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1 No. 15
Panasia Estates, Inc.,
Respondent,
v.
Hudson Insurance Company,
Appellant.

Janet P. Ford, for appellant.
Michael S. Zicherman, for respondent.

PIGOTT, J.:

Panasia Estates is the owner of commercial rental property located at 33 West 19th Street in Manhattan. Panasia had a commercial property insurance policy with Hudson Insurance Company, which included "Builders Risk Coverage," covering damage to its property while undergoing renovation. During the policy period, the roof of its 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.[1]

Shortly after the occurrence, Panasia claimed it promptly notified Hudson of the loss. According to Panasia, however, Hudson failed to investigate or adjust the claim until several weeks later. Hudson then denied the claim three months after that, stating that Panasia's loss was the result of repeated water infiltration over time and wear and tear rather than from a risk covered under the builders risk policy provision.

Panasia commenced this action against Hudson, alleging that it breached the insurance contract by failing to properly investigate the loss and denying the loss as not covered under the policy. Panasia sought both direct and consequential damages that it claimed stemmed from Hudson's breach.

Hudson moved for partial summary judgment "dismissing all of Panasia's bad faith allegations and all prayers for consequential, extra contractual, or incidental damages or attorneys [sic] fees." Hudson argued, among other things, that a contractual exclusion for "[a]ny other consequential loss" precluded Panasia's request for consequential damages.

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[1] As this is an appeal from a summary judgment motion, we view the facts in the light most favorable to Panasia, the non-moving party.

As pertinent here, Supreme Court denied that part of Hudson's motion to dismiss Panasia's claims for consequential damages. The Appellate Division affirmed, stating that "[a]n 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" (39 AD3d 343, 343, citing Acquista v New York Life Ins. Co., 285 AD2d 73 [1st Dept 2001]). In addition, the court concluded that Hudson failed to show that the contractual exclusion for "'consequential loss' applied to Panasia's claim, rejecting Hudson's argument that "consequential loss" and "consequential damages" were synonymous (id.).

The Appellate Division granted Hudson leave to appeal to this Court, certifying the question: "Was the order of the Supreme Court as affirmed by this Court, properly made?" We conclude that it was.

The courts below properly rejected Hudson's contention that it was entitled to judgment as a matter of law because consequential damages are not recoverable in a claim for breach of an insurance contract. As we explained in Bi-Economy Market v Harleysville Ins. Co. [decided today], consequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance contract context, so long as the damages were "'within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting'" (majority opn, at 5, quoting Kenford Co. v County of Erie (73 NY2d 312, 319 [1989]). Here, the courts below failed to consider whether the specific damages sought by Panasia were foreseeable damages as the result of Hudson's breach. Because the record before us is not fully developed on that issue, such claim must be considered by Supreme Court.

Lastly, as the Appellate Division correctly concluded, the contractual exclusion for consequential loss does not bar the recovery of consequential damages (see Bi-Economy, at 10-11).

Accordingly, the order of the Appellate Division should be affirmed, with costs, and certified question answered in the affirmative.

Bi-Economy Market, Inc. v Harleysville Insurance Company of New York, et al.

Panasia Estates, Inc. v Hudson Insurance Company

SMITH, J. (dissenting):

In Rocanova v Equitable Life Assur. Socy. of U.S. (83 NY2d 603 [1994]) and New York Univ. v Continental Ins. Co. (87 NY2d 308 [1995]), we rejected the argument that a bad faith failure by an insurer to pay a claim could, without more, justify a punitive damages award. We held that punitive damages are not available for breach of an insurance contract unless the plaintiff shows both "egregious tortious conduct" directed at the insured claimant and "a pattern of similar conduct directed at the public generally" (Rocanova, 83 NY2d at 613; see NYU, 87 NY2d at 316). Today, the majority abandons this rule, without discussing it and without acknowledging that it has done so. The majority achieves this simply by changing labels: Punitive damages are now called "consequential" damages, and a bad faith failure to pay a claim is called a "breach of the covenant of good faith and fair dealing."

I think that Rocanova and NYU were correctly decided, and that the majority makes a mistake in largely nullifying their holdings.

Underlying our refusal in Rocanova and NYU to open the door to awards of punitive damages was a recognition of the serious harm such awards can do. Punitive damages will sometimes serve to deter insurer wrongdoing and thus protect insureds from injustice, but they will do so at too great a cost. Insurers will fear that juries will view even legitimate claim denials unsympathetically, and that insurers will thus be exposed to damages without any predictable limit. This fear will inevitably lead insurers to increase their premiums -- and so will inflict a burden on every New Yorker who buys insurance.

This policy judgment was implicit in Rocanova and NYU. Not everyone agreed with it. The Appellate Division majority in Acquista v New York Life Ins. Co. (285 AD2d 73, 78 [1st Dept 2001]) hardly concealed its disagreement: "It is correct that, to date, this State has maintained the traditional view . . . [citing Rocanova and NYU]. Yet, for some time, courts and commentators around the country have increasingly acknowledged that a fundamental injustice may result . . . ." The Acquista court found a way to avoid what it thought an injustice: award "consequential," not punitive damages. Acquista adopted the rule of some sister-state decisions, notably Beck v Farmers Ins. Exch. (701 P.2d 795 [Utah 1985]), that an insurer that denies a claim in bad faith becomes liable for consequential damages beyond the policy limits (285 A2d at 80-81). With less frankness than the

Acquista court -- indeed, without even citing either Rocanova or Acquista -- the majority here reaches the same result.

The "consequential" damages authorized by the majority, though remedial in form, are obviously punitive in fact. They are not triggered, as true consequential damages are, simply by a breach of contract, but only by a breach committed in bad faith. The majority never explains why this should be true, but the explanation is self-evident: the purpose of the damages the majority authorizes can only be to punish wrongdoers and deter future wrongdoing. They have nothing to do with consequential damages, or with the covenant of good faith and fair dealing, as those terms are ordinarily understood.

The whole idea of "consequential damages" is out of place in a suit against an insurer that has failed to pay a claim -- or, indeed, in any case where the obligation breached is merely one to pay money. Consequential damages are a means of measuring the harm done when a party fails in some non-monetary performance -- say, the transportation of a broken mill shaft (Hadley v Baxendale, 9 Ex 341 [1854]) or the construction of a football stadium (Kenford Co. v County of Erie, 73 NY2d 312 [1989]). In such cases, where there is no agreement on what money will be paid in the event of a breach, a court must try to decide what damages the parties contemplated -- what damages they would have agreed to had they considered the question when the contract was signed (Kenford, 73 NY2d at 320). But in insurance contracts or other contracts for the payment of money, the parties have already told us what damages they contemplated; in the case of insurance, it is payment equal to the losses covered by the policy, up to the policy limits. There is no occasion for a Kenford analysis.

Nor could such an analysis, done in the way Kenford requires, support the results the majority reaches in these two cases. Under Kenford, the premise of consequential damages awards is that they effectuate the parties' presumed intentions at the time of contracting: "the commonsense rule to apply is to consider what the parties would have concluded had they considered the subject" (Kenford, 73 NY2d at 320 [emphasis in original]). Can anyone seriously believe that the parties in these cases would, if they had "considered the subject," have contracted for the results reached here? Imagine the dialogue. Applicant for insurance: "Suppose you refuse, in bad faith, to pay a claim. Will you agree to be liable for the consequences, including lost business, without regard to the policy limits?" Insurance company: "Oh, sure. Sorry, we forgot to put that in the policy."

The majority also departs from the established understanding of the "covenant of good faith and fair dealing" -- thus obscuring the fact that the predicate for "consequential" damages here is exactly the same conduct, bad faith failure to pay claims, that we refused to make a predicate for punitive damages in Rocanova and NYU. Ordinarily, the covenant of good faith and fair dealing is breached where a party has complied with the literal terms of the contract, but has done so in a way that undermines the purpose of the contract and deprives the other party of the benefit of the bargain (e.g., 511 West 232nd Owners Corp. v Jennifer Realty Co., 98 NY2d 144 [2002]). Here, plaintiffs allege that defendants breached, in bad faith, the express terms of the policies, by refusing to pay for the losses the policies covered. There is no need for resort to the implied covenant of good faith, and this is the first time, as far as I know, that we have relied on that implied covenant to condemn the bad faith breach of an express promise.

These two conceptual errors -- the misuse of the terms "consequential damages" and "covenant of good faith" -- are not the only ones in the majority opinions. The Bi-Economy opinion seems fundamentally to misunderstand the purpose of business interruption insurance -- which is to compensate the insured for a business interruption that has already occurred, not to prevent one from occurring (see Bi-Economy majority op at 8-9). If the insured's business is never interrupted, there can be no claim under a business interruption policy. This error seems unimportant, however, for the majority's discussion of business interruption insurance is apparently extraneous to its holding. The Panasia case involves no business interruption coverage -- yet the majority upholds the legal sufficiency of Panasia's claim for consequential damages on the basis of a simple citation to Bi-Economy (Panasia majority op at 3-4).

The majority's bad policy choice is more important than the flaws in its reasoning. This attempt to punish unscrupulous insurers will undoubtedly lead to the punishment of many honest ones. Under today's opinions, juries will 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. All these very difficult, often nearly unanswerable, questions will be put to jurors who will usually know little of the realities of either the insured's or the insurer's business. The jurors will no doubt do their best, but it is not hard to predict where their sympathies will lie.

The result of the uncertainty and error that the majority's opinions will generate can only be an increase in insurance premiums. That is the real "consequential damage" flowing from today's holdings.

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Order affirmed, with costs, and certified question answered in the affirmative. Opinion by Judge Pigott. Chief Judge Kaye and Judges Ciparick, Graffeo and Jones concur. Judge Smith dissents in an opinion in which Judge Read concurs.

Decided February 19, 2008