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TITLE INSURANCE ALERT
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New York Insureds Entitled to Consequential Damages

In February 2008, the New York Court of Appeals held that when a general liability insurer's unreasonable delay in paying a first-party claim causes further loss to the insured, and where such loss was reasonably foreseeable and contemplated by the parties, the insured may recover consequential damages. The court noted that such consequential damages were recoverable (i) even in the presence of specific policy exclusions for consequential damages, and (ii) in an amount in excess of policy limits.

Generally, consequential damages are not recoverable under a title insurance policy. In fact, the title policy permits the insurer to clear title, and no loss is payable unless the effort to clear title fails and the insured suffers a loss.[1] Therefore, consequential damages incurred while the title insurer clears title are not recoverable under a title insurance policy.[2] Moreover, New York courts have previously recognized a cause of action for an insurer's breach of the duty of good faith and fair dealing under insurance and title insurance policies only in very limited circumstances. But that has now changed in the general insurance context.

The Court of Appeals' decision described below allows insureds to seek consequential damages in bad faith claims against insurers in New York when they are the result of an insurer's excessive delay or improper denial of an insurance claim. While this decision did not involve a title insurance policy, it may raise the standard of good faith and fair dealing expected of insurers in general and may open the door for consequential damages claims against title insurers based on a theory of bad faith.

The Facts

In *Bi-Economy Market Inc. v. Harleysville Insurance Co. of New York,*[3] Bi-Economy Market, a wholesale and retail meat market, suffered structural damage to its facility and a complete loss of food inventory in a major fire in December 2002. Bi-Economy had a "Deluxe Business Owner's" policy through Harleysville Insurance Company that provided replacement cost coverage on the building and contents, and business interruption insurance for up to one year from the date of the fire. Bi-Economy submitted a claim to Harleysville, but

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[1] *See Conditions & Stipulations* ¶ 9 Owner's, ¶ 8 Loan Policy, J. Bushnell Nielsen, *Title and Escrow Claims Guide* §11.2 (2007 2nd ed.).
[2] *Id.*; *see also Halfmoon Professional Offices v. American Title Ins. Co.,* 652 N.Y.S.2d 390 (3d Dep't 1997) (stating that "only the direct losses [the insured] sustained are recoverable" and holding that "damages [claimed by the insured for lost profits] are remote and consequential in nature and not covered under the title insurance contract which is in the nature of an indemnity contract requiring actual loss").
[3] 2008 NY Slip Op 1418, 2008 N.Y. LEXIS 278 (Feb. 19, 2008).

Harleysville disputed Bi-Economy's claim for actual damages. Though it eventually increased its initial claim payment following alternative dispute resolution, Harleysville would pay only seven months of lost business income, despite the fact that the policy provided such coverage for twelve months. Bi-Economy never resumed business operations following the fire.

Bi-Economy sued Harleysville for bad faith claims handling, tortious interference with business relations and breach of contract, and sought consequential damages for the "complete demise of its business operations in an amount to be proved *[sic]* at trial." Bi-Economy alleged that Harleysville improperly delayed payment for its building and lost contents damage and failed to timely pay the full amount of its business interruption claim. Bi-Economy alleged that its business collapsed as a result of Harleysville's breach, and that liability for such consequential damages was reasonably foreseeable and contemplated by the parties at the time of contracting.

The Decision

Both the New York Supreme Court and Appellate Division ruled in favor of Harleysville, holding that the insurance policy expressly excluded coverage for consequential loss and, therefore, consequential damages were not contemplated by the parties when the contract was formed. However, the Court of Appeals reversed the rulings, holding that an insured *can* assert a claim for consequential damages for bad faith even though the policy excludes consequential losses.

In breach of contract actions, "the non-breaching party may recover general damages which are the natural and probable cause of the breach." But consequential damages, which "do not so directly flow from the breach," are recoverable only where the parties reasonably contemplated such consequential damages at the time they entered into the contract. Nevertheless, the Court considered that the purpose of the business interruption coverage under Bi-Economy's policy made Harleysville aware that, if it breached its contractual obligations to investigate claims 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. Bi-Economy claimed that Harleysville had failed to promptly adjust and pay the loss, which resulted in the collapse of its business. The Court ruled that when an insured in such a situation suffers additional damages as a result of an insurer's excessive delay or improper denial, the insurer is liable for these consequential damages. Such an award, the Court said, gives the insured its "bargained for benefit" and, in contrast to a punitive damages award, is not meant to punish the insurer.

The Potential Impact of the Decision on Title Insurance

In prior cases, the Court of Appeals had allowed an insured to recover bad faith damages only where the insured could prove that the insurer had engaged in (a) "egregious tortious conduct" and (b) "a pattern of similar conduct directed at the public generally." In the Bi-Economy case, a significant majority of the Court of Appeals has essentially lowered the standard for bad faith damages in first party claims by allowing an insured to recover consequential damages where an insurer's "excessive delay" or "improper denial" of a claim causes further loss to the insured. This lowered standard for consequential damages in the general insurance context may open the door for insureds to file claims under title insurance policies based on the title insurer's breach of the implied duty of good faith and fair dealing. Such bad faith claims could seek recovery of consequential damages such as construction delays, lost rent, lost profit, diminution in value of a property during a declining market, or other types of consequential damages related to property ownership.

For more information on this issue or other title insurance matters, please contact **Arthur Jakoby at** 212.592.1438 **or ajakoby@herrick.com**.