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ACQUISTA v. NEW YORK LIFE INSURANCE COMPANY: CONSEQUENTIAL DAMAGES, EMOTIONAL DISTRESS, AND PROTECTING THE INSURED AND THE INSURER

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INTRODUCTION

When a contract is breached, the modern approach of contract law is to award money damages to the nonbreaching party commensurate with that party's expectation interest—the amount that will place the nonbreaching party in a position equal to the one it would have achieved had the breaching party fulfilled its contractual obligations.1 When an insurance company breaches an insurance contract by refusing in bad faith to pay the amount due the policyholder, courts traditionally have limited damage awards to the amount of the policy.2 A number

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1 See E. ALLAN FARNSWORTH, CONTRACTS § 12.8 (3d ed. 1999) (stating that the “basic principle for the measurement of... the injured party's expectation... [is to compensate the insured party in the] amount that will put [the injured party] in as good a position as [it] would have been in had the contract been performed”); see also JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 14.4 (4th ed. 1998) (stating that “[f]or breach of contract, the law of damages seeks to place the aggrieved party in the same economic position the aggrieved party would have attained if the contract had been performed”); Alan O. Sykes, “Bad Faith” Breach of Contract by First-Party Insurers, 25(2) J. LEGAL STUDIES 405, 408–09 (1996) (“[I]t has long been said that the usual objective of contract damages is to place the promisee in the same position that the promisee would have enjoyed had the contract been performed.”).

2 See Sykes, supra note 1, at 408 (stating that courts in the past have refused to award policyholders damages in excess of the amount specified in policy); see also
of jurisdictions and commentators have concluded, however, that when an insured proves a bad faith breach on the part of an insurance company, damage awards limited to the amount of the policy may be insufficient to satisfy the insured's expectation. Numerous state high courts have responded by recognizing a tort cause of action that policyholders may bring against insurers who breach their contracts in bad faith. This tort action allows the aggrieved party to recover punitive damages. Alternatively, a handful of states have rejected the tort action in favor of an expanded contract remedy that allows insured parties to recover consequential damages beyond the amount specified in the policy. Indeed, states that continue to limit damages to the policy amount in insurer bad faith cases are in the minority. Recently, in Acquista v. New York Life Insurance Co., the First Department of the Appellate Division of the Supreme Court of New York held that damages awarded to a policyholder for an insurance company's bad faith breach need not be limited to the

Phyllis Savage, Note, The Availability of Excess Damages for Wrongful Refusal to Honor First Party Insurance Claims—An Emerging Trend, 45 FORDHAM L. REV. 164, 167 (1976-1977) (stating that damage awards to policyholders traditionally do not exceed the policy amount because (1) such additional damages are not foreseeable by the insurance company and (2) "in a suit for money due under a contract, recovery is normally limited to the debt plus interest").

3 See Beck v. Farmers Ins. Exch., 701 P.2d 795, 801 (Utah 1985) (stating that "[nothing inherent in the contract law approach" requires the courts to limit damages recoverable for an insurance company's bad faith breach to the amount of the policy); Sykes, supra note 1, at 409 (stating that an award of money damages "at the conclusion of litigation, equal to what the insurer should have paid in the first place, fails to achieve this goal [of satisfying the insured's contractual expectation]"); Savage, supra note 2, at 166, 168 (stating that several jurisdictions have endeavored to protect policyholders from insurance companies by "permitting first party insurance claimants to recover amounts in excess of policy limits plus interest" because traditional legal concepts have been inadequate to provide such protection).


5 See Acquista, 730 N.Y.S.2d at 277 (listing six states—Delaware, Maine, New Hampshire, New Jersey, Utah, and West Virginia—that allow an insured to recover foreseeable money damages in excess of the amount of the policy).
amount due under the policy but may include consequential damages extending beyond the policy limit when such damages are foreseeable.\(^6\)

In *Acquista*, the plaintiff, Angelo Acquista, was a physician who specialized in internal and pulmonary medicine.\(^7\) Numerous medical tests revealed that he possessed a blood disorder and, possibly, myelodysplasia, an ailment that could progress into leukemia.\(^8\) His symptoms included fatigue, headaches, and muscle and joint pain.\(^9\) Prior to his illness, the plaintiff purchased three disability insurance policies offered by the defendant, New York Life Insurance Company, through the defendant agents Jenny Kho and Helen Kho.\(^10\) The defendant insurance company rejected the plaintiff's claims for disability benefits "on the ground that he [could] still perform some of the 'substantial and material duties' of his regular job or jobs and therefore [was] not 'totally disabled.'"\(^11\) The plaintiff sued for breach of contract, bad faith, unfair practices, fraud, fraudulent misrepresentation, and negligent infliction of emotional distress.\(^12\) The bad faith claim was predicated on allegations that the insurer engaged in dilatory tactics to avoid paying the benefits.\(^13\) The trial court granted the defendant's motion to dismiss with respect to all claims but one, which was based on a policy provision for residual and partial disability benefits.\(^14\) The

\(^{6}\) See id. at 278–79.
\(^{7}\) Id. at 273.
\(^{8}\) Id.
\(^{9}\) Id.
\(^{10}\) Id. Two of the policies defined "total disability" as the inability of the insured to perform "the substantial and material duties" required of his position. Id. (quoting policies). The third policy defined "total disability" as the inability to perform "any of [those] substantial and material duties." Id. at 274 (quoting policy).
\(^{11}\) Id. at 273.
\(^{12}\) Id.
\(^{13}\) See id. at 275. The plaintiff alleged that the defendant "would make multiple requests for additional documentation, upon receipt of which further documents would be demanded, after which plaintiff's claims file would then be transferred to a new examiner, who in turn would make more requests." Id. Additionally, the plaintiff claimed that the defendant "waited more than two years to request or schedule an independent medical examination." Id. The plaintiff also alleged that the defendant "wrongfully and unjustifiably refused to accept" his reasonable offer of settlement. Id. at 280 (Andrias, J., dissenting). The dissent, however, enumerated facts indicating that, according to the dissent, the plaintiff himself contributed to the delays, thus suggesting that that the bad faith claim may have been manufactured. Id. at 282 (Andrias, J., dissenting).
\(^{14}\) Id. at 274.
appellate division modified the lower court’s decision by reinstituting the breach of contract, bad faith, and unfair practices claims and remanded the case for further proceedings.\textsuperscript{15}

In restoring the bad faith claim, Justice Saxe, writing for the majority, declined to adopt the tort cause of action for first-party breach by an insurance company.\textsuperscript{16} The court reasoned, however, that simply awarding a policyholder the face value of the policy plus interest due at the conclusion of trial may not accomplish the recognized objective of modern damages schemes—to place the aggrieved party in as good of a position in which he would have been had the insurer performed the contract in good faith.\textsuperscript{17} The court stated that the traditional view of limiting damages to the policy amount relies on the false assumption that a plaintiff has access to funds to pay for the loss caused by the event against which the plaintiff was insured.\textsuperscript{18} The plaintiff, in fact, could be damaged additionally if he does not have the funds to pay that which the insurer should have paid.\textsuperscript{19} The traditional view, the court reasoned, also fails to consider the emotional distress or further physical injury that may occur during protracted litigation when the plaintiff suffers from serious medical ailments.\textsuperscript{20} Critical to the court’s inquiry was the contention that insurance companies have little

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\textsuperscript{15} Id. at 279–80.  \\
\textsuperscript{16} See id. at 278. The court believed that adopting the tort would effect too great a change in New York law in light of two New York Court of Appeals decisions rejecting the tort. Id. at 275–76 (citing New York Univ. v. Cont’l Ins. Co., 662 N.E.2d 763 (N.Y. 1995), and Rocanova v. Equitable Life Assurance Soc’y of the U.S., 634 N.E.2d 940 (N.Y. 1994)). The court also explained that the relationship between an insurer and insured is contractual rather than fiduciary, thus precluding the imposition of a tort remedy. Id. at 278 (quoting Beck v. Farmers Ins. Exch., 701 P.2d 795, 800 (Utah 1985)).

\textsuperscript{17} See id. at 276 (citing CALAMARI & PERILLO, supra note 1, at § 14.4).  \\
\textsuperscript{18} See id.; see also Savage, supra note 2, at 169 (stating that one rationale for the traditional view is that “money is always available at approximately the legal rate of interest” but that this view is incorrect because “it is highly unlikely that a claimant who has recently suffered economic disaster would be able to obtain a loan at all”).

\textsuperscript{19} See Acquista, 730 N.Y.S.2d at 276; see also Beck v. Farmers Ins. Exch., 701 P.2d at 802 (stating that when an insured does not have access to funds and an insurer refuses to pay, “catastrophic consequences” could result, including, for example, loss of the insured’s home or business).

\textsuperscript{20} See Acquista, 730 N.Y.S.2d at 276; see also Beck, 701 P.2d at 802 (stating that inasmuch as it is generally recognized that insurance is purchased to secure “peace of mind,” damages for emotional distress might be provable “in unusual cases”).
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incentive to settle claims in good faith if they are held liable for the policy amount—they have nothing to lose and much to gain in delaying payment to insureds.  

Conscious of all these concerns, the court concluded that foreseeable consequential damages exceeding the policy limits, including damages for emotional distress and inconvenience, may be awarded to a plaintiff who has proved a bad faith breach on the part of his insurer.

The majority stated that it would adopt the reasoning of the Utah Supreme Court case *Beck v. Farmers Insurance Exchange* in support of its holding. The *Beck* court’s rationale encompassed several arguments. First, the relationship between an insurance company and a policyholder is essentially “contractual rather than fiduciary.” The absence of a fiduciary obligation between the parties renders the implementation of a tort action theoretically unsound. Second, parties to a contract must perform their countervailing obligations in good faith. Third, an insurance company easily may effect an outcome favorable to its own interests by avoiding or delaying payment because of the unequal bargaining power between the parties. The problem of insurance companies engaging in these tactics has become pervasive. As a matter of policy, therefore, an expanded contract remedy would provide a necessary incentive for insurers to deal in good faith. Fourth, contract law recognizes a consequential damages remedy, which may allow

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21 See Acquista, 730 N.Y.S.2d at 276 (“[I]f 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.”) (citing Savage, *supra* note 2, at 167); see also Beck, 701 P.2d at 801 (stating that the court, in adopting the expanded contract remedies, is persuaded by the “principle reason” other jurisdictions have adopted the tort approach, which is to eliminate the incentive for insurance companies to breach their contracts in bad faith).

22 See Acquista, 730 N.Y.S.2d at 278–79.

23 701 P.2d 795 (Utah 1985).

24 See Acquista, 730 N.Y.S.2d at 278 (“[I]n order to ensure the availability of an appropriate and sufficient remedy, we adopt the reasoning of the *Beck* court . . . “)


26 See Beck, 701 P.2d at 800.

27 See id. at 801.

28 See id. at 798; see also Acquista, 730 N.Y.S.2d at 276.

29 See Acquista, 730 N.Y.S.2d at 278.

30 See Beck, 701 P.2d at 799; see also Acquista, 730 N.Y.S.2d at 278.
recovery of an award beyond the stipulated contract amount.\textsuperscript{31} Such consequential damages should be permitted in the case of an insurer's bad faith breach because such breach could cause injury to policyholders in amounts above those set in the policies.\textsuperscript{32} Finally, insofar as insurance contracts are executed to provide and secure "peace of mind" for the insured, damages for emotional distress may be foreseeable and properly awarded.\textsuperscript{33}

The \textit{Aquista} dissent, written by Justice Andrias, argued for dismissal of the bad faith claim. A bad faith claim, according to the dissent, should not be adopted in New York because the use of dilatory tactics in settling a claim gives rise to a private dispute that only affects the parties to the contract, and not the general public.\textsuperscript{34} The majority, however, rejected this argument by stating that the problem of insurer bad faith breach has become "widespread enough to prompt most states to respond with some sort of remedy for aggrieved policyholders."\textsuperscript{35} To characterize these claims, therefore, as "unique to these parties... is to utterly ignore this fact."\textsuperscript{36} The dissent further contended that, in any event, the plaintiff had not alleged facts that established a bad faith case.\textsuperscript{37} Justice Andrias argued that the breach of the duty of good faith is governed by a "gross disregard" standard, which the plaintiff had failed to satisfy.\textsuperscript{38}

\textsuperscript{31} See \textit{Beck}, 701 P.2d at 801 ("[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... 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 a breach.").

\textsuperscript{32} See \textit{Beck}, 701 P.2d at 802 ("In an action for breach of a duty to bargain in good faith, a broad range of recoverable damages is conceivable, particularly given the unique nature and purpose of an insurance contract."); see also \textit{Aquista}, 730 N.Y.S.2d at 276 ("[A]n award, at the conclusion of litigation, of money damages equal to what the insurer should have paid in the first place, may not... place the plaintiff in the position he would have been in had the contract been performed.").

\textsuperscript{33} \textit{Beck}, 701 P.2d at 802; see also \textit{Aquista}, 730 N.Y.S.2d at 277–78.

\textsuperscript{34} \textit{Aquista}, 730 N.Y.S.2d at 280 (Andrias, J., dissenting) (citing N.Y. Univ. v. Cont'l Ins. Co., 662 N.E.2d 763, 771 (N.Y. 1995)).

\textsuperscript{35} \textit{Aquista}, 730 N.Y.S.2d at 278.

\textsuperscript{36} \textit{Id}.

\textsuperscript{37} \textit{Id}. at 280–81 (Andrias, J., dissenting).

\textsuperscript{38} \textit{Id}. at 281 (Andrias, J., dissenting) ("[A] bad-faith plaintiff must establish that the defendant insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the probability that an insured would be held personally accountable for a large judgment if a settlement offer within policy limits were not accepted." (citing Pavia v. State Farm Mutual Auto. Ins. Co., 626 N.E.2d 24, 27–28 (1993))). The dissent however, failed to acknowledge that the gross disregard
The plaintiff even failed to allege facts, the dissent contended, that would make out a bad faith claim under the standard adopted by the majority.\textsuperscript{39} The dissent, therefore, would have affirmed dismissal of the plaintiff's bad faith claim. The majority, on the other hand, concluded that dismissal pursuant to N.Y. C.P.L.R. 3211 based on the defendant's documentary evidence was inappropriate as a matter of procedure.\textsuperscript{40}

It is submitted that the Acquista court was correct to expand damage awards to include consequential damages, including damages for emotional distress, when an insurer commits a bad faith breach of a policy. The court, however, in focusing on the insured, did not consider the repercussions of its decision on insurance companies. This Comment contends that because insurance companies provide important benefits to policyholders, expanded awards could have a detrimental effect on society. It is submitted that, while an award of consequential damages would be appropriate in certain cases, the contours of such an award should be more sharply defined than they were in Acquista.

This Comment will first analyze the law of New York State with respect to consequential damages and the bad faith breach cause of action. It will be argued that bad faith breach is a valid contract action, but that consequential damages must be limited by giving full force to the concept of "foreseeability" within the meaning of \textit{Hadley v. Baxendale} principles. Finally, this Comment will urge that damages for emotional distress should be granted only in certain limited situations.

\textsuperscript{39} See id. at 282 (Andrias, J., dissenting) (stating that the plaintiff failed to allege that "the insurer failed to carry out an investigation, evaluate the feasibility of settlement [of the plaintiff's claim], . . . or to offer the policy limits . . . after the weaknesses of [the claim were] clearly and fully assessed").

\textsuperscript{40} See id. at 274. The court felt compelled to accept the plaintiff's factual allegations as true, as required under N.Y. C.P.L.R. 3211. \textit{Id.} The documentary evidence submitted by the defendant did not "flatly disprove" the plaintiff's contentions. \textit{Id.} The defendants, therefore, could not prevail on their motion to dismiss unless its evidence "conclusively establish[ed], as a matter of law, that contrary to plaintiff's allegations, he was still able to perform 'the substantial and material duties' of his regular job or jobs as they existed before he became ill." \textit{Id.} at 275 (emphasis in original).
I. CONSEQUENTIAL DAMAGES

A. Hadley v. Baxendale in New York

Because insurance policies traditionally have been regarded as contracts to pay money, damages for breach of a policy have been limited generally to the amount of the policy plus interest.41 As stated above, limiting damages to the amount of the policy may be insufficient to place the nonbreaching policyholder in the position in which it would have been if the insurance company had not breached the contract.42 Since the seminal case of Hadley v. Baxendale,43 decided in 1854, the common law has recognized that damages for a loss that would not naturally flow from a breach is recoverable as consequential damages only when such a loss was reasonably contemplated by the parties at the time they entered into the contract.44 Modern courts express the Hadley v. Baxendale test in terms of "foreseeability"; they allow damages only insofar as the possibility of the loss for which they are sought was foreseeable by the contracting parties at time of contracting.45 In order to meet the requirement of foreseeability, it is sufficient that the breaching party had been aware of the facts that rendered the loss foreseeable.46

New York State allows the award of consequential damages for breach of contract if the requirement set forth in Hadley v. Baxendale is satisfied.47 When determining whether a particular

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41 See id. 276 (citing Savage, supra note 2, at 167).
42 See supra notes 1–2 and accompanying text.
44 See id. 151 (explaining that damages are recoverable "such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it"). This is the second, more significant, principle espoused in Hadley v. Baxendale; see also CALAMARI & PERILLO, supra note 1, at § 14.5; FARNSWORTH, supra note 1, at § 2.14. The first principle given in Hadley is a restatement of the general rule that a nonbreaching party may recover damages "as may fairly and reasonably be considered [as] arising naturally, i.e., according to the usual course of things, from such breach of contract itself." See Hadley, 156 Eng. Rep. at 151; see also CALAMARI & PERILLO, supra note 1, at § 14.5; FARNSWORTH, supra note 1, at § 12.14.
45 See FARNSWORTH, supra note 1, at § 12.14; see also CALAMARI & PERILLO, supra note 1, at § 14.5.
46 See FARNSWORTH, supra note 1, at § 12.14; see also CALAMARI & PERILLO, supra note 1, at § 14.5.
47 See Kenford Co., Inc. v. Erie, 537 N.E.2d 176, 178 (N.Y. 1989) (stating that in order for a nonbreaching party to receive damages for loss beyond that which "naturally and directly [flow from the breach], i.e., in the ordinary course of
loss was foreseeable, meaning it was within the contemplation of the parties, the courts consider such factors as the nature and purpose of the contract and the surrounding circumstances as understood by the parties.\textsuperscript{48} Additionally, the courts determine whether the defendant reasonably should have recognized that such consequential loss could have occurred.\textsuperscript{49} New York, however, has declined to apply these principles to first-party breaches of insurance policies and has limited recovery for those breaches to the amount of the policy on the ground that there could be no damages accruing in excess of the policy.\textsuperscript{50} Over the past decade, however, New York's appellate division has refused to award consequential damages for an insurer's bad faith breach, not because such a breach could not cause damages in excess of the policy, but on the ground that the excess damages were not foreseeable or were too remote.\textsuperscript{51} It is submitted that New York courts would be willing to grant consequential damages for first-party bad faith breaches of insurance policies under the \textit{Hadley v. Baxendale} standard if the loss was found to

\textsuperscript{48} See id. at 179 ("In determining the reasonable contemplation of the parties, the nature, purpose and particular circumstances of the contract known by the parties should be considered." (citing Mortimer v. Otto, 99 N.E. 189, 190 (N.Y. 1912))).

\textsuperscript{49} See id. (stating that the courts should consider "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" (quoting Globe Ref. Co. v. Landa Cotton Oil Co., 190 U.S. 540, 544 (1903))).

\textsuperscript{50} See Halpin v. Prudential Ins. Co. of Am., 401 N.E.2d 171, 171–72 (N.Y. 1979) (stating that an insured may not recover damages in excess of the policy "where the insurer has terminated disability benefits allegedly payable to the insured, for there is no possibility of the insured being cast in damages which exceed policy limits by reason of the insurer's conduct"); see also LTS Contractors, Inc. v. Hartford Ins. Co., 472 N.Y.S.2d 222, 223 (4th Dept. 1984) (refusing to award consequential damages to the plaintiff for the insurer's failure to pay the "plaintiff's actual damages" on the ground that "such consequential damages [did not arise] from defendant's breach").

\textsuperscript{51} See Sweazey v. Merchs. Mut. Ins. Co., 571 N.Y.S.2d 131, 132 (3d Dep't. 1991) (stating that the plaintiff's claim for consequential damages should have been dismissed "in the absence of plaintiff's showing that such damages were foreseeable and within the contemplation of the parties at the time the contract was made"); see also Harriman v. Norfolk & Dedham Mut. Fire Ins. Co., 568 N.Y.S.2d 820, 820 (2d Dep't. 1991) (stating that the plaintiff could not recover consequential damages against her insurer because the claims were "speculative, remote, and could not have been within the contemplation of the parties at the time of the execution of [the] insurance contract").
have been foreseeable.

B. Justification for Applying Hadley v. Baxendale Principles to Insurance Policies

Necessity mandates that New York allow recovery of consequential damages for an insurer's bad faith breach of an insurance policy. Although some commentators argue that insurance contracts are no different from other commercial contracts, thus militating against special treatment by the courts, this Comment asserts that there are factors inherent in insurance policies and in the dealings between the parties that warrant the expanded contract remedy. Courts and commentators widely recognize that insurance companies engage in dilatory tactics to elude valid claims in most, if not all, jurisdictions. Unlike many other commercial contracts—where the tender of money occurs simultaneously with or closely follows the tender of goods to be received, or does not become due until a specified service is performed—with insurance contracts, the insured has been paying the countervailing party consistently over a period of time. By engaging in dilatory tactics, an insurance company can retain the money already paid to it. At best, the company will never have to pay benefits specified by the policy; at worst, it will defer payment of these benefits. In most cases, a policyholder attempting to recover on the policy is in a very difficult position because of his/her greatly inferior bargaining position. The insured, who generally has significant financial concerns, may be forced to accept an inadequate settlement or may not be in a position to litigate the

52 See Sykes, supra note 1, at 406.
53 See Acquista v. New York Life Ins. Co., 730 N.Y.S.2d 272, 278 (1st Dep't. 2001) (“The problem of dilatory tactics by insurance companies seeking to delay and avoid payment of proper claims has apparently become widespread enough to prompt most states to respond with some sort of remedy for aggrieved policyholders.”); see also Savage, supra note 2, at 164 (“The cases cited herein indicate that wrongful refusal to pay claims occurs with enough frequency that adequate legal recourse should be available to insureds in order to prevent this practice.”).
54 See supra note 21 and accompanying text.
55 See Beck v. Farmers Ins. Exch., 701 P.2d 795, 798 (Utah 1985) (“An insured who has suffered a loss and is pressed financially is at a marked disadvantage when bargaining with an insurer over payment for that loss.”); see also Savage, supra note 2, at 169 (“[T]he parties to an insurance policy generally do not have equal bargaining power.”).
issue against the insurer. It is submitted, therefore, that courts must provide an incentive to the insurance companies in the form of consequential damages to encourage settlement of meritorious claims in good faith.

The assumption that a policyholder will have access to funds to pay what the insurer refuses to pay is unfounded. In fact, the aggrieved party may indeed suffer losses that exceed the policy amount. Such losses could include litigation costs, losses due to bankruptcy, foreclosure of mortgaged property, interest debt on money borrowed from a lending institution, interest lost on money used to pay the amount the insurer did not pay, and penalties imposed for early withdrawal of a retirement plan or CD. If courts are to give effect to the recognized goal of contract damages—to place the nonbreaching party in as good a position as it would have achieved had the contract been performed—they must consider these extra-policy losses as possible consequential damages.

C. Limitations on Consequential Damages

Insurance is a significant component of our business, personal, and social lives upon which most of us have come to depend and rely. It is of great import, then, that excessive damage awards do not unduly burden insurance companies. It is submitted that strict adherence to Hadley v. Baxendale principles would serve to protect both the honest insurer and any maltreated insured. Furthermore, if New York were to adopt the expanded contract remedy, insurance companies would not be subject to damage awards in excess of the policy amount unless a plaintiff proved bad faith on the part of the defendant insurer.

The Acquista court concluded that the plaintiff’s “allegations may be employed to interpose a claim for consequential damages beyond the limits of the policy for the claimed breach of

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56 See Beck, 701 P.2d at 798; see also Savage, supra note 2, at 169.
57 See Acquista, 730 N.Y.S.2d at 276; Savage, supra note 2, at 169.
58 See Beck, 701 P.2d at 802 (stating that when an insured does not have access to funds to cover the insured loss after an insurer fails to settle a claim in good faith, losses exceeding the policy amount could include loss of a home or business due to bankruptcy and losses for emotional distress); see also Sykes, supra note 1, at 409 (stating that an insured’s consequential damages could include costs of litigation, repairs to a business, purchase of additional medical services, and emotional distress).
59 See Savage, supra note 2, at 164.
contract. The court, however, did not discuss whether the foreseeability requirement should be construed broadly or narrowly. The court cited decisions from six jurisdictions that have adopted the expanded contract damages rationale, but those courts were not consistent in their treatment of foreseeability. It is submitted that narrow effect be given to the concept of "foreseeability" within the context of awarding consequential damages for first-party bad faith breaches by an insurer. Although some commentators contend that this approach would severely limit a plaintiff's ability to recover consequential damages for numerous kinds of losses, such a limitation is necessary to strike the appropriate balance between what this Comment perceives to be the dual aims of the remedy: (1) to protect the insured from the effects of an insurer's bad faith breach by providing an incentive for insurers to settle claims in good faith and (2) to protect the insurer, as well as the existing insurance scheme, from the burdens of unforeseen and remote damages and opportunistic litigation. In addition, policyholders may be encouraged to disclose specific information regarding finances, mortgaged property, and business concerns. Such disclosure may not only provide the basis for a possible bad faith action in the future, but also encourage the insurance company to treat seriously its obligation to deal in good faith. Of course, an insurer may charge a higher premium if it is to be subject to greater risk. A policyholder, however, could avoid the higher premium by not disclosing his or her own particular circumstances, thus preserving the lower premium by foregoing the higher likelihood of receiving consequential damages in a bad faith action. It is submitted, therefore, that courts should allow an award of consequential damages for the bad faith breach of an insurer for losses that were foreseeable with particularity at the time the parties entered into the contract. Simply put, the courts should determine whether the specific loss suffered by the aggrieved party was contemplated by the parties, and not whether a general loss was foreseeable. In

60 Acquista, 730 N.Y.S.2d at 279.
61 See id. at 277 (citing decisions from Delaware, Maine, New Hampshire, New Jersey, Utah, and West Virginia).
62 See Savage, supra note 2, at 167 ("[T]he specific consequences of the insurer's breach, such as loss of a home because of inability to meet mortgage obligations, are not necessarily foreseeable. Thus, under the strict construction of the Hadley v. Baxendale rule, consequential damages for such losses are unavailable.").
determining whether this foreseeability with particularity test is satisfied, courts should thoroughly examine the circumstances, correspondence, and discussions between the parties.

For example, assume an individual with a catering business whose van is destroyed in an accident and whose insurer breaches his physical-damage policy in bad faith. If the caterer is unable to cater an affair due to the insurer's breach—assuming, of course, mitigation of damages by the insured was unreasonable—the insurer should be held liable for the caterer's lost profits as foreseeable consequential damages. If, however, the caterer is unable to acquire additional culinary equipment that he intended to purchase with the profits he expected to earn on the cancelled affair, and he thus consequently must cancel a future catering job for lack of the necessary equipment, the insurer should not be held liable for the lost profits relating to the subsequent job. The damages in the latter case are too remote to have been foreseeable by the insurer, absent special circumstances and communications that indicate the contrary.

Two of the jurisdictions cited by the Acquista court as having adopted the contract rationale for bad faith insurance breaches—New Jersey and Maine—have not adhered strictly to Hadley v. Baxendale principles. In Pickett v. Lloyd's,63 the New Jersey Supreme Court allowed the recovery of consequential damages for an insurance company's bad faith breach of a physical-damage policy on a Mack tractor-trailer truck.64 The plaintiff owned the truck, which he used to haul freight for a carrier.65 Because he had attained seniority, the plaintiff had the ability to choose among the more lucrative and desirable assignments.66 In the event of an accident, the carrier permitted senior "owner/operators" a sixty-day grace period in which to replace their trucks and return to work and thereby avoid losing their seniority status.67 The plaintiff, however, lost his seniority due to the fact that his claim was not settled within this grace period and, as a result, he suffered reduced earnings.68

Although the insurer was aware that the plaintiff could not

64 See id. at 447.
65 Id.
66 Id.
67 Id.
68 Id at 449.
work until he repaired his truck, it was not aware of the plaintiff's seniority status or of the benefits the plaintiff received due to seniority, nor was it aware that a grace period existed after which the plaintiff would lose seniority and its related benefits. The court sustained the consequential damages award, which included both the plaintiff's lost profits and the difference between what the plaintiff would have earned as a senior operator over four and a half years (the time remaining until he reached retirement age) and what he would have earned working for the lower pay as a non-senior operator. The court then held that it was sufficient that the insurer knew that plaintiff was out of work, concluding that the insurer "could reasonably have apprehended that a truck driver in this situation might lose an economic advantage such as his seniority entitlement." The court also dismissed, without discussion, the fact that the plaintiff had not considered leasing a truck, which would have allowed him to retain his seniority, although he did attempt to obtain a bank loan for the purpose of purchasing a new truck.

The Pickett court, in adopting the consequential damages remedy in bad faith breach of insurance policies cases, should have applied Hadley v. Baxendale principles more narrowly. Even if the insurer had been on notice at the time of contracting that the plaintiff would suffer loss of income if the truck were damaged, it was not on notice that the plaintiff was subject to loss of seniority. Assuming, arguendo, that the insurer should have foreseen plaintiff's loss of earnings during the period in which the truck remained damaged, it could not have foreseen being held liable for plaintiff's loss of earnings in the years subsequent to the repair of the truck and until the plaintiff reached retirement age. Because the court determined that loss of earnings, in general, was foreseeable by the defendant, it concluded that all lost earnings were foreseeable.

When applying the foreseeability limitation to bad faith claims, the courts must look to whether the particular loss

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69 Id. at 448, 457.
70 Id.
71 Id. at 457.
72 Id.
73 Id.
74 Id.
claimed was foreseeable, not to whether loss in general was possible. Limiting damages to foreseeable particular losses is important in order to prevent subjecting insurers to damages that are excessively disproportionate to the risks and benefits of the contract.\(^7\) A party to a contract will evaluate the benefits and risks involved and will fix the consideration commensurately. If a breaching party were held to damages it could not have reasonably contemplated, the aggrieved party would receive the retroactive benefit of having entered into a contract for consideration that was less in value than that which the breaching party would have demanded in return for being exposed to that greater risk.\(^7\) In other words, the aggrieved party subjects the breaching party to a greater risk without paying fair consideration. If the breaching party had been aware of the risk, it would have demanded greater consideration, which would have offset the expense of paying the damages awarded to the plaintiff. In the alternative, such a breaching party might not have entered into the contract.

If the *Pickett* defendant had been aware that it could have been held liable for the plaintiff's loss of earnings until retirement age, it undoubtedly would have charged higher premiums. If insurance companies believe that they will be held liable for unforeseen damages, they may raise premiums on all policies. Considering the fact that most people are affected by or rely on insurance to some extent, deleterious consequences to society could result if insurers are confronted with uncertainty in their dealings with individuals and business entities. The *Pickett* court should not have given such broad effect to the foreseeability concept, and New York should not adopt a similar approach. This Comment asserts that a foreseeability standard that requires greater particularity would strike the necessary

\(^7\) See FARNSWORTH, supra note 1, at § 12.14 at 821–22 (“The development of [the unforeseeability] limitation was encouraged by a realization that liability for unforeseeable loss might impose upon an entrepreneur a burden greatly out of proportion to the risk that the entrepreneur originally supposed was involved and to the corresponding benefit that the entrepreneur stood to gain.”).

\(^7\) See M. N. Kniffin, *A Newly Identified Contract Unconscionability: Unconscionability of Remedy*, 63 NOTRE DAME L. REV. 247, 260 (1988) (“If the breaching party had known of such liability, it surely would have demanded more consideration at the time of entering into the contract.”). Furthermore, “there are certain risks so unfair to a promisor, because of disproportion to the consideration received, that he would have refused to enter into the contract had he been aware that the law of damages would impose that risk upon him.” *Id.* at 255.
balance between the rights of the insurer and insured.

Additionally, the *Pickett* court was not disturbed by the fact that the plaintiff did not attempt to lease a substitute truck. If he had leased a truck, he would not have lost his seniority, and the defendant would have only been liable for the cost of the lease. It is generally agreed that a breaching party is not liable for damages that could have been avoided by the injured party. The plaintiff in this case could have avoided losing his seniority. The insurer, therefore, should not have been liable for damages relating to this loss. This Comment is not intended to diminish the hardship suffered by policyholders who are injured by their insurer’s bad faith breach, nor does this Comment assert that insurance companies are deserving of preferential treatment over policyholders. Rather, it is submitted that both insurers and insureds should be treated fairly, and fairness dictates that courts refrain from allowing their sympathies to color their application of law to facts by applying unfairly broad standards of foreseeability.

Another example of a court that incorrectly applied a foreseeability standard and, therefore, failed to adhere to *Hadley v. Baxendale* principles in the bad faith context is *County Forest Products, Inc. v. Green Mountain Agency, Inc.* The Supreme Judicial Court of Maine in that case upheld a consequential damages award to a sawmill that claimed, inter alia, that it was forced to auction off undamaged equipment to pay its creditors, due to the insurer’s failure to settle in good faith a dispute regarding a fire insurance policy. The court stated that even though consequential damages may not have been foreseeable at the time of contracting, they were foreseeable after the claim arose. This reasoning directly contradicts the principle that

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77 See FARNSWORTH, *supra* note 1, at § 12.8 at 786 (“One [limitation on the recovery of expectancy damages] is that the injured party cannot recover damages for loss that could have been avoided if that party had taken appropriate steps to do so.”).
78 758 A.2d 59 (Me. 2000).
79 See id. at 61–65.
80 The court stated:
With regard to the foreseeability of the consequential damages, it is possible that the consequential damages were not foreseeable at the time Green Mountain failed to procure the increased coverage, but they were foreseeable and readily capable of identification after the fire and during the time Green Mountain persisted in its actions of obfuscation and delay. The court [below] did not err in concluding that Green Mountain was
consequential damages must be foreseeable at the time the parties entered into the contract. Consequential damages are appropriate, and in fact necessary, in the bad faith context, but adherence to well-settled contract principles must be maintained.

It is important to emphasize that, under Acquista, insurance companies will be subject to adverse judgments for consequential damages only if they breach a policy in bad faith. New York must take care to adopt a bad faith standard that will not affect insurers who breach "honestly." The Acquista court would find bad faith "where an insured demonstrates more than merely a denial of benefits promised under a policy of insurance, . . . [where] the insurer's denial of the claim was deliberately made in bad faith, [and] with knowledge of the lack of a reasonable basis for the denial." This articulation of the bad faith standard is too vague to prove useful. The majority, in effect, stated that bad faith will be found when an insurance company deals in bad faith, without defining or describing the parameters of bad faith. Courts and juries need a more specific, objective standard when they review facts to indicate bad faith dealing. The majority's loose description allows for too subjective of an examination on the part of the fact finder, which could lead to inconsistent decisions. Without uniform decisions, insurance companies will be unable to determine whether they are acting in good faith when dealing with policyholders, and plaintiffs will be encouraged to litigate unfounded claims if they are lead to believe that a finding of bad faith is solely within a sympathetic jury's discretion.

In his Acquista dissent, Justice Andrias suggested that the court essentially adopt the bad faith standard described in Beck v. Farmers Insurance Exchange, the Utah Supreme Court case on which the court based its holding. The Beck court stated that if an insurer wished to satisfy its obligation of good faith

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81 Id. at 72.
82 See supra note 45 and accompanying text.
83 See supra note 4, at 182 (stating that "in some states, an honest mistake will expose an insurer to Bad Faith damages").
85 701 P.2d 795 (Utah 1985).
86 See Acquista, 730 N.Y.S.2d at 282 (Andrias, J., dissenting).
dealing, it must "diligently investigate the facts to enable it to determine whether a claim is valid, . . . fairly evaluate the claim, and . . . thereafter act promptly and reasonably in rejecting or settling the claim." The insurer must also "deal with laymen as laymen and not as experts in the subtleties of law and underwriting" and refrain from actions that will injure the insured's ability to obtain the benefits of the contract. The Beck or some similar standard should be adopted and fully articulated by the New York courts. This Comment asserts that a several-pronged approach, such as the one advocated by the Utah court in Beck, will protect insurance companies (and the courts) from frivolous claims. Insurance companies will have a standard against which to measure their own actions. If they conform to each of the prongs, they can expect to be protected against bad faith claims. Plaintiffs, too, will be better able to judge whether their claims have merit. If plaintiffs are presented with a more precise standard, they will be less likely to bring frivolous suits. If they cannot allege facts that show a violation of at least one of the prongs of the bad faith test, they will be hard-pressed to sue.

Having a clearly articulated standard will also address the dissent's concern that a bad faith claim could be "based solely upon an insurer's failure to respond to a time-limited settlement offer"—that insurers would be forced to adhere to a plaintiff's timetable. The dissent cites Pavia v. State Farm Mutual Automobile Insurance Co. for the proposition that New York has rejected the idea that bad faith could be proved solely on the basis of an insurer's delay in settling. The dissent's reliance on Pavia, however, is misplaced in that the claim at issue in Pavia was a third-party insurance claim since the policyholder was being sued and the insurance company was defending the policyholder, whereas the claim asserted in Acquista was a first-party claim since the policyholder sued the insurance company directly to recover compensation owed directly to the policyholder. Because the relationship between insurer and

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86 Beck, 701 P.2d at 801.
87 Id.
88 Acquista, 730 N.Y.S.2d at 281 (Andrias, J., dissenting).
89 626 N.E.2d 24 (N.Y. 1993).
90 See Acquista, 730 N.Y.S.2d at 281–82 (Andrias, J., dissenting).
91 Third party claims occur when the insured harms a person who is not a party to the insurance contract. When the harmed person makes a claim against the
insured in the third-party context is fiduciary, and the relationship between these parties in the first-party context is essentially contractual, some courts and commentators have declined to employ a third-party analysis to a first-party situation. Therefore, it is submitted that *Pavia* does not govern the bad faith contract claim in *Acquista*.

In any event, adoption of the *Beck* standard would address and dispel the dissent’s valid concerns. The test under *Beck* is whether the insurer acted “promptly and reasonably in rejecting or settling the claim” after an investigation of the facts and evaluation of the claim. It is submitted that, because this would be a question of fact to be determined by the factfinder, a plaintiff’s demand for payment within a certain period of time would be irrelevant. An insurer would still be afforded time to investigate and evaluate a claim; however, it could not use such an investigation and evaluation as a pretext for avoiding settlement of a claim. This Comment asserts, therefore, that a test for bad faith similar to the one adopted by the *Beck* court would prevent plaintiffs who claim bad faith from dictating to insurance companies a time frame in which the latter must agree to settle.

II. EMOTIONAL DISTRESS

Traditionally, damages are not awarded for emotional distress resulting from a breach of contract. Some jurisdictions

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92 See *Beck* v. *Farmers Ins. Exch.*., 701 P.2d 795, 799–800 (Utah 1985); *see also* Capozzola, *supra* note 4, at 184–85. By contrast, first-party claims “occur when the person insured on a policy—usually the policyholder—suffers an injury and seeks compensation directly from the insurance company.” *Id.*

93 *See Beck*, 701 P.2d at 799–800.

94 *See id.* at 800 (“[I]t is difficult to find a theoretically sound basis for analogizing the duty owed in a third-party context to that owed in a first-party context.”); *see also* Capozzola, *supra* note 4, at 191 (stating that “some courts continue to assert that the rationale behind Third-Party Bad Faith simply does not apply to First-Party Bad Faith”); *But see* Capozzola, *supra* note 4, at 193 (“The contention that the fiduciary duty present in the third-party relationship is lacking in first-party insurance policies misses the issue. . . . Bad Faith does not arise from a breach of contract [, but] stems from an obligation, implied by law, to act in the best interests of the insured.”).

95 *Beck*, 701 P.2d at 801.

96 *See FARNSWORTH, supra* note 1, at § 12.17; *see also* CALAMARI & PERILLO, *supra* note 1, at §14.5(b).
have carved out exceptions to this rule by allowing recovery for emotional distress if the breach was one likely to cause such distress, including, for example, eviction of guests from hotels, breaches of contracts for funeral arrangements, and breaches that caused physical injury. The rule in New York is that a plaintiff cannot recover damages for emotional distress for breach of a contract "absent a duty upon which liability can be based." New York, however, has allowed damage awards to compensate for emotional distress in contract situations where a public interest was perceived to exist, such as for expulsion from a bathhouse, for insults cast by a railway conductor and by an innkeeper's servant, and for failure to maintain a gravesite. But New York courts have consistently denied recovery for emotional distress caused by breaches of insurance policies such as policies for medical insurance, no-fault motor insurance, and fire insurance.

The Acquista court would allow a plaintiff to recover damages for emotional distress if such loss "were a foreseeable result of a [first-party bad faith] breach at the time the policy was entered into." The court would seem to allow damages for emotional distress in all cases where a plaintiff could prove that such loss was foreseeable at the time of contracting. It is submitted that the court's holding is too broad. Allowing recovery for emotional distress would effect a significant change in New York law, and, therefore, this Comment asserts that the award of such damages must be limited to plaintiffs who have suffered some type of physical injury, medical disability, or who would benefit from a policy relating to matters likely to cause emotional distress, such as life insurance.

There are two reasons to allow recovery for emotional distress...
distress in a bad faith case: (1) courts must provide an incentive to insurance companies to deal with insureds in good faith and (2) emotional distress is a foreseeable result of a breach of certain policies. As stated above, without the possibility of being subject to judgments in excess of the policy, insurance companies could find it financially beneficial to avoid settling claims in good faith.\(^{107}\) Also, under the standard of foreseeability with particularity herein proposed, emotional distress may be the only form of consequential damages recoverable by a plaintiff.\(^{108}\) The threat of being subject to damages for emotional distress, therefore, would provide a significant incentive to insurance companies to perform their obligations in good faith. Additionally, because insurance bad faith breaches have become widespread,\(^{109}\) and society relies on insurance to a great extent, it is submitted that a public interest does exist in these situations, rendering the award of damages for emotional distress appropriate.

Emotional distress is a highly foreseeable consequence of an insurance company's bad faith breach of a policy. The paramount purpose for the purchase of insurance is to obtain security, both financially and emotionally.\(^{110}\) Insurers also recognize this dual purpose of insurance by advertising their policies as providing "peace of mind."\(^{111}\) It is submitted, therefore, that given the fact that emotional distress will occur if

\(^{107}\) See supra note 21 and accompanying text.

\(^{108}\) See supra notes 59–78 and accompanying text. A further explanation of this concept will follow.

\(^{109}\) See supra note 53 and accompanying text.

\(^{110}\) See Beck v. Farmers Ins. Exch., 701 P.2d 795, 802 (Utah 1985) (“It is axiomatic that insurance frequently is purchased not only to provide funds in case of loss, but to provide peace of mind for the insured or his beneficiaries.”); see also Kewin v. Mass. Mut. Life Ins. Co., 295 N.W.2d 50, 69 (Mich. 1980) (“It is elemental that an insured is basically contracting for both financial and emotional security in the event of loss.”).

\(^{111}\) For example, on its website, New York Life characterizes its disability insurance (the kind of insurance Acquista purchased) as follows: “Disability insurance can provide peace of mind and removes the uncertainty in case of an accident or sickness that makes someone incapable of working.” At http://www.newyorklife.com/NYL2/CategoryDisplay/0,1233,10602,00.html (last visited May 19, 2002). Aetna Life Insurance described its own long-term disability insurance as follows: “Aetna long term care insurance can help [with the costs related to a policyholder’s disability]. And along the way it will give you precious peace of mind, when you may need it most.” At http://www.aetnaushc.com/groupinsurance/members_set.htm (last visited May 19, 2002).
the policyholder does not have sufficient funds at the time of the loss, this fact is within the contemplation of both parties at the time the contract was formed. Indeed, the insurance companies propose and stress the point in their own materials.\textsuperscript{112} Insofar as emotional distress is foreseeable within the meaning of Hadley v. Baxendale principles, recovery for loss due to its occurrence should be allowed as consequential damages, but only in limited contexts.

This Comment acknowledges that awarding damages for emotional distress for a bad faith breach of an insurance policy would produce a significant change in the law of New York. It is submitted, therefore, that, just as consequential damages in general should be limited,\textsuperscript{113} so should limits be imposed on the award of damages for emotional distress. As courts have done in other jurisdictions, New York should look to the "nature of the breach" when deciding when to grant such damages.\textsuperscript{114} It is submitted that a bad faith claim for emotional distress should be permitted only where the insured suffers physical pain or serious medical illness, such as the kind accompanying situations covered by medical and disability insurance or where the insured suffers an injury in an automobile accident or fire, or when the contract deals with an emotional subject likely to cause distress, such as policies for life insurance or for a cemetery plot. This approach would avoid effecting too great a change in New York law. It would provide protection to policyholders, while at the same time limiting in a reasonable manner, the amount of claims under which insurance companies could be held liable for emotional distress.

CONCLUSION

The cases and commentaries proclaim the necessity of providing protection to policyholders from first-party bad faith breaches by their insurers. The possibility of awards for consequential damages, including damages for emotional distress, in excess of the amount of the policy is a practical and effective approach to this problem. Insurance companies, however, must be safeguarded from the burdens of having to pay

\textsuperscript{112} See supra note 112.
\textsuperscript{113} See supra notes 59–96 and accompanying text.
\textsuperscript{114} FARNSWORTH, supra note 1, at § 12.17.
disproportionate damages and from frivolous suits. Consequential damages, therefore, must be granted pursuant to strict adherence to *Hadley v. Baxendale* principles. Allowing damages only for losses that were foreseeable with particularity by the parties at the time of contracting would ensure that these principles are followed. New York must also adopt a clear standard articulating the elements of a bad faith breach. For example, bad faith could be found if: (1) the insurer did not diligently investigate the facts to determine whether the claim was valid; (2) the insurer did not fairly evaluate the claim; or (3) the insurer did not act promptly and reasonably in settling or rejecting the claim. Finally, awards for emotional distress should only be granted in cases where the plaintiff suffers from a physical injury or from a medical ailment, or the policy relates to a subject that is likely to cause emotional distress, such as life insurance. This Comment asserts that the expanded contract remedy, together with the judicial limitations set forth above, would provide adequate protection to insurance companies and would, at the same time, encourage them to deal with their policyholders in good faith.

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