



ATTORNEYS AT LAW

Consequential Damages

Policyholders Can Now Recover For Damages Beyond Policy Limits Caused By Insurance Company's Breach Of The Policy.

For years, New York courts have been predominantly pro-insurer, especially in disputes between the policyholder and insurer over the scope and availability of policy coverage. Consistently, courts limited the remedy available to policyholders who successfully sued for coverage to simply requiring the carrier to pay the amount due under the policy that it had previously refused to pay, without any other damage being assessed against the carrier for its conduct. However, as a result of a pair of landmark 2008 decisions by the New York Court of Appeals (NY's highest court), it's a whole new ball game for the policyholder in a coverage dispute with its carrier.

In two cases where the policyholder was suing for coverage under a property damage and business interruption policy, the New York Court of Appeals finally recognized the tremendous harm suffered by policyholders as a result of an insurer's bad faith in failing to properly investigate, adjust and pay claims in accordance with the applicable policies, thereby warranting an award above the policy proceeds.

In the first case, the insured suffered a major fire resulting in the complete loss of its inventory and heavy structural damage to the building and business-related equipment. Its insurance policy provided for replacement cost coverage on the building, business property or "contents" lost coverage, as well as business interruption insurance for up to one year from the date of the fire, under which the insurer would pay for the actual loss of business income sustained due to the suspension of the insured's business operations.

In the second case, the insured had a commercial property insurance policy which included "Builder's Risk Coverage," covering damage to its property while undergoing renovation. During the policy period, the roof of the insured's 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.

In both cases, it was claimed that the insurance companies failed to timely investigate and pay the claims submitted by the policyholders, resulting in substantial damages, and, at least in one case, the complete cessation of business operations of the policyholder. As a result, the policyholders sought coverage not only for their direct damages (that is the amounts that were due but not paid under the policies), but also for consequential damages (amounts in excess of

the policy limits). In both cases the insurer claimed that the applicable insurance policies excluded consequential damages.

According to the Court of Appeals, included in all insurance contracts is a promise by the insurer to act in good faith and deal fairly with the policyholder, which necessarily includes timely investigation and payment of covered claims in good faith. The Court of Appeals recognized that most businesses cannot operate without insurance proceeds in the event of a disaster and that policyholders bargain for peace of mind and financial support to sustain business operations during a period of catastrophic loss in taking out a policy to protect, not only their business property, but also their lost business income in case of a disaster. The Court, therefore, held that limiting the policyholder's damage to the policy proceeds plus interest "does not place the insured in the position it would have been in had the contract been performed." Accordingly, where the insurer does not act in accordance with its good faith contractual obligations to uphold its end of the bargain and pay claims in timely fashion, the Court held it is foreseeable that the policyholder will not be able to financially sustain its business operations and the business might terminate. Therefore, the Court held it is only fair for the insurer to be liable for not only that which should have been paid under the policy, but also for additional damages to compensate the policyholder for the resultant loss of the business.

The significance of the Court's decision to award such consequential damages cannot be overlooked. At last, New York is on even keel with other states which have, for years, provided statutory and common law remedies for insurance companies' bad faith in unreasonably denying and delaying coverage. Moreover, the possibility of consequential damages should prompt insurers to take seriously their duty to properly and timely investigate and pay for covered claims, thereby giving the policyholder what they bargained for – peace of mind that they will be able to sustain their business during a time of disastrous loss.

More importantly, the Court's express recognition that the demise of the policyholder's business is a probable and foreseeable consequence of an insurer's failure to promptly pay a claim under a business interruption policy, thereby warranting consequential damages, can have far reaching effects beyond cases of bad faith on property damage and business interruption claims. In particular, the Court's rationale would seem to apply equally concerning litigation coverage, which is part of almost all insurance policies.

By purchasing general liability coverage it is quite clear that part of what a policyholder bargains for is the insurance company hiring and paying for an attorney to defend the policyholder when the policyholder is sued. Given the fact that most policyholders take out such coverage because they cannot afford the legal fees associated with defending million dollar claims, a foreseeable and probable consequence of the insurer's failure to act in good faith to provide the bargained-for legal representation could be the demise of the business (just as in the case of an insurer's failure to provide business interruption losses). In this regard, litigation coverage under an insurance policy is exactly the kind of obligation the Court spoke of, the breach of which should make the insurer answerable for not only the policy proceeds, but also consequential damages, which should compensate the policyholder for the loss of its business, either in whole or in part.

G&C Commentary:

The Court of Appeals' recent decisions have demonstrated a step in the right direction towards appropriate protection of policyholders in coverage disputes. Significantly, it has opened the door for policyholders to finally recover the damages that adequately compensate them for their full, actual and foreseeable losses when their insurer refuses to honor its policy obligations. With the courts now willing and required, as a matter of law, to allow the recovery of consequential damages, there is more reason than ever to pursue coverage claims against your insurer.

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