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# Revisiting 'Bi-Economy' And Consequential Damages

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In February 2008, the New York State Court of Appeals issued two companion rulings addressing the circumstances in which an insured can seek recovery of consequential damages resulting from an insurer's breach of the covenant of good faith and fair dealing. We wrote about *Bi-Economy Market Inc. v. Harleysville*[1] and *Panasia Estates Inc. v. Hudson Ins. Co.*[2] and the implications of those cases, both authored by Judge Eugene F. Pigott, in our May 2008 Corporate Insurance Law column.[3] Now, almost three years later, we revisit those rulings and review how the cases that have followed have interpreted them.

There are at least five important takeaways regarding claims for consequential damages in the context of an insurance dispute that can be gleaned from the Court of Appeals' opinions in *Bi-Economy* and *Panasia*: (i) an insured may maintain a claim for consequential damages only where such damages were within the contemplation of the parties as to the probable result of a breach at the time the insurance contract was negotiated or issued; (ii) the claim is not a separate cause of action, but rather is a potential remedy for breach of the implied duty of good faith and fair dealing, which itself is part of a cause of action for breach of contract; (iii) a policy exclusion for consequential loss does not necessarily bar a claim for consequential damages; (iv) consequential damages may not be limited by a policy's limit of liability; and (v) a claim for consequential damages is not a claim for punitive damages and the law on punitive damages was not altered by these decisions.

### 'Bi-Economy' and 'Panasia'

In *Bi-Economy*, the insured's family-owned wholesale and retail meat market was badly damaged by fire and forced to close down due to damage to the facility, equipment and loss of inventory. The insured submitted a claim under a business interruption policy that provided coverage for damage to business property and lost income. However, the insurance carrier only agreed to pay for seven out of the 12 months of lost income claimed. The insured filed suit seeking consequential damages, claiming that the insurer's failure to pay the full amount of lost income caused the complete demise of the market.

> Based on the cases decided since 'Bi-Economy' and 'Panasia,' it does not appear that the courts intend to ease historical restrictions on punitive damages claims.

In *Panasia*, the insured owned a commercial rental property in Manhattan that was damaged during renovation, when rain entered the building through an opening in the roof and caused extensive water damage. The insured submitted a claim under its builders' risk coverage, which provided insurance for damage to the property during renovation. The insurer denied the claim, contending that the damage was from wear and tear over time and not from the rain event. The insured filed suit seeking to recover consequential damages, including the costs of obtaining loans (i.e., interest and legal fees) to pay for repair work that the insured contended should have been paid by insurance policy proceeds.

The Court of Appeals relied on its prior decision in *Kenford Co. v. County of Erie*[4] to explain the rules regarding contract damages and, specifically, in what circumstances consequential damages may be recovered. According to the Court, under New York law, a claimant that demonstrates a breach of contract may recover "general damages which are the natural and probable consequences of the breach."[5] Consequential damages are considered a special damage, recoverable only in limited circumstances. In order to recover consequential damages, the claimant must establish that such damages "were reasonably contemplated by the parties during their negotiations or at the time the contract was executed."[6] Thus, in the insurance context, the consequential damages must be contemplated and foreseeable at the time the insurance policy was negotiated or issued.

In both *Bi-Economy* and *Panasia*, the defendant insurers sought dismissal of the claims for consequential damages. In *Bi-Economy*, the Court of Appeals denied the carriers' motion for partial summary judgment, finding that the requirements of *Kenford* had been satisfied. The Court explained that the purpose of business interruption insurance is to ensure that the business has the financial support necessary to continue in the event of a disaster.

The Court determined that Bi-Economy had purchased the business interruption insurance not just to receive money "but to receive it promptly so that in the aftermath of a calamitous event as [the insured] experienced here, the business could avoid defeat and get back on its feet as soon as possible."[7] Thus, the Court relied on the purpose of business interruption insurance to hold that consequential damages were foreseeable. In *Panasia*, the Court was less sure whether consequential damages were foreseeable and remanded the case to the trial court to determine whether such damages were within the contemplation of the parties at the time of contract.

### Punitive Damages

Judge Robert S. Smith filed a nearly identical dissent (in which Judge Susan P. Read concurred) in both *Bi-Economy* and *Panasia*, taking issue with several aspects of the majority opinion, including the applicability of *Kenford* to an insurance dispute.[8] The dissent expressed concern that the majority had stealthily overruled New York law, which restricts recovery of punitive damages in the absence of an

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independent tort claim and injury to the public, simply by labeling the damages consequential instead of punitive. Judge Smith also cautioned that the majority decision could open the door to an increase in punitive damages claims against insurers, leaving juries to determine difficult factual issues regarding allegedly bad faith claims handling and ultimately driving up insurance premiums.

While the dissent may yet be proven correct in the sense that the *Bi-Economy* and *Panasia* rulings may lead to an increase in jury trials on factual issues related to consequential damages, to date, the concerns about a loosening of the restrictions on punitive damage claims do not appear to have been confirmed. In fact, two recent cases that addressed the issue expressly determined that *Bi-Economy* did not alter or expand existing law regarding punitive damages claims.

In *Silverman v. State Farm & Cas. Co.*,[9] the Supreme Court, Nassau County, rejected the insured's claim for punitive damages, holding that *Bi-Economy* had not altered the law on punitive damage claims and pointing out that the majority opinion in *Bi-Economy* expressly distinguished between consequential damages and punitive damages. Likewise, in *Haym Salomon Home for the Aged, LLC v. HSB Group Inc.*,[10] the U.S. District Court for the Eastern District of New York confirmed that neither *Bi-Economy* nor *Panasia* addressed claims for punitive damages.

### Foreseeability

Another concern raised by *Bi-Economy* and *Panasia* centers around the factual question at the heart of the foreseeability analysis. The majority decision in *Bi-Economy* makes clear that, under *Kenford*, consequential damages are available only in the limited circumstances where such damages were foreseeable and contemplated by the parties at the time the insurance policy was negotiated. But the majority provides little guidance as to what circumstances are sufficient to demonstrate that foreseeability.

Here again, the dissent was critical, suggesting that had the insurer and insured actually contemplated the issue, the insurer would never have agreed to be responsible for consequential damages. And recent case law suggests that in the absence of additional guidance, courts may be too quick to conclude that consequential damages were contemplated by the parties.

In *Bi-Economy*, the Court relied on the "very purpose of business interruption coverage," holding that the insurer would necessarily have understood, due to the nature of the insurance, that if it breached the contract it would be held responsible for business loss resulting from the breach. Several recent cases have attempted to apply that same rationale to other forms of insurance, leading to perhaps less restriction on the circumstances in which consequential damages are deemed recoverable than the Court of Appeals intended.

For example, in *Woodworth v. Erie Insurance Co.*,[11] the U.S. District Court for the Western District of New York accepted the argument that consequential damages would be available for an insurer's wrongful refusal to pay a claim for living expense coverage under a homeowners' insurance policy pursuant to the *Bi-Economy* rationale. According to the District Court, "[a]pplying the reasoning from *Bi-Economy*, the very purpose of additional living expense coverage would have made defendant aware that if it failed to act in good faith, and breached the policy in such a way as to hinder Plaintiffs from rebuilding their home, it would cause Plaintiffs to incur additional living expenses until such time as the house was replaced." The only reason the court dismissed the insured's claim for consequential damages was because it was not asserted in a timely manner.

Two other recent Northern District cases have also applied *Bi-Economy* broadly, finding that the nature of the insurance was alone sufficient to satisfy the foreseeability requirement for consequential damages. In *Chernish v. Massachusetts Mutual Life Ins. Co.*,[12] the court paraphrased *Bi-Economy*, holding that the very nature of disability insurance would also have made the defendant aware that it would have liability for consequential damages in the event of a breach. Similarly, in *Whiteface Real Estate Development and Cons. LLC v. Selective Ins. Co. of America*,[13] the Northern District denied the insurer's motion for summary judgment, holding that a fact finder might conclude that consequential damages, including interest paid on a loan to cover reconstruction costs and attorney fees, were the foreseeable consequences of the insurer's breach of a builder's risk policy.

### Breach of Duty

It does appear that courts interpreting *Bi-Economy* and *Panasia* have correctly determined that those cases did not create a separate cause of action for bad faith breach of an insurance contract. Rather, courts that have recently addressed the issue have confirmed that consequential damages are only available as a remedy for breach of the implied duty of good faith and fair dealing, which is a component of a cause of action for breach of contract. For example, in *Chaffee v. Farmers New Century Ins. Co.*,[14] the Northern District held that plaintiffs' "claim for consequential, extra-contractual damages is properly part of their breach-of-contract claim and not a separate cause of action…" Likewise, in *Simon v. Unum Group*,[15] the U.S. District Court for the Southern District of New York ruled that the claimant could not sustain a claim for consequential damages in the absence of evidence that the insurer had breached the implied duty of good faith.

### Looking Forward

In sum, based on the cases decided since *Bi-Economy* and *Panasia*, it does not appear that the courts intend to ease historical restrictions on punitive damages claims or to open the floodgates to a separate cause of action for damages for bad faith breach of the insurance contract. On the other hand, it does appear that some clarification is needed regarding what factual evidence is sufficient to demonstrate that consequential damages were foreseeable and contemplated by the parties at the time the policy was negotiated.

If courts continue to utilize a shortcut, concluding that the type of insurance alone is sufficient to demonstrate foreseeability, the result may be that claimants in insurance disputes will be permitted to assert claims for consequential damages even when they do not meet the requirements of New York law under *Kenford*. That does not appear to be what the Court of Appeals contemplated when it issued the opinions in *Bi-Economy* and *Panasia*.

1. *Bi-Economy Market Inc. v. Harleysville Ins. Co.*, 10 N.Y.3d 187, 856 N.Y.S.2d 505 (2008).
2. *Panasia Estates Inc. v. Hudson Ins. Co.*, 10 N.Y.3d 200, 856 N.Y.S.2d 513 (2008).
3. Howard B. Epstein and Theodore A. Keyes, "Consequential Damages: Only if Foreseen at the Time of Pact," New York Law Journal, Vol. 239, No. 89 (May 8,2008).
4. *Kenford Co. v. County of Erie*, 73 N.Y.2d 312, 540 N.Y.S.2d 1 (1989).
5. Id. at 319.
6. Id. at 321.
7. *Bi-Economy Market Inc.*, 10 N.Y.3d at 195.
8. Id. at 196.
9. *Silverman v. State Farm Fire & Cas. Co.*, 11 Misc.3d 591, 867 N.Y.S.2d 881 (Sup. Ct., Nassau Co. 2008).
10. *Haym Salomon Home for the Aged, LLC v. HSB Group Inc.*, No. 06-CV-3266, 2010 WL 301991 (E.D.N.Y. Jan. 20, 2010).
11. *Woodworth v. Erie Ins. Co.*, __F.Supp.2d__, 2010 WL 3749227 (W.D.N.Y. Sept. 21, 2010).
12. *Chernish v. Massachusetts Mut. Life Ins. Co.*, No. 5:08-CV-0957, 2009 WL 385418 (N.D.N.Y. Feb. 10, 2009).
13. *Whiteface Real Estate Development and Const., LLC v. Selective Ins. Co. of America*, No. 8:08-CV-24, 2010 WL 2521794 (N.D.N.Y. June 16, 2010).
14. *Chaffee v. Farmers New Century Ins. Co.*, No. 5:04-CV-1493, 2008 WL 4426620 (N.D.N.Y. Sept. 24, 2008).
15. *Simon v. Unum Group*, No. 07 Civ. 111426, 2009 WL 2596618 (S.D.N.Y. Aug. 21, 2009).

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