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Insurance Bad Faith

Why Sue For Bad Faith When Consequential Damages Are Available?

by
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Commentary

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I. Introduction

Bad faith aside, insurers often assume a claim's "total" exposure under the insurance contract is the policy's limit. Courts traditionally allow insureds to recover contractual damages based on the limit, plus legal interest. However, a new trend is emerging in some jurisdictions. This trend — the excess damages approach — expands the insured's available damages in first-party breach of contract actions. It permits insureds to sue for "extra" consequential damages above and beyond the policy limit. The typical lawsuit under the excess damages approach is not complex or ingenious by any means. The insured alleges the insurer breached the contract when it denied the claim or delayed payment for a covered loss. According to the insured, the insurer's actions during the claims process (i.e., denial or delayed payment) caused it to incur a "laundry list" of consequential damages. These alleged consequential damages clearly exceed the policy's limit, but the insured sues for them anyway. Insurers handling first-party breach of contract claims must therefore anticipate exposure for consequential damages that may result from coverage denials or delayed payment to the insured.

Consequential damages are not direct damages. Rather, they result indirectly as a consequence of the loss. The term "consequential damages" is defined as "losses that do not flow directly and immediately from an injurious act, but that result *indirectly* from the act."[1] Generally, consequential damages that exceed the policy limits are more appropriately alleged in bad faith or tort causes of action, not actions for breach of contract. Several jurisdictions allow insureds to seek and recover damages beyond the policy limits under the contract. Many of these decisions award consequential damages on a factually intensive case-by-case basis without much legal explanation or guidance. However, an excess consequential damage award for the insured will likely turn on whether the court: 1) treats insurance contracts the same as any other contract; and 2) is satisfied that the damages alleged were foreseeable and contemplated by the parties.

This article will first identify the emergence of excess consequential damage recoveries in first-party breach of contract actions. Second, it will analyze how courts justify and award consequential damages by applying the "foreseeability" standard. Third, it will argue that insurance contracts are contracts to pay money distinct from performance contracts. Lastly, it will advocate that courts must adhere to a strict "policy limits" approach. Otherwise, the real danger for insurers is that they may be exposed to damages that, arguably, are not foreseeable or contemplated at all. Courts should prevent "extra" consequential damage recoveries in breach of contract actions. "Extracontractual" damages are extra; and therefore, should be limited to bad faith and tort actions.

II. Face Amount Or Expanded Contractual Recovery

Over the last four decades, legal writers have argued a lot over consequential damages. The competing arguments

sometimes confuse contract and tort law. But one thoughtful discussion predicted it was only a matter of time before excess damages beyond the policy limits would be available to first-party insureds nationwide.[2] The prediction is now a reality in several jurisdictions. In these jurisdictions, insurers cannot guarantee that their damage exposure for breach of contract will stop at the policy limits — end of story.[3] Instead, some insureds are finding a more successful path to excess recovery. Insureds are suing insurers under the insurance contract, demanding consequential damages beyond the contract's face amount. And they do it without any allegation of bad faith. The "consequential damage" decisions present two very different and distinct views.

A. Limiting Damages To The Policy Limits Plus Legal Interest

Every policy contains some form of payment limitation clause. Most limitation clauses assert something like this: *The most we will pay for loss in any one occurrence is the applicable Limit of Insurance shown in the Declarations.* So, if the policy limit is $1 million, the insured's damages for the loss should not exceed $1 million, plus applicable legal interest.[4] Traditionally, this amount will determine the insurer's maximum exposure, aside from prejudgment interest.[5] Unfortunately, policy limits are not always the maximum recoverable damages. Some courts do not enforce policy limitation clauses when an insured demands consequential damages that are really extracontractual.

Whether consequential damages are recoverable often depends on whether a jurisdiction recognizes the existence of a bad faith remedy.[6] The decision in *Anderson v. Georgia Farm Bureau Mut. Ins. Co.*[7] illustrates this point. A fire destroyed an insured's building and all personal property inside the building. The policy limited building coverage to $45,000 with no personal property coverage. After the fire, the insurer paid the $45,000 building limit. After accepting payment, the insured sued the insurer and its agents in tort. The insured requested damages for living expenses incurred after the fire, bad faith and various consequential damages. The consequential damages focused on the insurer's alleged delay in responding to the claim. The trial court ultimately granted the insurer summary judgment. The appellate court affirmed and held that consequential damages were not available for the insurer's delay in responding to the claim. The exclusive remedy available to the insured under Georgia law was through Georgia's bad faith statute.[8]

B. *Hadley v. Baxendale*: The Enduring 'Foreseeability' Requirement

Several jurisdictions conclude that the policy limits and coverages do not represent the insured's maximum recovery. These courts allow "backdoor" extracontractual damage recoveries in breach of contract actions, relying overwhelmingly on a seminal case of contract law: *Hadley v. Baxendale*.[9] Most practitioners will recall reading *Hadley v. Baxendale* in their first-year Contracts class. No Contracts casebook would be complete without it. Interestingly, *Hadley* is a 19th century English case that American courts at all levels rely on for determining whether consequential damages are available when a party breaches a contract.[10]

Hadley involved a mill owner who contracted to purchase a new crankshaft for a steam engine at his mill. The crankshaft, which was critical to the mill's production, broke. The mill owner contracted with a company to replace it. However, the company building the new crankshaft wanted to see the old crankshaft to make sure the new one would fit into the steam engine. So the mill owner hired a company to deliver the crankshaft to the builder for inspection. The contract required a certain delivery date. Unfortunately, the delivery company failed to deliver the crankshaft on the date stated in the contract. As a result of this late delivery, the mill was forced to shut down. Predictably, the mill owner lost business profits. The owner sued the delivery company for breach of contract, seeking both direct costs caused by the late delivery as well as consequential damages resulting from the mill's shutdown and lost production.

The *Hadley* decision created the "foreseeability" standard for recovery of consequential damages. *Hadley* held that the mill owner could not recover his lost profits resulting from the late delivery. The loss was not foreseeable or within the contemplation of the parties at the time they entered into the contract. The delivery company could only be held liable for losses that are foreseeable or discussed and contemplated by the parties in advance of the contract's consummation. Thus, the *Hadley* decision stands for a simple legal proposition. A party cannot be held liable for damages it was not aware of that might be incurred if the contract is breached. United States Supreme Court Justice

Oliver Wendell Holmes applied *Hadley's* foreseeability test in *Globe Refining Co. v. Landa Cotton Oil Co.*[11] That decision denied consequential damages for a corporation's failure to deliver ten tanks of crude oil. The foreseeability standard is also codified in Section 351 of the Restatement (Second) of Contracts. The Restatement provision limits a party from recovering damages that the breaching party had no reason to foresee when the contract was made.[12] Moreover, when evaluating "foreseeability," some courts do not require that the parties contemplate the precise damages which occurred so long as the actual consequences are reasonably expected to flow from the breach.[13] Foreseeability appears simple in theory.

Hadley's rationale is relevant in first-party breach of contract cases too. In a minority of jurisdictions, several courts reject the notion that policy limits define recoverable damages. These courts expand recoverable damages beyond the contract, even when the damages alleged are not really foreseeable. Moreover, these courts seem to abandon the policy limits, plus interest view. Instead, these courts opt for a more relaxed "foreseeability" analysis — an analysis that is unnecessary and not applicable to insurance contracts. This is extremely dangerous for insurers because there is no real boundary for the insured's purported consequential damages. An infinite number of "so called" consequences could feasibly flow from an insurer's alleged breach.

C. Allowing Recovery For Consequential Damages

Applying *Hadley* principles (i.e., "foreseeability" and "contemplation of the parties"), several jurisdictions have abandoned the traditional view that policy limits define maximum recovery. By 2001, at least six states allowed insureds to recover foreseeable money damages in excess of the policy's limit in first-party breach of contract cases.[14] These states split the insurer's potential liability in two parts. The policy limits only define the insurer's liability for performance of the insurance contract. However, policy limits do <u>not</u> necessarily define the amount the insurer may be liable for any damages caused directly or indirectly by the insurer's breach. Damages for the breach are separate, and distinct, from damages for performance. For example, in *Lawton v. Great Southwest Fire Ins. Co.*,[15] the New Hampshire Supreme Court allowed an insured to recover consequential damages for loss of business opportunity, damage to professional reputation, and emotional distress related to a fire loss to its commercial building. The *Lawton* decision emphasized the distinction between damages recoverable for failure to *perform* the insurance contract and damages caused by the insurer's *breach* of the insurance contract. In *Beck v. Farmers Ins. Exchange*,[16] the Utah Supreme Court made the same point, explaining that damages recoverable for breach of contract include both general damages (i.e., those flowing naturally from the breach) <u>and</u> consequential damages (i.e., reasonably foreseeable or within the contemplation of the parties at the time the parties enter into the contract).[17]

Eight years after *Beck*, the New Jersey Supreme Court in *Pickett v. Lloyd's*[18] concluded that consequential damages were recoverable in a first-party breach of contract action. In *Pickett*, the insured was a seniority status truck driver with thirty-seven years experience hauling freight. An automobile collision completely destroyed the insured's Mack tractor-trailer truck. A physical-damage policy covered the truck with a $30,000 limit. After the accident, the insured submitted his property damage claim to the insurer. He could not return to work without the truck. A series of delays and blunders by the insurer in handling the claim eventually led to the insured losing his seniority status. The insured sued the insurer, alleging negligent handling of his insurance claim, breach of the insurance contract, and unfair and deceptive practices. The insured sought consequential damages related to his loss of income and loss of seniority. The case proceeded to trial.

At trial, a jury awarded the insured $70,000 in damages despite the $30,000 policy limit. The insurer appealed, but the appellate court affirmed the damage award. The New Jersey Supreme Court also affirmed the award, holding that liability may be imposed for consequential economic losses fairly within the contemplation of the insurer.[19] Under these facts, it was foreseeable that a truck driver in this situation might lose an economic advantage like his seniority entitlement.[20] The insured recovered his consequential damages, even though those damages clearly exceeded the policy limit.

Similarly, Indiana courts allowed excess consequential damages beyond the policy limits in a series of property damage cases.[21] In these decisions, the courts did not focus on the insurer's motivation for delaying its payment. Motivation is irrelevant.[22] The economic consequence itself stemming from the insurer's failure to pay

is more important. A failure to pay or any delayed payment, whether as a result of good or bad faith, will undoubtedly result in the failure of the owner's business. Without the payment, the owner cannot generate income to pay his bills.[23] This rationale suggests that any consequential damages stemming from the loss are foreseeable — even those damages that exceed the policy limits.

III. New York Developments

New York is the latest state to permit recovery of consequential damages beyond the policy limits.[24] However, the evolution of consequential damages in New York jurisprudence is fraught with some level of inconsistency. At one time, New York law reflected decisions that dismissed consequential damage claims that were speculative[25] or in excess of the contemplated policy limits.[26] In 2008 the tide inexplicably turned when the New York Court of Appeals[27] decided two cases on the same day. Both cases involved the specific issue of whether consequential damages beyond the policy limits are available in first-party breach of contract cases for an insurer's breach of the implied covenant of good faith and fair dealing.[28] Each case refused to limit maximum recovery at the policy limit. Each case refused to treat a "consequential loss" exclusion as a complete bar to "consequential damages." And each case relied on the "foreseeability" standard to justify its conclusion. These two decisions essentially set the stage for insureds to argue in future cases that policy limits, plus interest, may not be all that is recoverable in first-party breach of contract cases.

In *Bi-Economy Market, Inc. v. Harleysville Ins. Co. of New York*,[29] New York's highest court held that an insured may assert a claim for consequential damages for an insurer's breach of its covenant of good faith and fair dealing. More importantly, those damages may exceed the policy's limits. The insured property was a family-owned wholesale and retail meat market. A major fire caused a complete food inventory loss and heavy structural damage to the building and business-related equipment. A "Deluxe Business Owners" policy provided: 1) replacement cost coverage on the building; 2) business property loss coverage on the contents; and 3) business interruption coverage for lost business income. The policy specifically stated that the insurer would pay for the actual loss of Business Income sustained due to the necessary suspension of business operations during the period of restoration.[30]

After the fire, the insured submitted a damage claim to its insurer which included lost business income. The insurer disputed the actual damages, but made an advance payment of $163,161.92. Although the policy provided coverage for 12 full months of business income, the insurer never offered to pay more than 7 months worth. The parties participated in pre-suit alternative dispute resolution and the insured was awarded an additional sum of $244,019.88. After obtaining this award, the insured sued, alleging causes of action for bad faith claims handling, tortuous interference with business relations and breach of contract. For its damages, the insured requested consequential damages for "the complete demise of its business operation in an amount to be proved at trial."[31]

Basically, the insured alleged that the insurer did two things wrong. First, it delayed payment for building and business property damage. Secondly, it failed to timely pay the full amount of the insured's business income loss. The insured claimed the insurer's breach of contract caused its business to collapse and that collapse was reasonably foreseeable and contemplated by the parties at the time of contracting.[32]

At the trial court level, the insured defended on grounds that the contract excluded consequential damages and eventually moved for partial summary judgment on the breach of contract count. The insurer relied on a policy provision that specifically excluded coverage for "consequential loss." The trial court granted partial summary judgment in favor of the insurer. The appellate court affirmed. However, New York's highest court reversed the order granting partial summary judgment, concluding that the trial court should not have dismissed the insured's breach of contract action.

On the issue of consequential damages, the decision directs courts to 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."[33] This is a longer, and less concise, foreseeability analysis. The court did clarify however that "proof of consequential damages cannot be speculative or conjectural."[34] In reaching its decision, the court found it persuasive to look at the purpose behind business interruption coverage. That particular type of coverage ensures the financial support necessary for the

insured to sustain its business operation in case a disaster occurs. Without the disputed insurance proceeds, Bi-Economy, like many other businesses, would lack the resources to continue its business operations.[35] The "very purpose of business interruption coverage would have made [the insurer] aware that, if it breached its obligations under the contract to investigate in good faith and pay covered claims, it would have to respond in damages to Bi-Economy for the loss of its business as a result of the breach."[36] Imagine the impact this holding could have on prolonged and expensive business interruption claims related to Hurricane Sandy's wrath.

It is tempting for defense practitioners to read *Bi-Economy's* holding narrowly and argue to courts that it only applies to business interruption losses. However, any narrow interpretation argument available in theory was completely undermined by another case decided on the same day as *Bi-Economy*. That case did not involve a business interruption claim.

Panasia Estates Inc. v. Hudson Ins. Co.[37] presented a slightly different set of facts and argument, but the court reached the same legal conclusion as it did in *Bi-Economy*. Consequential damages in excess of policy limits are available for breach of the implied covenant of good faith and fair dealing. In *Panasia*, an insured building owner sued its insurer for breach of contract when the building suffered water damage during renovations. The insured alleged that the insurer: 1) failed to properly investigate the loss; and 2) improperly denied coverage under a "Builders' Risk" policy. During the building's renovation, it was opened up to perform construction work. While open, bad weather and rain caused extensive damage. After conducting its investigation, the insurer denied coverage. The insurer concluded the loss was caused by repeated water infiltration over time and wear and tear — causes excluded by the policy. The insured sued for breach of contract, requesting both direct and consequential damages stemming from the insurer's alleged breach.[38]

The insurer moved for summary judgment, requesting dismissal of the insured's bad faith allegations and requests for consequential, extra-contractual, incidental damages and attorney's fees. The insurer also argued, *inter alia*, that the insured's consequential damages were barred because the policy contained an exclusion for "[a]ny other consequential loss."[39] The trial court denied the insurer's motion to dismiss. The appellate court affirmed the dismissal and made two separate findings. Like *Bi-Economy*, it stated the insured could indeed recover "foreseeable damages" beyond the policy limits for the insurer's "breach of a duty to investigate, bargain for and settle claims in good faith."[40] Also, the "consequential loss" exclusion did not apply to "consequential damages" because the two were not synonymous.[41]

New York's highest court agreed that the consequential loss exclusion did not apply to bar coverage. However, on the main issue of whether the insured could recover consequential damages beyond policy limits, the court remanded the case back to the lower court to determine whether the specific damages were "foreseeable."[42] The *Panasia* decision ultimately agrees with *Bi-Economy's* holding that consequential damages are recoverable, but left the "foreseeability" issue up to the lower court to develop more fully on remand.

A. Dissent: 'Punitive Damages Are Now Called Consequential Damages And Bad Faith Is Called Breach Of The Covenant Of Good Faith And Fair Dealing.'

Judge Smith's practical and concise dissent in *Bi-Economy*[43] focuses on several important legal propositions. First, an insurance contract is a contract to pay money. Second, insurance contracts are different than performance contracts — a fact some courts conflate or overlook.[44] Third, breach of the implied covenant of good faith and fair dealing does not automatically trigger bad faith, as the majority suggests. On this point, Judge Smith recognizes the often overlooked distinction. An insurer may deny a claim in good faith without ever breaching the contract or committing a bad faith tort. When an insurer is wrong on coverage, it is not necessarily bad faith, but rather, a good faith mistake. Fourth, consequential damages are not punitive damages. Consequential damages do not punish, they compensate.

Judge Smith's artfully-worded dissent casts doubt on the majority's reasoning and directly challenges its conclusions. According to him, there is a difference between an obligation to pay money and the non-monetary performance of an act (i.e., transporting a broken mill shaft, delivering wheat or constructing a football stadium).[45] Instead of blindly adopting *Hadley* and the foreseeability standard, he applies the policy limits. His straightforward dissent underscores the fundamental differences

between insurance contracts and performance contracts. A court does not need to determine damages with any foreseeability analysis if it applies the policy limits. There is nothing for the parties to contemplate when the contract is for payment of money, as opposed to performance. When the contract involves insurance and the payment of money, the parties already contemplated, agreed to, and accepted the available damages. The parties know that any future payment for a covered loss may exist "up to the policy limits."[46] Judge Smith illustrates this point through an imaginary, yet absurd, conversation:

> 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."[47]

Judge Smith accuses the majority of transforming "punitive damages" into "consequential damages."[48] The consequential damages authorized by the majority are "remedial in form," but "punitive in fact."[49] He astutely points out that punitive damages, by design, are intended to penalize bad behavior. The mere threat of punitive damages will often deter bad faith conduct. But interestingly, Judge Smith emphasizes a more practical argument than just the mere transformation of damages. He suggests that "[p]unitive damages will sometimes serve to deter insurer wrongdoing and thus protect insureds from injustice, but they will do so at too great a cost."[50] He predicts that juries will view even legitimate claim denials unsympathetically; and therefore, insurers will be exposed to damages without any predictable limit.[51] Fear alone "will inevitably lead insurers to increase their premiums."[52] This fear will inflict a heavier burden on anyone who buys insurance. In the end, all insureds will pay more to off-set the exposure of limitless consequential damage claims.

B. Recent Case Developments Since *Bi-Economy* and *Panasia*

The *Bi-Economy* and *Panasia* decisions clearly could open the gates for expansion of consequential damages in first-party breach of contract cases. New York courts seem to be adopting the logic of these two decisions for the most part, allowing insured's to plead consequential damages and survive summary judgment in a number of different factual circumstances.[53] Those courts that follow *Bi-Economy* and *Panasia* still focus first and foremost on whether the damages are "foreseeable."[54] One recent decision allowed an insured to seek consequential damages for interest paid on a loan that the insured took out to cover reconstruction costs and attorney's fees associated with fire damage to the insured's property.[55]

However, several decisions distinguish the holdings of *Bi-Economy* and *Panasia*.[56] At least one federal appellate opinion, applying New York law in a diversity action, concluded an insured could not recover consequential damages for bad faith under a breach of contract claim where the insurer's breaches "were made in good faith and without malice."[57]

Perhaps the most interesting discussion is the *Woodworth v. Erie Ins. Co.*[58] decision. In *Woodworth*, the insured property was completely destroyed when a defective water heater exploded, causing a fire. The insurer paid the insured $308,183 for actual cash value damages, $165,750 for the property contents (the policy limit) and $29,414.04 for ten months worth of living expenses. The insureds disputed the actual cash value damages, contending that the insurer underpaid by $145,501. The insureds further argued that they were entitled to all living expenses incurred to date beyond the 12-month policy limit. In short, the insureds claimed that the insurer breached the policy by failing to pay them the loss' correct actual cash value. This failure to pay prevented the insureds from rebuilding their home, which, in turn, caused them to incur additional living expenses beyond the 12-month deadline in the policy.[59] The court indicated that the insureds could pursue consequential damages under *Bi-Economy*.[60] However, in an interesting twist, the court dismissed the additional living expenses portion of the claim because the complaint failed to state a claim for consequential damages. The court granted the insurer summary judgment on any portion of the claim seeking damages for additional living expenses that exceeded the policy's twelve month limit.[61]

Fortunately, with the exception of the few jurisdictions that already do allow excess damages beyond the limits, most jurisdictions are not so quick to follow *Bi-Economy* and *Panasia*. However, insurers must remain cognizant that it is still quite early (and probably too early) to predict how various courts will approach and decide this issue in the future. Hopefully, those jurisdictions that apply policy limits now will continue to adhere to that disciplined view.

IV. Insurance Contracts Are Different

Insurance contracts are different from other contracts, including performance contracts. Insurance policies are traditionally regarded as contracts to pay money; and therefore, damages for a policy breach are limited generally to the amount of the policy plus interest.[62] There is a good reason for this. Insurance contracts do not have the consequential damage clause contained in most performance contracts. Moreover, most insurance contracts only cover "direct" damages caused by a fortuitous loss or accident. As discussed above, consequential damages are not direct damages. There is also no specific timeframe for when policy proceeds must be paid. This is different from most performance contracts, which often state when performance is due. Lastly, there is very little, if any, bargaining or negotiation at all regarding the policy terms. The insured can either "take it or leave it." When the insured takes it, he or she accepts all terms of the policy. This acceptance includes a stated policy limit. However, for courts to suggest that proceeds beyond the limits are still available promotes a "backdoor" bad faith recovery. If insureds are always permitted to "backdoor" extra damages under the guise of breach of contract or breach of the covenant of fair dealing, what is the point of even having a policy limit?

Courts that permit extracontractual recoveries under the contract are overlooking the distinction between the insurance contract and the performance contract. Because the vast majority of courts apply *Hadley's* foreseeability standard, many insureds see an opportunity. That opportunity means trying to recover consequential damages under the insurance contract for what really amounts to classic bad faith conduct (i.e. improper claim handling, delayed investigation and willful failure to pay damages purportedly owed). The lasting legacy of *Hadley* in American jurisprudence is undoubtedly remarkable. However, the foreseeability standard it created provides no ascertainable limit in first-party breach of contract cases.

The legal nuance that distinguishes a breach of contract from bad faith is also important. Unlike bad faith damages which arise from a tort (i.e. some action or inaction by the insurer), consequential damages are purely contractual. Unfortunately, some courts across the country are forgetting the difference. In theory, consequential damages are supposed to return the non-breaching party back to the position it would have been in had the contract been performed. Judge Smith's dissent in *Bi-Economy* is absolutely right. Courts should reject turning consequential damages into punitive-type damages. Consequential damages are not punitive because they are not intended to deter future conduct. Bad faith "extracontractual" damages, unlike consequential damages, deter future bad faith conduct (i.e. excessive claim delay and improper failure to pay).

V. Conclusion

There is obvious tension among jurisdictions regarding whether consequential damages are recoverable beyond the policy limits in first-party breach of contract actions. The legal arguments however are relatively consistent from insureds and insurers alike. Insureds argue that all consequential damages, if foreseeable, are fair game regardless of the stated policy limit. Insurance contracts, they protest, are just like any other type of contract, including performance contracts. Insurers argue that consequential damages beyond the policy limits are "extra" or "special" damages, which are not recoverable in pure breach of contract actions. The argument by insurers is simple and direct. Allowing an insured to recover consequential damages above the policy limits in a breach of contract action constitutes a "backdoor," "end-round," and "extra" bad faith — type recovery. In those jurisdictions that do not recognize bad faith, the cause of action should come from the legislature, not the insurance contract.

Insurers should be aware that policy limits may not always define their maximum exposure. Several major jurisdictions have already concluded that consequential damages are available without bad faith. More jurisdictions may follow this rationale in the future. The reality

is that the policy limits may not always serve as the definitive payment ceiling. Potentially looming around the corner of every major property damage claim is an infinite number and type of purported "consequential damages," especially if the jurisdiction is quick to apply *Hadley* principles to the insurance contract. Consequential damages turn into an unpredictable scenario where the insured asserts: "You delayed or failed to pay me, and as a consequence I incurred x, y, or z expense." The possibilities are really limitless. However, policy limits appropriately reign in the insured's recoverable damages. Bad faith aside, courts should lock the "backdoor" when the damages sought by insureds are contractual. In such cases, the insured should only be able to recover, at maximum, the damages available under the insurance contract: the limits.

Endnotes

1. *Black's Law Dictionary* (7th ed. 1999).

2. Phyllis Savage, *The Availability of Excess Damages for Wrongful Refusal To Honor First Party Insurance Claims-An Emerging Trend*, 45 Fordham L. Rev. 164 (1976).

3. Courts in California were among the first to allow excess damage judgments above the policy limits in first party insurance contracts for breach of the implied duty of good faith and fair dealing. The important nuance is that the cause of action was a tort. *See Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973)(allowing damages for severe emotional distress where insured sustained property damage).

4. *See Harriman v. Norfolk & Dedham Mutual Fire Ins. Co.*, 568 N.Y.S.2d 820 (N.Y. 2nd Dept. 1991)(insurer's liability is limited to face amount of policy, plus appropriate interest, and dismissing insured's consequential damages as too speculative and remote); *Renfroe v. Preferred Risk Mut. Ins. Co.*, 296 F. Supp. 1137 (D.C. Okl. 1969)(barring damages for insurer's allegedly willful refusal to pay claims because a breach of obligation to pay money is limited by the amount due by the policy, with interest).

5. One counterargument suggested by insureds is that an insurer may have no incentive to settle expeditiously when it knows from the outset of the claim that its liability exposure will always be limited to the policy limits. The criticism to the policy limits view is that the insurer has nothing to lose by contesting every claim.

6. Most states recognize bad faith causes of action as either a common law or statutory right. At least twenty-five states have judicially adopted the first-party bad faith tort: Alabama, Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Idaho, Indiana, Iowa, Kentucky, Mississippi, Montana, Nebraska, Nevada, New Mexico, North Dakota, Ohio, Oklahoma, Rhode Island, South Carolina, South Dakota, Texas, Wisconsin, and Wyoming. *See Acquista v. N.Y. Life Ins. Co.*, 730 N.Y.S.2d 272, 276-277 (N.Y. 1st Dept. 2001); *See also*, John Bauco, *Acquista v. New York Life Insurance Company: Consequential Damages, Emotional Distress, and Protecting the Insured and the Insurer*, 76 St. John's L. Rev. 201, 202, fn. 4 (2002). Some states like Florida, Georgia, Louisiana, Pennsylvania, Texas and Washington (just to name a few) have bad faith statutes. For example, in Florida, an insurer may be held liable for extracontractual bad faith damages where it does "not attempt in good faith to settle claims, when under all the circumstances it could and should have done so, had it acted fairly and honestly towards its insured and with due regard for her or his interests." Fla. Stat. § 624.155(1). However, Florida does not recognize a claim for breach of the implied warranty of good faith and fair dealing based on the insurer's failure to investigate the claim within a reasonable period of time. *See QBE Ins. Corp. v. Chalfonte Condo. Apt. Ass'n, Inc.*, 94 So. 3d 541 (Fla. 2012).

7. 566 S.E.2d 342 (Ga. App. 2002).

8. *Id.* at 345.

9. 156 Eng. Rep. 145 (1854).

10. Thomas A. Diamond and Howard Foss, *Consequential Damages for Commercial Loss: An Alternative to Hadley v. Baxendale*, 63 Fordham L. Rev. 665 (1994)(noting that the state supreme courts of 43 states cite the case with approval). *See also*, *Primrose v. Western Union Tel. Co.*, 154 U.S. 1 (1894) (discussing *Hadley* as the standard for a jury to estimate the damages caused by a breach of contract).

11. 190 U.S. 540 (1903)(holding transportation charges and damage for loss of use of tanks in breach of oil contract were not recoverable damages and discussing that the consequences must be in the contemplation of the parties at the time of the making of the contract).

12. Restatement (Second) of Contracts, § 351(1) (1981) ("Damages are not recoverable for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made.").

13. *See, e.g.*, *T.D.S. Inc. v. Shelby Mut. Ins. Co.*, 760 F.2d 1520, 1532 n. 11 (11th Cir. 1985).

14. *See Acquista*, 730 N.Y.S.2d at 277 (listing Delaware, Maine, New Hampshire, New Jersey, Utah, and West Virginia, but failing to list Indiana); *See, e.g.*, *Miller v. Fluharty*, 500 S.E. 2d 310 (W. Va. 1997)(excess recovery of consequential damages in addition to the full policy limit allowed after insurer did not conduct prompt, thorough investigation of insured's claim for underinsured motorist benefits).

15. 392 A.2d 576 (N.H. 1978).

16. 701 P.2d 795 (Utah 1985).

17. *Id.* at 801.

18. 621 A.2d 445 (N.J. 1993).

19. *Id.* at 458.

20. *Id.* at 457.

21. *See, e.g.*, *Indiana Ins. Co. v. Plummer Power Mower & Tool Rental, Inc.*, 590 N.E.2d 1085 (Ind. App. 1992)(award of consequential damages for explosion and fire to commercial building could exceed policy limits and insureds were not required to show insurer acted in bad faith to recover consequential damages); *Rockford Mut. Ins. Co. v. Pirtle*, 911 N.E.2d 60 (Ind. App. 2010)(affirming jury verdict awarding damages on breach of contract claim and separate consequential damages in excess of the policy limits and explaining that the consequential damages were reasonably foreseeable); *Lee v. The Home Indemnity Co.*, 1994 WL 16495091 (S.D. Ind., Dec. 15, 1994)(denying insurers motion for summary judgment with respect to consequential damages related to fire damage where insured claimed excess damages for loss of rent and use of property).

22. *See Rockford Mut. Ins. Co.* at 68.

23. *Id.* at 68, quoting *Plummer*, 590 N.E.2d at 1092.

24. *See Bi-Economy Market, Inc. v. Harleysville Ins. Co. of New York*, 856 N.Y.S.2d 505 (2008); *Panasia Estates Inc. v. Hudson Ins. Co.*, 886 N.E.2d 135 (N.Y. 2008).

25. *See Harriman v. Norfolk & Dedham Mutual Fire Ins. Co.*, 568 N.Y.S.2d 820 (N.Y. 2nd Dept. 1991).

26. *See Grand Metro Transit Mix Corp. v. Michigan Mut. Ins. Co.*, 652 N.Y.S.2d 691 (N.Y. 2nd Dept. 1996)(dismissing insured's complaint for consequential damages under policy covering property and business interruption loss due to fire and finding that the parties did not specifically contemplate and contract for consequential damages beyond the business interruption endorsement).

27. The New York Court of Appeals is New York's highest court.

28. In addition to tort and bad faith remedies, insureds often argue that implicit in every contract is an implied covenant of good faith and fair dealing.

29. 856 N.Y.S.2d 505 (2008).

30. The policy defined "period of restoration" as beginning with the date of direct physical loss or damage and ending on the date when the property should be repaired, rebuilt or replaced with reasonable speed and similar quality.

31. 856 N.Y.S.2d at 191.

32. *Id.*

33. *Id.* at 192, quoting *Globe Refining Co. v. Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903).

34. *Id.*

35. *Id.* at 194.

36. *Id.* at 195. One case comment characterizes the *Bi-Economy* decision as an expansion of general contract remedies that shift away from the more rigid *Hadley* foreseeability restrictions. *See Contract Law-Consequential Damages-New York Court of Appeals Holds that Insurers May Be Liable For Consequential Damages-BI-Economy Market, Inc.v. Harleysville Insurance Co.*, 122 Harv. L. Rev. 998 (2009).

37. 886 N.E.2d 135 (N.Y. 2008).

38. *Id.* at 136.

39. *Id.*

40. *Id.* at 136-137.

41. *Id.* at 137.

42. *Id.*

43. This dissent applies directly to *Panasia* as well.

44. *See, e.g., Beck v. Farmer's Ins. Exchange*, 701 P.2d 795, 800 (Utah 1985)("there is no sound theoretical difference between a first-party insurance contract and any other contract, at least no difference that justifies permitting punitive damages for the breach of one and not the other").

45. The counter by insureds is that payment by the insurer equates to performance of the insurance contract.

46. 856 N.Y.S.2d at 512.

47. *Id.*

48. *Id.* at 511.

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

53. *See Harriprashad v. Metropolitan Prop. & Cas. Ins. Co.*, 2011 WL 6337699 (E.D.N.Y., Nov. 17, 2011) (insured permitted to amend complaint to add claims for "special damages" to compensate insured for fire that caused property to be uninhabitable, city environmental fines, costs related to legal suits brought against the insured and charges concerning demolition costs imposed by the city); *Runge v. Erie Ins. Corp.*, 2010 WL 5860401 (W.D.N.Y., May 24, 2010)(at pleading stage, insured adequately alleged claim for consequential damages for lost income and attorney's fees as a result of insurer's bad faith for failing to reimburse insured for replacement costs for fire damage to home); *Carden v. Allstate Ins. Co.*, 912 N.Y.S.2d 867(N.Y. 2010)(consequential damages for additional living expenses related to fire damage claim recoverable based on insurer's bad faith delay in settling claim where insurer initially offered $265,000 to settle, later offered $575,000, and ultimately paid the insured $832,982); *Silverman, D.M.D. v. State Farm Fire & Cas. Co.*, 867 N.Y.S.2d 881 (N.Y. 2008)(granting insured leave to add claim for consequential damages caused by insurer's allegedly excessive delay and improper denial).

54. *See Rodriguez v. Allstate Ins. Co.*, 931 N.Y.S.2d 462 (N.Y. 2011)(car payments on stolen vehicle in excess of policy limits were recoverable as foreseeable consequence of automobile insurer's alleged breach of contract).

55. *See Whiteface Real Estate Dev. & Const., LLC v. Selective Ins. Co. of Amer.*, 2010 WL 2521794 (N.D.N.Y., June 16, 2010)(rejecting insurer's argument that consequential loss exclusion barred recovery for consequential damages under Builder's Risk Policy). Similar to *Bi-Economy*, this court viewed "consequential loss" as distinct from "consequential damages."

56. *See Grinshpun v. Travelers Cas. Co. of Conn.*, 2009 WL 1025747 (N.Y. 2009); *Haym Salomon Home for the Aged, LLC v. HSB Group, Inc.*, 2010 WL 301991 (E.D.N.Y., Jan. 20, 2010); *Allegrino v. Conway E&S, Inc.*, 2010 WL 1687558 at *15 (W.D. Pa., April 26, 2010)(discussing that *Bi-Economy* did not address whether an independent adjuster could be liable for consequential damages).

57. *See Egan Marine Corp. v. Great Amer. Ins. Co. of N.Y.*, 665 F.3d 800, 813 (7th Cir. 2011)(affirming trial court).

58. 743 F. Supp. 2d 201 (W.D.N.Y. 2010).

59. *Id.* at 213.

60. *Id.* at 218.

61. *Id.* at 219.

62. Phyllis Savage, *The Availability of Excess Damages for Wrongful Refusal To Honor First Party Insurance Claims-An Emerging Trend*, 45 FORDHAM L. REV. 164 (1976). ■

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