate cause of his injuries and any comparative negligence on plaintiff's part is not a defense to a claim under Labor Law §240(1). Thus, the Court concluded, that ACP should not have been granted summary judgment in favor of plaintiff.

- In Balbuena v. New York Stock Exchange, Inc., 2008 WL 667198 (1st Dept. 2008), decided on March 13, the issue before the Court involved the Stock Exchange's entitlement to summary judgment on its motion for summary judgment based upon contractual indemnification.

In Balbuena, the plaintiff/laborer sustained injury when the scaffold on which he was standing collapsed. The owner, the Stock Exchange, hired the non-party construction manager, AMEC, to oversee the renovation of its building. AMEC contracted with Regional Scaffolding to design and erect a scaffold. Regional subcontracted with B&C to erect and dismantle the scaffold. During the dismantling process, the protective railings and certain steel wiring were removed. Plaintiff, an employee of AMEC, was using the scaffold to wash down internal walls and fell when a plank, no longer properly secured, overturned.

The First Department found that no issues of fact existed as to the Stock Exchange's liability under Labor Law §240(1) because both the Stock Exchange and AMEC knew that the scaffold was in the process of being dismantled and was unsafe. Therefore, there was no merit to the Stock Exchange's contention that the plaintiff's injuries were the result of his own "sole

negligence". The Court also found that the designer of the scaffold, Regional, was not liable, as a matter of law. Although Regional designed the scaffold, it had subcontracted with B&C to erect and dismantle it. The Court noted that, as there were no allegations of design defect in plaintiff's Complaint and no evidence that Regional exercise supervisory control over the dismantling process, the lower court had properly dismissed plaintiff's claims against it.

The Appellate Division held that the trial court erred when it found issues of fact regarding whether plaintiff's injury arose "out of, resulted from, or was incidental" to the work required under the relevant contracts involving the erection and dismantling of the scaffold. The Court found that, based upon the Record, plaintiff's injuries were indisputably caused, at least in part, by his presence on the partially dismantled scaffold. Thus, the Court found that under any fair reading of the contract's provision, plaintiff's injury either arose out of, was incident to, or resulted from the work of erecting or dismantling the scaffold. Further, the Court held that it was not necessary that plaintiff himself be actively engaged in the type of work covered by the indemnity contract in order for this injury to fall within the broadly worded indemnification provision of the contract. Accordingly, the Appellate Division found that the Stock Exchange's claim for contractual indemnification against both Regional and B&C, should have been granted.

• In Cohen v. Memorial Sloan Kettering Cancer Center, 850 N.Y.S.2d 435 (1st Dept. 2008), decided on February 5, 2008, plaintiff, Cohen, was employed by an electrical subcontractor on a renovation project at defendant, Memorial Sloan Kettering Cancer Center. Defendant, HRH Construction, was the project's construction manager. Plaintiff was assigned the task of installing metal racks in the ceiling of a particular room. A six-foot A-frame ladder was made available for plaintiff's use. However, the ladder was inadequate for the task at one spot in the room, not because it was too short or lacked appropriate parts. Rather, when the ladder was placed in the only possible position at the location, its first rung was completely blocked and inaccessible by a metal rod that protruded from a piece of cast iron installed in the wall as a plumber's roughing for a toilet to be installed later. Plaintiff was therefore forced to step directly from the second rung to the floor when descending. Moreover, another cast iron rod protruded a few inches behind the ladder's second rung.

Plaintiff claimed that, when he began to step down to the floor from the second rung with his right foot, his left foot got caught between the second rung and rod behind it. His knee twisted and he fell to the concrete floor.

The court below denied plaintiff's motion for summary judgment under Labor Law §240(1) on the ground that where an employee is injured in a fall from a ladder which is not otherwise shown to be defective, the issue of whether

the ladder provided to the employee with the proper protection required under the statute is a question of fact for the jury.

In reversing the decision below, the First Department noted that, while it is appropriate to deny summary judgment where an issue of fact is whether a plaintiff's fall was caused by a failure to provide an adequate safety device, there is nothing in the record in this case to contradict plaintiff's showing that his fall was proximately caused by his inability to step down one rung at a time because of the absence of a safety device which would allow a safe descent to the floor.

The majority of the Court found that plaintiff was caused to fall due to the lack of a proper device, amenable to placement at that spot in a manner that would permit him to avoid the hazard in the course of his descent. Because plaintiff demonstrated that the ladder provided for him to perform the assigned work was not adequate to the task in the assigned location and defendants failed to make a showing that the safety device that they provided was adequate to the task or that plaintiff misused or failed to use it, the First Department held that plaintiff's cross-motion for summary judgment under Labor Law §240(1) should have been granted.

AGFJ DEVELOPMENTS

• AGFJ is pleased to announce that Laura Colatrella and Jay Weintraub have joined the firm as associates. Laura is an experienced insurance defense and appellate attorney. She earned her J.D. from New York Law School in 1994, and her B.A. from Upsala College. Jay's experience is primarily in insurance coverage and litigation. He earned his J.D. from the University of Virginia School of Law in 1998 and his B.A. from S.U.N.Y. Albany.

• In January, Irwin Miller and Dennis Monaco won summary judgment for AGFJ clients in two separate auto liability actions in Supreme Court, Bronx County. In both cases, Irwin and Dennis persuaded the Court that, based upon the medical evidence, each plaintiff had failed to establish that he had sustained a "serious injury" as defined by New York Insurance Law §5102(d), as a matter of law. Thus, the Complaints against AGFJ's clients were dismissed.

• Finally, AGFJ regrets to announce that Jade Priest has withdrawn from the firm and moved to her native Ohio in order to raise her young family. We wish her the best and thank her for her many contributions to the firm.

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