NEW YORK COURT HOLDS THAT POLICYHOLDERS CAN RECOVER DAMAGES BEYOND THE LIMITS OF AN INSURANCE POLICY FOR BAD FAITH CLAIMS AGAINST INSURERS

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On July 5, 2001, the Appellate Division of the Supreme Court for the First Department issued a 3-2 decision in Acquista v. New York Life Insurance Company, No. 2277, 2001 WL 752640 (N.Y.A.D. 1st Dep't), that allowed a claim for consequential damages beyond the limits of the policy for a policyholder's bad faith claim against an insurer. The Court found that limiting a policyholder's recovery to the amount specified in the insurance policy may not be an adequate remedy to redress an insurer's bad faith refusal of benefits under its policy. However, the Court declined to recognize an independent tort cause of action for bad faith conduct against an insurer. This decision is a significant departure from well-established New York precedent that an insurer's failure to make payments or provide benefits in accordance with an insurance policy is remedied solely by contract damages limited to the amount of the policy plus interest.

THE LOWER COURT DECISION

The Acquista case involves a physician who sought payment after he became ill under three disability insurance policies issued to him by New York Life Insurance Company ("New York Life"), which denied coverage on the ground that plaintiff could still perform his job and thus was not "totally disabled."

Plaintiff sued, alleging that the insurer undertook a conscious campaign to delay and avoid payment of his claims while having determined at the outset that it would deny coverage. Plaintiff's complaint alleged that the insurer's conduct constituted bad faith and sought damages for emotional distress and economic and non-economic injury. The Supreme Court of New York dismissed plaintiff's cause of action for bad faith, and plaintiff appealed to the Appellate Division.

THE APPELLATE DIVISION DECISION

In the majority opinion authored by Justice David B. Saxe, and joined by Justices Angela M. Mazzarelli and Richard W. Wallach, the Appellate Division observed that New York courts historically ruled that an insurer's failure to make payments is a breach of contract, remedied exclusively by contract damages. The courts viewed insurance policies as contracts for the payment of money only and the damages available for an insurer's failure to pay was limited to the amount of the policy plus interest.

The Court noted, however, that "courts and commentators around the country have increasingly acknowledged that a fundamental injustice may result when a traditional contract analysis is applied to circumstances where insurance claims were denied despite the insurers' lack of a reasonable basis to deny them." Acquista, 2001 WL 752640 at *3. The Court found that an award of money damages equal to what the insurer was obligated to pay in the first place may not actually achieve the goal of contract damages, which is to place the plaintiff in the position he would have been in had the contract been performed. The Court stated that limiting damages to the policy limit for an insurer's bad faith failure to pay a claim might not adequately compensate a policyholder:

> [T]his concept of damages presumes that a plaintiff has access to an alternative source of funds from which to pay that which the insurer refuses to pay. This is frequently an inaccurate assumption. Additionally, an insured's inability to pay that which the insurer should be covering may result in further damages to the insured. Of course, limiting the potential damages to the policy amount also fails to address the potential for emotional distress or even further physical injury that may result where a plaintiff under the strain of serious medical problems is forced to undertake the stress of extended litigation. What is more, if statutory interest is lower than that which the insurer can earn on the sums payable, the insurer has a financial incentive to decline to cover or pay on a claim.

Id. at *4.

The Court observed that many states recognize a tort cause of action for an insurer's bad faith handling of a policyholder's claim, allowing an insured to recover compensatory tort damages.[1] The Court recognized that other states have taken a more conservative approach and

[1] The Court identified twenty-seven states that recognize a tort cause of action for bad faith against insurers: Chavers v. National Sec. Fire & Cas. Co., 405 So. 2d 1, 6 (Ala. 1981); State Farm Fire & Cas. Co. v. Nicholson, 777 P.2d 1152, 1156-1157 (Alaska 1989); Noble v. National Am. Life Ins. Co., 128 Ariz. 188, 189-190, 624 P.2d 866, 867-868 (1981); Aetna Cas. & Sur. Co. v. Broadway Arms Corp., 281 Ark. 128, 133-134, 664 S.W.2d 463, 465 (1984); Gruenberg v. Aetna Ins. Co., 9 Cal. 3d 566, 573, 510 P.2d 1032, 1037 (1973); Travelers Ins. Co. v. Savio, 706 P.2d 1258, 1271 (Colo. 1985); Buckman v. People

instead expanded the scope of contract remedies for bad faith breach of contract claims to include foreseeable money damages beyond the policy limit.[2]

The Acquista Court was unwilling to recognize a tort cause of action against insurers for bad faith as it would "constitute an extreme change in the law of [New York]." Acquista, 2001 WL 752640 at *5. Instead, the Court expanded the scope of the contract remedy for a bad faith breach of contract claim beyond the policy limit:

> [T]here is no reason to limit damages recoverable for breach of a duty to investigate, bargain, and settle claims in good faith to the amount specified in the insurance policy. Nothing inherent in the contract law approach mandates this narrow definition of recoverable damages. Although the policy limits define the amount for which the insurer may be held responsible in performing the contract, they do not define the amount for which it may be liable upon breach.

Id. The Court considered the need for an expanded form of damages to be apparent due to the "problem of dilatory tactics by insurance companies seeking to delay and avoid payment of proper claims." Id. at *6.

Express, Inc., 205 Conn. 166, 169-170, 530 A.2d 596, 599 (1987); 37 Fla. Stat. § 624 (West 2000); White v. Unigard Mut. Ins. Co., 112 Idaho 94, 99, 730 P.2d 1014, 1019 (1986); Erie Ins. Co. v. Hickman, 622 N.E.2d 515, 518-519 (Ind. 1993); Dolan v. Aid Ins. Co., 431 N.W.2d 790, 794 (Iowa 1988); Curry v. Fireman's Fund Ins. Co., 784 S.W.2d 176, 178 (Ky. 1989); State Farm Fire & Cas. Co. v. Simpson, 477 So. 2d 242, 249 (Miss. 1985); Lipinski v. Title Ins. Co., 202 Mont. 1, 14-15, 655 P.2d 970, 977 (1982); Braesch v. Union Ins. Co., 237 Neb. 44, 49-50, 464 N.W.2d 769, 773 (1991); United Fire Ins. Co. v. McClelland, 105 Nev. 504, 510-511, 780 P.2d 193, 197 (1989); State Farm Gen. Ins. Co. v. Clifton, 86 N.M. 757, 759, 527 P.2d 798, 800 (1974); Corwin Chrysler-Plymouth, Inc. v. Westchester Fire Ins. Co., 279 N.W.2d 638, 643 (N.D. 1979); Hoskins v. Aetna Life Ins. Co., 6 Ohio St. 3d 272, 275-276, 452 N.E.2d 1315, 1319 (1983); Christian v. American Home Assur. Co., 577 P.2d 899, 904 (Okla. 1978); Bibeault v. Hanover Ins. Co., 417 A.2d 313, 319 (R.I. 1980); 42 Pa. Cons. Stat. § 8371 (West 2000); Nichols v. State Farm Mut. Auto. Ins. Co., 279 S.C. 336, 340, 306 S.E.2d 616, 618-619 (1983); Champion v. U.S. Fid. & Guar. Co., 399 N.W.2d 320, 324 (S.D. 1987); Arnold v. National County Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987); Anderson v. Continental Ins. Co., 85 Wis. 2d 675, 684, 271 N.W.2d 368, 373 (1978); McCullough v. Golden Rule Ins. Co., 789 P.2d 855, 856-860 (Wyo. 1990).

[2] The Court identified six states that have adopted this expanded contract remedies approach: Pickett v. Lloyd's, 131 N.J 457, 465, 621 A.2d 445, 449 (1993); Tackett v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254, 262 (Del. 1995); Marquis v. Farm Family Mut. Ins. Co., 628 A.2d 644, 649 (Me. 1993); Lawton v. Great Southwest Fire Ins. Co., 118 N.H. 607, 614-615, 392 A.2d 576, 581-582 (1978); Beck v. Farmers Ins. Exch., 701 P.2d 795, 798-799 (Utah 1985); Hayseeds, Inc. v. State Farm Fire & Cas., 177 W. Va. 323, 352 S.E.2d 73 (1986).

THE DISSENT REFUSES TO DEPART FROM TRADITION

In an opinion authored by Justice Richard T. Andrias, and joined by Justice Peter Tom, the dissent argued that recognizing plaintiff's claim for bad faith breach of contract was an unwarranted departure from the Court of Appeal's decision in *New York University v. Continental Ins. Co.*, 639 N.Y.S.2d 283 (1995), which rejected the availability of a bad faith claim against an insurer unless an insurer's conduct was so egregious that it warranted the imposition of punitive damages. Acquista, 2001 WL 752640 at * 8. The dissent was concerned that allowing bad faith breach of contract claims in the absence of an insurer's severe misconduct would force "premature settlement of [policyholders'] claims" and "contravene an insurer's contractual right and obligation of thorough investigation." Id.

THE SIGNIFICANCE OF THE COURT'S DECISION

The Appellate Division's holding in Acquista is a significant departure from well-established insurance law in New York. Moreover, the Acquista holding does not appear to be limited to actions involving disability policies. The majority's opinion expanding damages for bad faith breach of contract claims is stated in broad terms and is arguably applicable to all types of first party insurance policies. Moreover, we expect that policyholders will argue that the holding in Acquista should also be applied to third party policies, including comprehensive general liability policies.

While obviously an intermediate court decision, the Acquista opinion is binding in the First Department and will have persuasive effect in the rest of the state. The decision is not appealable as of right, and the Court of Appeals has been strict in permitting discretionary review, granting only 5% of all motions for leave to appeal in civil cases in the year 2000. Because the Acquista decision represents a significant departure from well-established New York insurance law, however, there is likely to be some interest among the members of the Court of Appeals in granting review. On the one hand, the more conservative jurists of the Court may see Acquista as an unacceptable departure from prior precedent. Conversely, supporters of the decision could argue that it is merely a logical extension of the various damages theories applicable to traditional contract claims. New York Life is seeking leave to appeal the decision.

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If you have any questions concerning the Acquista decision or its effect on insurance contracts, please contact Barry R. Ostrager (at 212-455-2655; bostrager@stblaw.com); Mary Kay Vyskocil (at 212-455-3093; mvyskocil@stblaw.com); or Lynn K. Neuner (at 212-455-2696; lneuner@stblaw.com).

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