

PAINTING THE LILY

© Thomas M. Bower 2005

In New York, policyholders who sue insurance companies generally allege claims for (a) a declaratory judgment and/or (b) compensatory damages for breach of contract. Sometimes, however, policyholders' counsel try to build up their cases – to “paint the lily” – by adding claims based on theories of “unfair business practices,” “bad faith,” violation of the New York Insurance Law, breach of fiduciary duty, and even fraud. They usually do so for one or more of the following reasons:

- as a basis for claiming tort damages, punitive damages, and attorneys' fees, none of which is available in an ordinary breach of contract case;
 - Claims for such relief increase the potential pay-off for the plaintiff and its counsel. They also increase the defendant's potential risk, and may therefore encourage the insurer to settle.
- to provide a potential alternative basis for recovery, if the plaintiff is unable to prove its case on the main breach of contract claim;
- to try to get the benefit of a statute of limitations longer than the one or two years permitted under many policies' “suit limitation” provisions;
- to distract defense counsel (and sometimes the court) from the central coverage issues in the case;
- to lay a basis for a diffuse attack on the defendant's business practices, as opposed to focusing on specific coverage issues;
- to try to broaden the scope of discovery beyond what would otherwise be available in a garden-variety declaratory judgment or breach of contract case;
- to try to make it more difficult for the defendant to have the entire case disposed of on a motion for summary judgment; and
- to try to impress a jury and convince it – even if only subliminally – that the plaintiff's case has greater merit and importance than it actually does, on the theory that any plaintiff pleading that many separate causes of action must really have something to gripe about.

This monograph surveys New York case law relevant to such “built-up” claims. Insurers may be able to use such case law to get such claims dismissed. Insureds can use such case law to help them plead claims less vulnerable to dismissal.

UNFAIR BUSINESS PRACTICES AND GENERAL BUSINESS LAW § 349

Section 349(a) of New York's General Business Law provides that "[d]eceptive acts or practices in the conduct of any business, trade or commerce or in the furnishing of any service in this state are hereby declared unlawful." N.Y. GEN. BUS. LAW § 349(a). That statute applies to the business of insurance as much as it applies to any other kind of business. *Gaidon v. Guardian Life Ins. Co. of America*, 94 N.Y.2d 330, 704 N.Y.S.2d 177, 725 N.E.2d 598 (1999).

However, the statute was **not** intended to turn a simple breach of contract into a statutory tort, or to supplant an ordinary breach of contract action between parties to an arm's length contract. As discussed below, case law has limited the reach of the statute to only certain types of cases. Nevertheless, plaintiffs often seek to dress up ordinary breach of contract claims as violations of General Business Law § 349, simply by adding conclusory allegations to the effect that the defendant's breach of contract was a "deceptive act or practice" in violation of § 349. It takes much more than that to plead a claim under the statute.

To state a cause of action under G.B.L. § 349, a claim must be predicated on a deceptive act or practice that is both (a) "consumer-oriented" and (b) threatens rights of consumers generally, or at least of a broad section of the public. *Gaidon v. Guardian Life Ins. Co. of America*, 94 N.Y.2d 330, 704 N.Y.S.2d 177, 725 N.E.2d 598 (1999) [statute applied to allegedly deceptive mass-marketing of "vanishing premium" life policies]; *Oswego Laborers' Local 214 Pension Fund v. Marine Midland Bank, N.A.*, 85 N.Y.2d 20, 623 N.Y.S.2d 529, 647 N.E.2d 741 (1995) [statute applied to bank's practice of steering customers to non-interest-bearing accounts, rather than interest-bearing ones]. The statute does **not** apply to what are essentially private contract disputes that are unique to the parties, or that arise from non-consumer, commercial transactions. *Quail Ridge Associates v. Chemical Bank*, 162 A.D.2d 917, 558 N.Y.S.2d 655 (3rd Dep't 1990), *appeal dismissed*, 76 N.Y.2d 936, 563 N.Y.S.2d 64, 564 N.E.2d 674 (1990) [G.B.L. § 349 did not apply to commercial dispute between condominium developer and bank, concerning acceleration of delinquent loan]; *Teller v. Bill Hayes, Ltd.*, 213 A.D.2d 141, 630 N.Y.S.2d 769 (2nd Dep't 1995), *lve to appeal dismissed and denied*, 87 N.Y.2d 937, 641 N.Y.S.2d 596, 664 N.E.2d 507 (1996) [statute did not apply to contract dispute between homeowner and renovation contractor]; *Teller v. Bill Hayes, Ltd.*, 213 A.D.2d 141, 630 N.Y.S.2d 769 (2nd Dep't 1995), *lve to appeal dismissed and denied*, 87 N.Y.2d 937, 641 N.Y.S.2d 596, 664 N.E.2d 507 (1996) [statute "was not intended to turn a simple breach of contract into a tort,"

but “to empower consumers; to even the playing field in their disputes.... It was not intended to supplant an action between parties to an arm’s length contract.” *Id.*, 213 A.D.2d at 148, 630 N.Y.S.2d at 774]; *Graham v. Eagle Distributing Co., Inc.*, 224 A.D.2d 921, 637 N.Y.S.2d 583 (4th Dep’t 1996) [same].

Defense counsel must carefully examine a complaint’s factual allegations to see if they pass muster under the above case law. Shorn of conclusory allegations and overwrought characterizations, most complaints in insured vs. insurer actions allege only that (a) the insured had a claim or loss, (b) the insurer concluded that, because of the facts of the case and the policy’s terms and conditions, the claim or loss was not covered, and (c) the insured believes the carrier’s determination was incorrect and a breach of the insurance contract. Sometimes, a complaint will go a bit farther, and include a long list of “unfair claims practices,” but will not clearly allege that the carrier *committed* any of them. In yet other cases, a complaint will allege in a conclusory way that an insurer committed two specific “deceptive acts or practices”: (a) making a “bad faith interpretation of the insurance contract” and (b) “refusing the insured’s demand for the payment of its loss without the need to institute suit.”¹ None of those, by itself, sufficiently alleges a deceptive act or practice within the meaning of G.B.L. § 349. In most coverage disputes, such allegations will be neither “consumer-oriented” nor implicate the rights of consumers generally, or of a broad section of the public at large.

Insurance coverage disputes are therefore usually held to be private, non-consumer, commercial contract disputes that are unique to the parties and, therefore, beyond the intended scope of G.B.L. § 349. *E.g.*, *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995) [statute did not apply to commercial insurance coverage dispute, unique to the parties]; *Fekete v. GA Ins. Co. of New York*, 279 A.D.2d 300, 719 N.Y.S.2d 52 (1st Dep’t 2001) [statute did not apply to private contract dispute regarding policy coverage and the processing of a claim]; *Security Mut. Life Ins. Co. of New York v. DiPasquale*, 283 A.D.2d 182, 724 N.Y.S.2d 594 (1st Dep’t 2001), *lve to appeal dismissed*, 97 N.Y.2d 653, 737 N.Y.S.2d 53, 762 N.E.2d 931 (2001) *and* 97 N.Y.2d 700, 739 N.Y.S.2d 99, 765 N.E.2d 302 (2002) [same]; *Korn v. First Unum Life Ins. Co.*, 277 A.D.2d 355, 717 N.Y.S.2d 606 (2nd Dep’t 2000) [same]; *Egan v. New York Care*

¹ Those allegations are drawn from the definition of “unfair business practices” in the New York Insurance Law. However, under the Insurance Law, refusing an insured’s demand for payment is not an “unfair business practice” *per se*. The Insurance Law says it is an unfair business practice only when done (a) “without just cause” **and** (b) “with such frequency as to indicate a general business practice.” N.Y. INS. LAW § 2601(a).

Plus Inc. Co., Inc., 227 A.D.2d 652, 716 N.Y.S.2d 430 (3rd Dep't 2000) [same]; *Pellechia & Pellechia, Inc. v. American National Fire Ins. Co.*, 244 A.D.2d 395, 665 N.Y.S.2d 565 (2nd Dep't 1997) [same]; *DePasquale v. Allstate Ins. Co.*, 179 F.Supp.2d 51 (E.D.N.Y.2002), *aff'd*, 50 Fed.Appx. 475 (2nd Cir. 2002) ["Almost uniformly, . . . courts have held that such disputes are nothing more than private contractual disputes that lack the consumer impact necessary to state a claim pursuant to Section 349." *Id.*, 179 F.Supp.2d at 62].

A plaintiff cannot salvage a G.B.L. §349 claim by making *pro forma* allegations of a "potential to harm the public at large." Conclusory, non-specific allegations "upon information and belief," to the effect that a defendant's conduct is "part and parcel of a scheme to deceive the public at large," that a defendant "engaged in a pattern and practice," or words of similar import, are also not enough to state a claim under G.B.L. § 349. *Grand General Stores, Inc. v. Royal Indem. Co.*, 1994 WL 163973 (S.D.N.Y. 1994). Rather, a plaintiff must plead evidentiary **facts** showing a pattern of deceptive acts amounting to a general business practice designed to deceive the public at large, *id.*, plead the sources of its information and belief, and otherwise come forward with whatever specific facts it has showing the alleged pattern and practice. *E.g., Belco Petroleum Corp. v. AIG Oil Rig, Inc.*, 164 A.D.2d 583, 598-99, 565 N.Y.S.2d 776, 785-86 (1st Dep't 1991); *Halpin v. Prudential Ins. Co. of America*, 48 N.Y.2d 906, 425 N.Y.S.2d 48, 401 N.E.2d 171 (1979); C.P.L.R. § 3016(b).

THERE IS NO PRIVATE RIGHT OF ACTION FOR VIOLATIONS OF NEW YORK'S INSURANCE LAW OR REGULATIONS ON "UNFAIR CLAIM SETTLEMENT PRACTICES"

Plaintiffs often attempt to plead claims based on alleged violations of New York State Insurance Department regulations concerning unfair claim settlement practices, 11 N.Y.C.R.R. §§ 216 *et seq.* Those regulations are promulgated pursuant to Insurance Law § 2601, New York's unfair claim settlement practices statute. However, that statute imposes no tort duty on insurers; no private right of action arises from a violation of it, or of regulations promulgated under it. *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995); *Rocanova v. Equitable Life Assur. Society of the United States*, 612 N.Y.S.2d 339, 83 N.Y.2d 603, 634 N.E.2d 940 (1994). Therefore, although such alleged violations might conceivably be relevant to a plaintiff's breach of contract claim, they do **not** state an independent cause of action in and of themselves.

AN ALLEGATION OF “BAD FAITH” DOES NOT STATE AN INDEPENDENT CAUSE OF ACTION

Plaintiffs often plead, as if it were a separate cause of action, a claim based on an alleged breach of the implied covenant of good faith and fair dealing. However, under New York law such a claim is derived from the insurance contract and does not state a cause of action separate and apart from the plaintiff’s breach of contract claim. *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995); *Quail Ridge Associates v. Chemical Bank*, 162 A.D.2d 917, 558 N.Y.S.2d 655 (3rd Dep’t 1990), *appeal dismissed*, 76 N.Y.2d 936, 563 N.Y.S.2d 64, 564 N.E.2d 674 (1990); *Page One Auto Sales v. Commercial Union Ins. Cos.*, 176 Misc.2d 820, 674 N.Y.S.2d 577 (Sup.Ct., Monroe Co., 1998); *Schunk v. New York Central Mut. Fire Ins. Co.*, 237 A.D.2d 913, 655 N.Y.S.2d 210 (4th Dep’t 1997). A plaintiff’s allegation of a separate “bad faith” cause of action is therefore duplicative of its breach of contract claim, does not state an independent cause of action, and should be dismissed.

MANY FRAUD CLAIMS EITHER FAIL TO PLEAD FRAUD WITH PARTICULARITY, OR FAIL AS A MATTER OF LAW TO STATE A CLAIM FOR FRAUD, OR BOTH

In coverage cases, plaintiffs may sometimes attempt to plead claims for fraud. The gist of such claims may be either:

- (a) that the insurer, when it sold the policy, never intended to live up to the policy’s terms; *i.e.*, that the insurer fraudulently misrepresented what it would do in the event of a claim or loss and never intended to live up to the promises made in the policy; or
- (b) that the insurer knew, or should have known, that the insured needed or was looking for a particular kind of coverage the policy would not provide, but failed to point that out to the insured; *i.e.*, that the insurer committed fraud “by omission.”

Such claims often fail to state a cause of action, for a number of reasons.

Plaintiffs are required to plead fraud with particularity.

New York law requires that “where a cause of action...is based upon...fraud...the circumstances constituting the wrong shall be stated **in detail**.” C.P.L.R. § 3016(b) [emphasis added]. Such a claim will be dismissed unless supported by “specific and detailed allegations of fact in the pleadings.” *E.g.*, *Callas v. Eisenberg*, 192 A.D.2d 349, 350, 595 N.Y.S.2d 775 (1st

Dep't 1993). In many cases, plaintiffs fail to allege such facts, leaving one to wonder what the plaintiff is talking about concerning one or more of the basic elements of a fraud claim: falsity, materiality, *scienter*, actual and reasonable reliance, and actual injury.

Where a fraud claim would be duplicative of a breach of contract claim, no separate fraud claim is permissible.

Under New York law, the breach of a contract can give rise to a tort claim (*e.g.*, a claim for fraud) only where the contract creates a relation out of which springs a separate duty – ***independent of the contract obligation*** – and that independent duty is also violated. *Quail Ridge Associates v. Chemical Bank*, 162 A.D.2d 917, 558 N.Y.S.2d 655 (3rd Dep't 1990), *appeal dismissed*, 76 N.Y.2d 936, 563 N.Y.S.2d 64, 564 N.E.2d 674 (1990). Therefore, where the only fraud alleged in a complaint relates to the same breach of contract that is already alleged elsewhere in the complaint, a separate cause of action for fraud does not arise. Such fraud claims cannot stand and are usually dismissed. *Id.*; *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995); *Egan v. New York Care Plus Ins. Co.*, 277 A.D.2d 652, 716 N.Y.S.2d 430 (3rd Dep't 2000); *Schunk v. N.Y. Central Mut. Fire Ins. Co.*, 237 A.D.2d 913, 655 N.Y.S.2d 210 (4th Dep't 1997); *Teller v. Bill Hayes, Ltd.*, 213 A.D.2d 141, 630 N.Y.S.2d 769 (2nd Dep't 1995), *lve to appeal dismissed and denied*, 87 N.Y.2d 937, 641 N.Y.S.2d 596, 664 N.E.2d 507 (1996).

An insurer usually has no duty to advise or instruct a policyholder concerning the contents of its policy.

Fraud-by-omission claims are usually premised on an assumption – either explicit or implicit – that the insurer knew or should have known what kind of coverage the insured really needed, and had a duty to advise the insured to buy it. Such an assumption is contrary to law: absent a specific request for a type of coverage not already provided in its policy, an insurer usually has **no** obligation to advise its insured concerning the contents of the policy, or to advise the insured to procure additional coverage. *E.g.*, *Reilly v. Progressive Ins. Co.*, 288 A.D.2d 365, 733 N.Y.S.2d 220 (2nd Dep't 2001). Rather, it is the insured's duty to familiarize itself with the contents of its policy, and an insured is conclusively presumed as a matter of law to know the contents of its policy. *Metzger v. Aetna Ins. Co.*, 227 N.Y. 411, 125 N.E. 814 (1920); *Wausau Underwriters Ins. Co. v. St. Barnabas Hosp.*, 145 A.D.2d 314, 534 N.Y.S.2d 982 (1st Dep't 1988); *Rogers v. Urbanke*, 194 A.D.2d 1024, 599 N.Y.S.2d 697 (3rd Dep't 1993).

Although a duty to disclose may sometimes arise when one party has information the other party is entitled to know because of a fiduciary or similar relation of trust and confidence between them, no such relation exists in the typical insurer-insured relationship. Except when it is defending an insured under a third-party liability coverage, an insurer is not a fiduciary for its insureds and does not owe policyholders the common law duties of a fiduciary. *Fiala v. Metropolitan Life Ins. Co.*, 6 A.D.3d 320, 776 N.Y.S.2d 29 (1st Dep't 2004). Rather, insurance companies deal with their insureds at arm's length. *Goshen v. Mut. Life Ins. Co.*, 1997 WL 710669, *8-9, 1997 N.Y. Misc. LEXIS 486, *25-26, *aff'd*, 259 A.D.2d 360, 684 N.Y.S.2d 791, *mod. on other grounds*, 94 N.Y.2d 330, 704 N.Y.S.2d 177, 725 N.E.2d 598 (1999). That is especially so where the insured is a sophisticated business, or is advised and represented by an insurance broker in its dealings with the insurer.

IN MOST CASES, CLAIMS FOR PUNITIVE DAMAGES AND ATTORNEYS' FEES SHOULD BE DISMISSED

In New York, punitive damages are not recoverable for a breach of contract unless the breach (a) involves the commission of an independent, actionable tort **and** (b) the conduct constituting that tort evinces a "high degree of moral turpitude," demonstrating "such wanton dishonesty as to imply a criminal indifference to civil obligations." *Rocanova v. Equitable Life Assur. Society of the United States*, 612 N.Y.S.2d 339, 83 N.Y.2d 603, 634 N.E.2d 940 (1994). In a first-party insurance coverage dispute, punitive damages are an "extraordinary remedy," the pleading standard for seeking them is "a strict one," and they will be available "only in a limited number of instances." *Id.*, 612 N.Y.S.2d at 342-43, 83 N.Y.2d at 613, 634 N.E.2d at 943-44.

To claim punitive damages for a breach of contract, it is not enough to allege in a conclusory way that an insurer engaged in "a pattern of bad-faith conduct." Rather, the complaint must first state **facts** alleging an actionable tort involving egregious, wantonly dishonest, tortious conduct directed at the insured, and then punitive damages may be claimed only if the complaint **also** alleges facts showing a pattern of bad-faith conduct directed at the public generally. *Rocanova v. Equitable Life Assur. Society of the United States, id.*; *New York University v. Continental Ins. Co.*, 87 N.Y.2d 308, 639 N.Y.S.2d 283, 662 N.E.2d 763 (1995); *Holoness Realty Corp. v. New York Property Ins. Underwriting Ass'n*, 75 A.D.2d 569, 427 N.Y.S.2d 264

(1st Dep't 1980). In most coverage disputes, the plaintiff's complaint does not come close to satisfying those requirements.

In addition, an insured that brings a coverage suit against its insurer is normally not entitled to an award of attorneys' fees; the insured is entitled to an award of attorneys' fees only if the *insurer* brings such a suit and loses. *E.g.*, *U.S. Underwriters Ins. Co. v. City Club Hotel, LLC*, 3 N.Y.3d 592, ___ N.Y.S.2d ___, ___ N.E.2d ___, 2004 WL 2902402 (2004); *Mighty Midgets, Inc. v. Centennial Ins. Co.*, 47 N.Y.2d 12, 416 N.Y.S.2d 559, 389 N.E.2d 1080 (1979).