NEW YORK COURT OF APPEALS ROUNDUP:

CONSEQUENTIAL DAMAGES, EMPLOYMENT-AT-WILL, FINGERPRINT AND DNA TEST RESULTS

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This month we discuss two recent decisions of the Court of Appeals involving an insured's claim for consequential damages from its insurer for failure to promptly investigate and/or properly pay valid claims; a decision dismissing claims against an employer for fraudulently inducing plaintiffs to accept employment-at-will when the employees' only damages arose from their termination; and two decisions addressing when testing results are testimonial in nature and thus can only be introduced in a criminal trial by a witness subject to cross-examination. We also provide a post-script to the so-called "libel tourism" decision discussed in last month's column, *Ehrenfeld v. Mahfouz.*

Consequential Damages

Two cases posed the issue of whether consequential damages may be available on a claim for breach of an insurance contract, and the Court ruled (5-2) that they may. Judge Eugene F. Pigott, Jr. wrote the majority opinions in *Bi-Economy Market, Inc. v. Harleysville Ins. Co. of New York*, and *Panasia Estates, Inc. v. Hudson Ins. Co*. Judge Theodore T. Jones wrote a strongly worded dissenting opinion, in which Judge Susan Phillips Read joined, that was appended to both decisions.

In *Bi-Economy,* a retail market purchased commercial property insurance, including business interruption insurance. A fire destroyed the market's inventory and caused significant damage to its building and equipment. The insurer disputed the amount of actual damages claimed, initially paying a sum that was more than doubled over a year later when the parties submitted the issue to alternative dispute resolution, and offered to pay only seven months of lost business income although the policy provided for twelve months of coverage. The market never reopened. It sued the insurer for bad faith claims handling and breach of

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contract.

The Supreme Court granted the insurer partial summary judgment dismissing Bi-Economy's claim for consequential damages for the demise of its business, relying upon the policy exclusions of "consequential losses." Here, as in *Panasia*, the Court of Appeals found that consequential damages were not included within consequential losses, and thus were not expressly excluded under the policy. It then considered whether the requirements for the availability of consequential damages were present.

Consequential or "special" damages are those that do not flow directly from the breach of contract, but that are proximately caused by the breach and "within the contemplation of the parties as the probable result of a breach at the time of contracting," the Court explained. It reasoned that an insured is purchasing not just insurance coverage up to the policy's limits but also the "comfort" of knowing that it will be protected in the event of a catastrophe, and that included in the implied covenant of good faith and fair dealing is the insurer's promise to investigate in good faith and pay covered claims. In this case, when the insurer failed to act promptly and pay the claim in full, it deprived Bi-Economy of the benefit of its bargain, resulting in a loss of the business – the very risk against which business interruption insurance is intended to protect.

The Court held that when excessive delay in investigating and paying claims or improper denial of coverage causes an insured additional damages, the insurer may be held liable for those damages, and it reversed the order granting summary judgment to the insurer.

Panasia involved "builders risk" insurance, which provides coverage for damage to property undergoing renovation. The insured alleged that water damage to its building was incurred as a result of a rain storm when the roof was opened as part of a renovation. The insurer, however, declined coverage, concluding after investigation that the damage was caused by water infiltration over time due to wear and tear. While the lower courts were correct in rejecting insurer's position that consequential damages are never available for breach of an insurance contract as a matter of law, the Court of Appeals ruled, those courts had failed to consider whether the specific damages sought by the insured were "foreseeable damages as a result of [the insurer's] breach," and thus remanded the case for consideration of that issue.

In his dissent, Judge Jones accused the Court of abandoning its prior rulings that an insurer's bad faith failure to pay a claim, without more, cannot support the imposition of punitive damages. The damages authorized by the majority's holding in *Bi-Economy* were "remedial in form, [but] obviously punitive in fact," because they were triggered by the insurer's bad faith, not by its breach of the contract. Such a result has significant policy implications, the dissent maintained, because insurers will not be able to predict the damages to which they may be exposed, which will result in higher insurance premiums. Further, Judge Jones argued, consequential damages should be available to redress harm caused by failure to perform a non-monetary obligation, whereas insurance policies are contracts for the payment of

money that express by their terms the damages the parties contemplate.

Employment-at-Will/Fraudulent Inducement

The employee-at-will doctrine is alive and well in New York – indeed, it is robust.

In *Smalley v. The Dreyfus Corp.*, Chief Judge Judith S. Kaye, for a unanimous Court, reversed the order of the Appellate Division, First Department, and dismissed the complaint of five at-will employees of The Dreyfus Corporation who claimed that they had been fraudulently induced to become or remain as employees.

The employees were part of Dreyfus' Taxable Fixed Income Group ("TFIG"). They sued for breach of contract, fraud, quantum merit, and defamation following their termination. The basis of the claims was that, in agreeing to join Dreyfus and then continuing to stay with the company, they had been misled as to the intentions of Dreyfus' parent, Mellon Financial Corporation. Specifically, in January 2001 one of the plaintiffs (the director of the TFIG) asked about a rumor that Mellon had made an offer to acquire the fund management company of Standish Ayer & Woods. Dreyfus management denied the rumor. Two months later, Mellon acquired Standish. Between that time and 2004, during which period Dreyfus management repeatedly denied any plans to merge the group with Standish, the four other plaintiffs joined Dreyfus and the TFIG. In late 2004 the TGIF was merged with Standish, and in February 2005 the plaintiffs were fired. The lawsuit followed.

Each of the employees had a written agreement with Dreyfus providing that he or she was an at-will employee and could be terminated at any time, without notice.

The motion court dismissed the complaint in its entirety. The fraudulent inducement cause of action was dismissed on the basis that at-will employees cannot reasonably rely upon an employer's promise of continued employment, and that the employees did not allege injuries apart from the termination. The Appellate Division, in a 4-1 decision, affirmed the dismissal of the other claims but reinstated the fraud cause of action on the basis that plaintiffs alleged Dreyfus had made "misrepresentations of existing fact."

In reversing, the Court cited its "decades" of authority holding that, in the absence of an impermissible constitutional purpose, a statutory proscription, or an express limitation in the contract of employment, an employer's right to terminate an employment at-will, for any or no reason, cannot be impaired. In doing so, the Court discussed, without accepting or rejecting its rationale, a Second Circuit decision cited by plaintiffs, *Stewart v. Jackson & Nash*, 976 F.2d 86 (2d Cir. 1992). That case sustained a lawyer's claim against a law firm based upon its representations that, if she joined the firm, she would serve a new, large environmental law client and would head a to-be formed environmental law department. Neither inducement proved true, and she was later terminated. The Court distinguished *Stewart* on the basis that the plaintiff in that case alleged that, as a result of being thwarted in

her objective of specializing in environmental law, her career potential had been damaged, whereas the plaintiffs in the *Dreyfus* case claimed no injury separate from termination.

While courts in other states have recognized a claim of fraudulent inducement where a misrepresentations of present material fact was made upon which the plaintiff relied in accepting an offer of at-will employment, New York shows no inclination to do so.

DNA/Fingerprint Reports

In two criminal cases decided together under the caption *People v. Michael Rawlins,* the Court grappled with the question of when a report prepared by an expert is "testimonial" in nature and thus cannot be admitted unless the preparer testifies, thereby affording the defendant the opportunity to conduct a cross-examination. The Court, in an opinion by Judge Theodore T. Jones, rejected the interpretation of the seminal confrontation clause decision, *Crawford v. Washington,* 541 U.S. 36 (2004), given by some courts and advocated by Judge Susan Phillips Read in her concurring opinion – that a business record is by definition not testimonial – adopting instead a case-by-case approach.

Rawlins was convicted of robbing six stores. Latent fingerprints were lifted at each of the robbery locations. One detective, who did not testify at the trial, had prepared a report stating that fingerprints found at two of the locations matched the defendant's fingerprints, and the admission of his report as a business record was at issue on the appeal. A second detective, who testified for the defense, prepared a report stating that fingerprints found at two other locations matched the defendant's. A third detective testified for the prosecution that he had examined fingerprints from each location and determined they matched defendant's, and agreed with the conclusions of the two other detectives' reports.

Although the Court held that the first detective's report should not have been admitted into evidence, it found the error harmless in light of the third detective's testimony as to the same sets of fingerprints.

The defendant in *People v. Dwain Meekins*, was convicted of various charges, including sodomy. He challenged the admission of an independent lab report that did not attempt to link the tested semen sample with any individual's DNA, but only generated "raw data" later analyzed by others. He also challenged the admission of a letter prepared by the Division of Criminal Justice Services ("Division") that the sample had the same DNA profile as the defendant. Those two documents became part of a file that was admitted as a business record of the Medical Examiner's office. An employee of that office testified that her own analysis confirmed the DNA match.

The Court held that the independent lab report was a business record and was not testimonial, and thus was properly admitted. It found that the Division's report was testimonial and thus improperly admitted, but held the error was harmless in light of the

testimony of the Medial Examiner's employee.

In deciding these cases, the Court declined to adopt any bright-line test. The People had argued that the confrontation clause is not implicated by the admission of business records, but the majority determined such documents can be testimonial, particularly under New York's broad definition of a business record that can include the reports of law enforcement agencies. The Court also rejected the approach of some courts that whether a statement was made with the expectation it would be available at trial is determinative. Instead, the Court undertook a fact-intensive analysis of objective factors relevant to each report to evaluate whether the statements contained therein were "properly viewed as a surrogate for accusatory in-court testimony."

A common element of the reports that the Court found were erroneously admitted – the detective's fingerprint analysis in *Rawlins* and the Division's DNA analysis in *Meekins* – is that they pointed to the respective defendants as the perpetrators, unlike the lab report in *Meekins* that merely generated data without interpretation. The Court also considered that the independent DNA lab's technician would have no subjective interest in the outcome of the "objective, highly scientific" testing conducted, the results of which could prove either inculpatory or exculpatory.

While the Court declined to provide an exhaustive list of factors to be considered in evaluating "testimoniality," it did identify two important factors: whether the statement "was prepared in a manner resembling *ex parte* examination," and whether the statement accuses the defendant of wrongdoing. It seems likely that proper application of the decision's guidance will be the subject of much motion practice in criminal cases, at least in the near term.

Libel Tourism

Last month we discussed in this column the Court's decision in *Ehrenfeld v. Mahfouz*, which held that the long-arm statute did not provide a basis for asserting jurisdiction over an individual who successfully brought a libel action in another forum against a New York resident and who might seek to enforce that judgment here. The Legislature responded promptly, introducing The Libel Terrorism Protection Act that would limit the enforceability of foreign libel judgments, and provide for long-arm jurisdiction over a person who sues a New York-based publisher or author for libel in a foreign court – a provision that, if enacted, is sure to draw constitutional challenges when applied. The Advisory Committee on Civil Practice is urging the Legislature not to pass the bill.