Escaping The Shadow Of Mighty Midgets


As the Bi-Economy court explained, insurers are responsible for these damages because insurance proceeds are to be received “promptly so that in the aftermath of a calamitous event,” the policyholder can “get back on its feet as soon as possible.”[3]

Bi-Economy and Panasia raise important questions: do “consequential” damages include legal expenses and attorneys’ fees incurred by a policyholder that must sue to enforce its rights? Or should a policyholder be made to absorb the costs of a coverage dispute simply to receive its bargained-for benefit?

Before Bi-Economy and Panasia, policyholders lived under the shadow of Mighty Midgets v. Centennial Insurance Co.[4], which limited a policyholder’s ability to recover attorneys' fees to situations in which the insurer sued for a declaratory judgment freeing it from its policy obligations.

Fees have generally been unavailable outside that context, even where an insurer has breached a policy. But since Bi-Economy and Panasia, state and federal courts have allowed policyholders to claim that litigation, and the expense it entails, are foreseeable consequences of an insurer’s breach.

Policyholders’ Pursuit of Attorneys' Fees After Bi-Economy and Panasia

Courts applying Bi-Economy and Panasia have treated policyholders’ requests for attorneys' fees inconsistently. For example, in Authelet v. Nationwide[5], one of the first published opinions on the subject, a New York state trial court permitted a policyholder’s claim for consequential damages to survive a dispositive motion, but dismissed its claim for attorneys' fees. Citing Mighty Midgets, Authelet specifically rejected the argument that Bi-Economy authorized a claim for attorneys' fees as consequential damages.[6]

But a few months later, the Northern District of New York found that Bi-Economy permitted a
policyholder to recover attorneys' fees, in the case of Chernish v. Massachusetts Mutual Life Insurance Company[7]. There, one year after purchasing a 30-year disability policy from Mass Mutual, the policyholder fell ill with several medical conditions. When Mass Mutual ceased benefit payments, Chernish filed suit, alleging that she had expended time and money to reinstate her benefits, and that Mass Mutual delayed payment, required repeated production of documents, made unreasonable settlement offers and otherwise acted in bad faith.

Among her damages, Chernish sought her legal fees for pursuing the benefits. Mass Mutual moved to dismiss Chernish’s breach of the covenant of good faith and fair dealing claim, asserting that, in the insurance context, it was not separate from a breach of contract claim, and that Chernish could not recover consequential damages.

The court denied Mass Mutual’s motion, finding that Bi-Economy and Panasia recognized the availability of “consequential damages resulting from a breach of the covenant” where the parties had contemplated these damages as a probable result of the breach.[8]

Chernish’s damages were deemed within Mass Mutual’s contemplation because the purpose of disability income insurance made Mass Mutual aware that it would have to respond in damages for breach of its obligations to act in good faith. The court specifically rejected the cases cited by Mass Mutual because they predated Bi-Economy, which had “changed the landscape.”[9]

Shortly thereafter, in the October 2009 case of Woodworth v. Erie Insurance[10], a magistrate judge for the Western District of New York took a position contrary to Chernish. Plaintiff policyholders had responded to the Bi-Economy decision by moving to amend their complaint to request consequential damages, including attorneys’ fees. Ultimately, the district court denied the motion for lack of diligence, since the policyholders had waited 11 months after Bi-Economy to move. But not before the magistrate judge had issued a recommendation that the attorneys’ fees request was “futile.” The recommendation noted that Bi-Economy did not “alter in the insurance context the traditional American rule that each party should bear its own attorneys' fees.”[11]

But in Quick Response Commercial Division LLC v. Travelers Property Casualty Co.[12], the Northern District of New York allowed a policyholder’s request for fees and costs to survive a motion to dismiss.

BBL Construction had a builder’s risk policy with Travelers. When its premises sustained a covered loss, BBL hired Quick Response to inspect and repair the damage. The companies signed a contract including provisions relating to invoices: 18 percent interest would be assessed on any that BBL failed to pay, and BBL would be responsible for attorneys' fees expended in pursuing their payment.

When Quick Response’s invoices went unpaid for months, BBL assigned its rights under its Travelers policy to Quick Response. Quick Response sued Travelers claiming breach of contract for failing to pay the invoices, and breach of the implied covenant of good faith and fair dealing for failing to “fairly, timely and accurately adjust BBL’s claim following the loss.”[13] In addition to the invoiced amounts and
the 18 percent accrued interest, Quick Response sought the fees and costs incurred to pursue Travelers.

The court agreed with Quick Response, and in just a few sentences denied Travelers’ motion to bar recovery of legal expenses and nonstatutory interest. The court observed that Quick Response had adequately pled its claim for these damages to include all interest as well as fees and costs.

Because Bi-Economy allowed recovery of consequential damages in a breach of contract action, the court permitted Quick Response’s claims for attorneys’ fees. Moreover, the court found that, although recovery of the damages would ultimately require a showing of foreseeability, Quick Response was not required to allege at the pleading stage that the damages were foreseeable.[14]

In 2010, the New York Supreme Court found in J.M. Electrical Corp. v. Nationwide Mutual Fire Insurance[15] that a policyholder’s legal expenses were a “natural and probable consequence” of the insurer’s breach.

Siemens had contracted with JMEC to renovate a university’s Manhattan property. Although the contract required JMEC to indemnify Siemens under certain circumstances and to name Siemens as an additional insured on its Nationwide policy, JMEC failed to do so.

When a third subcontractor’s employee filed a personal injury action due to injuries sustained at the job site, the defendants filed a third-party suit against Siemens and JMEC. Nationwide agreed to defend JMEC, but refused to cover Siemens, claiming JMEC never named it an additional insured. Siemens sued JMEC seeking indemnification, and won a judgment that JMEC had breached the parties’ contract.

JMEC then sued Nationwide for the $60,000 it paid to settle Siemens’s indemnification claim, and for the legal fees it incurred in that action. The court awarded both, finding that JMEC’s policy required Nationwide to defend Siemens in the underlying action and that Nationwide’s refusal to do so was a breach of the policy, making it liable to JMEC for the amount paid to settle with Siemens.

Moreover, because Nationwide knew that JMEC was obligated by contract to indemnify Siemens, and that litigation against them was already in progress, Siemens’s lawsuit was a foreseeable consequence of Nationwide’s refusal to defend. The court viewed the case through the lens of Bi-Economy: whatever legal expenses JMEC incurred to defend against Siemens were a “natural and probable consequence” of Nationwide’s own breach.

In July 2010, in Whiteface Real Estate Development & Construction LLC v. Selective Insurance Co.[16], a policyholder’s claim for legal expenses survived summary judgment.

While Whiteface was building a residential duplex, a fire in one of the units consumed the entire building. Because the property owner had already occupied one of the units, its insurer paid for the occupied unit and then subrogated against Whiteface.

The property owner also sued for its uninsured losses. Whiteface’s insurer, Selective, defended and settled these claims under Whiteface’s commercial liability policy. But when Whiteface sought coverage
for the unoccupied unit under its builder’s risk policy, Selective denied the claim.

Selective argued that all builder’s risk coverage for the building had ceased when the property owner began occupying one of the units, even though the other unit was under construction. Without coverage by Selective, and obligated by contract with the landlord to clean up and rebuild the other unit, Whiteface took out a loan to finish the project.

Whiteface sued Selective seeking a declaration that its builder’s risk coverage extended to the unit, and asserted a claim for bad faith demanding consequential damages. On Selective’s summary judgment motion, the court first rejected Selective’s argument that its “consequential loss” exclusion barred the claim because the Court of Appeals had already decided in Panasia that a policy’s “exclusion for consequential loss does not bar the recovery of consequential damages.”[17]

The court next found that a reasonable factfinder could conclude that the burden Whiteface had shouldered after Selective denied coverage — including the loan to finance reconstruction and the legal costs — was “reasonably contemplated” by the parties, and necessary to return Whiteface to the position it would have occupied had coverage not been denied.[18]

**Fees and Costs Apart From Bi-Economy and Panasia**

In Grinshpun v. Travelers Casualty Co.[19], another noteworthy case contemplating an award of legal fees outside the Bi-Economy and Panasia framework, three plaintiffs were involved in a car accident with a driver insured by Geico.

Geico tendered its insured’s policy to the plaintiffs, who accepted with the approval of their own insurer, Travelers. But the plaintiffs alleged injuries in excess of Geico’s policy limits, and requested $100,000 each, the maximum provided under their own supplementary uninsured/underinsured motorist coverage with Travelers.

When Travelers denied the claims, the plaintiffs filed suit alleging bad faith and sought the $100,000 provided under the policy as well as $1,000,000 in unspecified, extra-contractual damages for Travelers’s alleged bad faith denial of coverage. Travelers moved to dismiss this second claim for failure to state a cause of action.

The court denied the motion based on the 1968 case of Sukup v. State of New York[20], in which the Court of Appeals recognized a cause of action for legal expenses as extra-contractual damages resulting from an insurer’s bad faith denial of coverage.

Under Sukup an insurer might be held liable not where a denial resulted from a simple difference of opinion, but rather where it was made in such bad faith that “no reasonable carrier” could assert it.[21] Ultimately, no such bad faith was found in Sukup, but Grinshpun discussed three other cases in which the cause of action was acknowledged. Thus, Grinshpun found that a dismissal of the plaintiffs’ second claim was unwarranted.
Notably, the court in Grinshpun explicitly declined to rest its holding on Bi-Economy and Panasia. The court found that the plaintiffs’ damage claims were for legal fees incurred in pursuing coverage and were not for fees arising from damages from the insurer’s denial. But as Bi-Economy and Panasia did nothing to disturb Sukup, the Grinshpun court denied Travelers’ motion to dismiss.

**Conclusion**

Although the law is still developing, Chernish, J.M. Electrical Corp., Whiteface and Quick Response show an increasing willingness by New York courts to allow policyholders to seek their attorneys' fees and costs as consequential damages for pursuing coverage after an insurer’s improper denial of coverage.

Moreover, the Grinshpun case shows that a claim for attorneys' fees and costs may be viable even when not founded on Bi-Economy and Panasia where no reasonable insurer could have denied the claim.

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[3] Id. at 195.


[8] Id. at 3.

[9] Id. at 4, 5.


[13] Id. at 1.

[14] Id. at 2 n.5.


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