New York Law Journal
SERVING THE BENCH AND BAR SINCE 1888
WWW.NYLJ.COM

An ALM Publication
VOLUME 241—NO. 50
TUESDAY, MARCH 17, 2009

Outside Counsel

Expert Analysis

State Insurer Bad Faith Law After 'Bi-Economy' and 'Panasia'

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Last February, the New York Court of Appeals decided two ground-breaking cases permitting policyholders to seek consequential damages from their insurance carriers for the insurers' breach of their implied duty of good faith and fair dealing.

The rulings, *Bi-Economy* and *Panasia*,[1] involved the insurers' failure to adjust and pay first-party property insurance claims in a timely manner. In *Bi-Economy*, the insurer's failure to pay Bi-Economy Market Inc.'s business interruption claim resulted in a complete loss of its business enterprise. And in *Panasia*, the insurer's failure to promptly investigate and adjust Panasia Estates Inc.'s claim resulted in additional lost rents and interest that Panasia owed on a construction loan.

Consequential damages were warranted in those cases because "limiting an insured's damages to the amount of the policy, i.e., the 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."[2]

Since *Bi-Economy* and *Panasia*, New York law has continued to develop, and the types of cases in which consequential damages are available has continued to expand. For example, two recent decisions by New York courts and one federal district court allowed insureds to seek consequential damages in the context of environmental remediation liability and a disability claim.

This trend should continue as more insureds bring actions seeking consequential damages for their insurers' breach of the duty of good faith and fair dealing in failing to adjust and pay claims in an ever-expanding variety of claims in a timely manner.

In *Handy & Harman v. AIG Inc.*,[3] a Manhattan Supreme Court ruling, Handy & Harman operated a large precious metals manufacturing facility in Fairfield, Conn., and entered a sale agreement for the property wherein Handy & Harman agreed to demolish the existing structures on the site and perform any necessary environmental remediation.

In connection with the remediation, Handy & Harman purchased a Pollution Legal Liability Select Clean-Up Cost Cap insurance policy from AIG with a $4.7 million self-insured retention (SIR) and a $2 million limit of liability for remediation of pollutants in connection with a Remediation Action Work Plan (RAWP).[4] The RAWP estimated remediation costs of more than $6.7 million for which Handy & Harman paid the $4.7 million SIR and AIG paid the additional $2 million for the remediation.

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Later, Handy & Harman's contractors found previously undiscovered underground pollutants at the site that the Connecticut Department of Environmental Protection (DEP) directed Handy & Harman to remediate. Handy & Harman put AIG on notice of the DEP's directive and sought coverage for the additional remediation costs under the policy's $10 million sub-limit.

AIG initially denied the claim, and Handy & Harman aggressively pursued AIG for coverage. But AIG passed the claims file from adjuster to adjuster and refused to pay the claim based on an ever-changing and elusive basis. For example, AIG initially denied coverage by ignoring the $10 million sub-limit and claiming that its $2 million payment exhausted the policy.

AIG also attempted to support its denial by relying on an inapplicable endorsement that, on its face, bolstered Handy & Harman's claim.

Three months later, a new claims adjuster again changed AIG's story and argued that the DEP directive was not a "claim." A full year after first receiving the claim, AIG sent a letter from a third claims adjuster still maintaining that the claim was not covered under the policy.

Handy & Harman filed breach of contract and tort claims for AIG's breach of the covenant of good faith and fair dealing and sought consequential damages. AIG moved to dismiss the tort claim arguing that it duplicated the breach of contract claim and that the allegations could not support an independent cause of action for separate or additional damages.

In August 2008, Manhattan Supreme Court Justice Herman S. Cahn granted AIG's motion only with respect to the tort claim, but relied upon *Bi-Economy* and *Panasia* to allow Handy & Harman to seek consequential damages in connection with its breach of contract claim.[5] Justice Cahn further found that the parties contemplated consequential damages as a probable result of the breach, stating in pertinent part:

> The purpose of this environmental pollution liability policy was to ensure that the business paying for and conducting the pollution remediation, the insured, had the financial support to conduct and finish the remediation when the costs went beyond the self-insured retention amount for pollution conditions identified in the remedial plan, and to pay third-party claims for clean-up costs of the pollution conditions. Plaintif™f purchased the insurance so that it could avoid financial pressure on its business upon funding the costs of a pollution remediation. An insurer in these

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> circumstances fairly may be supposed to have assumed, when the insurance contract was made, that if it breached its obligations under the contract to timely investigate in good faith and pay covered claims it would have to respond in damages for damages to plaintiff's business.

Accordingly, despite throwing out the separate tort claim for AIG's conduct, Justice Cahn allowed Handy & Harman to seek consequential damages in connection with its breach of contract claim.

'Hoffman'

In Hoffman v. Union Mutual Stock Life Insurance Company,[6] the Union Mutual Stock Life Insurance Company (First Unum) insured Hoffman under a disability income policy.

Hoffman suffered three strokes and filed a claim based on his treating physician's report and diagnosis of disability. But First Unum summarily "closed the claim" and argued that Hoffman did not properly document the claim.

After Hoffman protested, First Unum required a medical examination by one of its own physicians that it used to deny Hoffman's claim because the examination concluded that Hoffman may be able to perform "light work."

Hoffman filed a breach of contract and bad faith insurance coverage action against First Unum. Hoffman claimed that First Unum improperly handled his claim. Hoffman argued, among other things, that First Unum violated a regulatory agreement that it entered with multiple states (including the state of New York) and the federal government that required First Unum to give "significant weight" to the opinions of "attending physicians" when it ignored Hoffman's attending physician's findings and required that Hoffman be examined by a doctor of First Unum's choosing. First Unum moved to strike the bad faith causes of action.

Brooklyn Supreme Court granted First Unum's motion to strike the bad faith causes of action, adopting First Unum's argument that an insured cannot state a tort claim for the insurer's conduct in denying its claim. But the court granted Hoffman's subsequent motion for leave to amend the complaint to incorporate the bad faith allegations into a cause of action premised on breach of contract. Hoffman subsequently filed an amended complaint that alleged bad faith in the context of a breach of contract case of action from which First Unum promptly moved to strike the bad faith allegations.

The court denied the motion and First Unum appealed from the orders granting Hoffman's motion for leave to amend and denying First Unum's motion to strike the bad faith allegations from the amended complaint.

The Appellate Division, Second Department, relying on *Bi-Economy* and *Panasia*, affirmed, holding that:

> Contrary to [First Unum's] assertion, the Supreme Court was correct in allowing the allegations of bad faith to be incorporated in an amended complaint and in denying that branch of the appellant's motion… to strike those portions of the amended complaint.[7]

'Bunge'

At least one U.S. District Court outside of New York has recognized the availability of consequential damages to policyholders in coverage actions following *Bi-Economy* and *Panasia*.

In *U.S. Fire Insurance Company v. Bunge North America*,[8] Bunge North America incurred remediation, settlement, and defense costs with respect to environmentally contaminated sites in Kansas.

Travelers Casualty and Surety Company issued Bunge eight consecutive $1 million primary general liability insurance policies covering from 1970 to 1978. Bunge filed a claim with Travelers, but Travelers denied the claim, in part, arguing that the contamination was not an occurrence.[9]

Bunge sued for breach of contract and sought consequential damages alleging bad faith and a breach of the duty of good faith and fair dealing because Travelers failed to adequately investigate and pay Bunge's claims.

The parties filed several motions for summary judgment, including Travelers' motion for summary judgment on Bunge's bad faith and breach of the duty of good faith and fair dealing claims. The parties agreed that because the policies were negotiated and issued in New York, New York's substantive law controlled.[10]

Relying on the New York Court of Appeals' 1995 decision in *New York University v. Continental Insurance. Co.*,[11] the court found that Bunge had not alleged any independent tort supporting its bad faith claim and dismissed Bunge's separate claim for breach of the duty of good faith and fair dealing as duplicative under New York law.

But relying on *Bi-Economy* and *Panasia*, the court denied Travelers' motion for summary judgment on Bunge's consequential damages claim within the context of its breach of contract claims.

Here, the court found that Travelers did not make any showing that Bunge's consequential damages were not reasonably foreseeable when it issued the policies. Within one month after the issuance of the *Bunge* decision confirming the viability of Bunge's consequential damages claim, Bunge and Travelers reached an undisclosed settlement agreement that released all claims against each other.[12]

Conclusion

Handy & Harman, *Hoffman*, and *Bunge* indicate that the watershed decisions in *Bi-Economy* and *Panasia* are gaining momentum and that policyholders can seek consequential damages in connection with insurance coverage actions in more than just the first-party property context.

While courts continue to rely on *New York University v. Continental Insurance Co.* to dismiss bad faith causes of action that do not allege independent torts, *Handy & Harman*, *Hoffman*, and *Bunge* make clear that consequential damages may still lie in a breach of contract case even without the independent tort required for a bad faith action.

Indeed, all that may be necessary are supportable allegations that the policyholder suffered damages as a consequence of an insurer's breach of its duty to investigate and handle a claim in good faith and that those consequential damages were reasonably foreseeable or within the contemplation of the parties when the parties negotiated the policies.

These decisions reflect New York's prevailing view that simply awarding a policyholder the money which should have been paid by the insurer in the first instance, plus interest, does not place the insured in the position it would have been in had the insurer performed under the policy in the first place.

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1. See *Bi-Economy Mkt. Inc. v. Harleysville Ins. Co. of N.Y.*, 10 N.Y.3d 187 (2008); *Panasia Estates Inc. v. Hudson Ins. Co.*, 10 N.Y.3d 200 (2008).
2. See *Bi-Economy*, 10 N.Y.3d at 195.
3. No. 0115666/07, 2008 WL 3999964 (N.Y. Sup. Ct. N.Y. County Aug. 25, 2008).
4. Coverages (K) and (L).
5. Id.
6. 51 A.D.3d 633 (2d Dep't 2008).
7. *Hoffman*, 51 A.D.3d at 634.
8. No. 05-2192-JWL, 2008 WL 3077074 (D. Kan. Aug. 4, 2008) (applying New York law).
9. Travelers alleges several coverage defenses, and Bunge countered with several arguments and significant evidence in favor of coverage, which are all beyond the scope of this article.
10. See supra note 3.
11. 87 N.Y.2d 308 (1995).
12. No. 05-CV-2192 JWL, 2008 WL 5354307 (D. Kan. Aug. 25, 2008).