

State Of California v. Allstate Insurance Company

Proskauer Rose LLP's Insurance Coverage Practice Group
March 2009

On March 9, 2009, the Supreme Court of California held that a policyholder is entitled to coverage for environmental damage that results from a combination of covered and excluded causes. In *State of California v. Allstate Insurance Company*, 09 C.D.O.S. 2890, the high court issued one of its most important insurance coverage decisions in recent years. "The insured's inability to allocate the damages by cause does not excuse the insurer from its duty to indemnify," the court explained.

This decision will likely influence the outcome of insurance disputes around the country in which the policyholder is unable to quantify the extent to which an excluded cause might have contributed to the damage for which it seeks coverage. Such disputes are central to many first-party property claims such as hurricane claims, which often involve a combination of covered wind damage and excluded flood damage, and third-party liability claims such as environmental and product claims.

In *Allstate*, the trial court had granted summary judgment in favor of four insurers that had denied coverage for the State of California's costs of remediating environmental contamination related to the Stringfellow Acid Pits, a disposal site in Riverside County, California. The trial court ruled that the State was not entitled to coverage

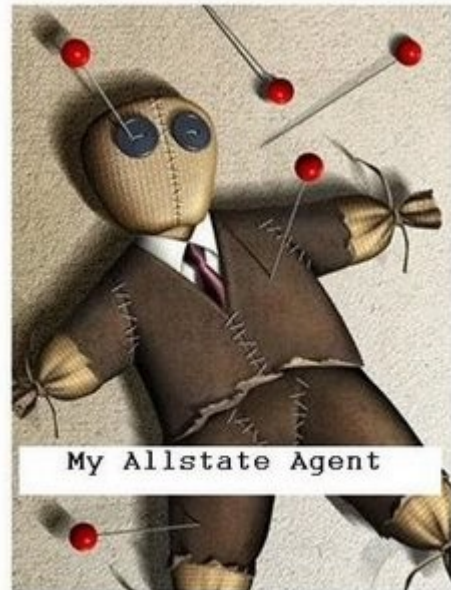
because it could not quantify the amount of damage resulting from "sudden and accidental" releases, which were covered, as opposed to gradual or expected releases, which were excluded. The Court of Appeal reversed, and the California Supreme Court largely affirmed that ruling.

First, the Supreme Court explained that the operative event for determining whether the release of a contaminant into the environment is "accidental" is not the initial deposit of hazardous waste into a disposal site, but the subsequent migration of contamination into the surrounding environment. The court held that the policyholder is entitled to coverage unless subjectively "substantially certain" that further damage will ensue. Even intended releases of hazardous waste into the environment are covered, the court reasoned, if the policyholder does not expect further damage to result.

Second, if covered ("sudden and accidental") releases contribute "appreciably" to the property damage, along with excluded (gradual or expected) releases, the insured is entitled to full coverage for the resulting damage unless the insurer can prove how much of the damage was caused solely by the excluded causes. The fact that the policyholder cannot prove how much of the property damage resulted from covered causes does not relieve the insurer from its duty to indemnify the policyholder in full.

The *Allstate* decision will benefit policyholders not only in California, but also around the country as other states frequently look to California's highest court for guidance on the "concurrent causation" issue – that is, the important question of whether insurance companies must pay for damage that may have been caused in part by causes that are excluded under their insurance policies. This issue arises not only in environmental insurance coverage cases involving "sudden and accidental" pollution exclusions, like *Allstate*, but also in first-party property cases.

For example, a central issue in hurricane and other property claims is often whether excluded causes such as flooding or mold or earthquake contributed to damage that would otherwise be covered. The same issue is often at the heart of third-party liability claims – which frequently hinge on disputes such as whether damage to a structure is due not only to a contractor's covered negligence but also to excluded earth movement, or whether flood damage is caused not only by an excluded storm surge but also by the covered, negligent design of a levy. In such cases, *Allstate* provides an important pro-policyholder precedent from a court to which courts around the country often look for guidance.



COASTAL INSURANCE CRISIS

March 08, 2009

By DAVID McGRATH

Special to the Press-Register (Opinion)

A group of us used to play poker every Friday night until the wee hours. Supposedly, it was a friendly game, a way to blow off steam at the end of the work week and have a few laughs.

I'd like to say our winnings and losses evened out over the long run, except that one of the regulars nicknamed "Mumpsy" — so-called because of his bulging red cheeks — usually ended up with most of our money.

Mumpsy did not cheat. But unlike the rest of the gang, he played only to win and would quit while he was ahead.

The reason nobody called him on his lack of sportsmanship is that we did not notice him hiding the bulk of his winnings in his coat pocket, leaving only a short stack of money on the table.

And then he'd slip out early, saying something like, "This game is too rich for me," leaving us oblivious losers to fight and grub over the meager leftovers.

Mumpsy's system is apparently similar to what State Farm Insurance has been doing in Florida, according to recent news out of our neighboring Sunshine State. After State Farm was denied its request to raise house insurance premiums there, it petulantly announced that it would get out of the game and cancel all homeowner policies in Florida, while poor-mouthing about its \$20 million monthly losses for doing business in the hurricane-vulnerable state.

But according to the Sarasota Herald Tribune, state and federal insurance regulators have found that for the last 10-year period, "State Farm Florida collected \$2.6 billion more in premiums than it paid out in claims," showing that it has been hugely profitable, even in the face of worse-than-average hurricane damage.

What, then, were these so-called losses they were citing to justify higher rates?

The answer, though not technically illegal, is closer to what might be called "cooking the books."

State Farm Florida had been using a scheme similar to Mumpsy's system, clandestinely shifting huge sums to its national State Farm parent company — \$2 billion in the last four years — so that it appears to be operating at a loss, in order to get approval from regulators for jacking up the insurance bill of Joe the Homeowner.

But Florida's insurance commissioner, Kevin McCarty,

wouldn't bite. He scoffed at the company's argument that the \$2 billion in transfers amounted to "expenses" and "reinsurance."

State Farm Florida reacted to his denial by storming out and announcing cancellation of existing policies and its intent not to write any more.

McCarty, though, believes they're bluffing in order to win higher premiums. And he has called their bluff by pointing out that there are plenty of other companies eager to fill the void left by State Farm, whose rates have been among the highest, anyway.

Florida Gov. Charlie Crist raised the bet, vowing to disallow State Farm's lucrative auto insurance business in Florida if the company follows through on its threat to stop insuring houses.

It's a showdown worthy of Dodge City, and you can bet every beleaguered homeowner is rooting for "Marshall" Charlie Crist.

What does all of this have to do with us in south Alabama? Everything.

Six months ago, State Farm requested hikes of 12 percent to 18 percent for homeowners' insurance policies in Mobile and Baldwin counties. That is almost 20 percent above and beyond the \$3,000 to \$4,000 average annual premium paid by owners of median-priced homes within 40 miles of the Gulf Coast.

Alabama Insurance Commissioner Jim Ridling, sympathetic to State Farm's burdensome "expenses," approved the premium hikes. This came as no surprise. Prior to serving as commissioner, Ridling was CEO of Southern Guaranty Insurance Co.

So if State Farm is pulling a "Mumpsy" in Alabama, as well as in Florida, hiding its profits to unfairly snag higher rates, consumers will have to rely on the attorney general, state legislators or Gov. Bob Riley to represent their interests, investigate the truth, and hold State Farm's and other insurers' hands to the fire.

Let's hope they're looking into it today. Better yet, in this economy, yesterday.



Fla. lawmakers 'waking up' to insurance failures

By EVAN LEHMANN, ClimateWire, April 2009

Florida is trying to cure its insurance "disease."

State lawmakers are abandoning long-held promises to lower rates for hurricane policies -- even amid the prospect of stronger storms -- in favor of rapid hikes to rescue public insurance programs that could sink, financially speaking, during the looming cyclone season.

The sudden turnaround amounts to a sobriety test, some contend, as the nation's top and most damage-prone target of hurricanes tries to reduce its vast exposure to loss as scientists predict greenhouse gas emissions will fuel stronger winds and more powerful storm surges.

"I think that everyone's waking up," said Ron Reagan, the state's House speaker pro tempore, a Republican and an insurance agent.

The alarm can be heard, too, in the governor's office, as Charlie Crist (R) moves away from a position that helped get him elected -- lowering rates -- to acknowledging that coastal residents are bound to pay more for their risky real estate positioning.

At the outset of 2007, Crist and lawmakers imposed a rate freeze on the state-operated insurance company, Citizens Property Insurance Corp., the state's largest insurer. The move followed a political campaign season filled with pledges to hold the line on premiums, after a crushing series of storms 16 months earlier swamped pri-

vate insurers and prompted many of them to retreat from the seashore.

Now, in the third year of frozen rates, lawmakers are scrambling to shore up Citizens and the state-run reinsurance program, the Florida Hurricane Catastrophe Fund. Both are short of

surplus to pay claims if a massive hurricane barges ashore. That means nearly every policyholder in the state -- even inland motorists with private car insurance -- could have to fill the gap through additional fees.

Citizens' life expectancy in a storm: 'a few short hours'

"If we have a major hurricane that hits a major metropolitan area, neither one of [the programs] would be able to pay their claims," said state Rep. Bill Proctor, a Republican who introduced a bill that would allow private insurers to charge whatever they want. "Frankly, we've just dug the hole deeper since 2005."

Residents would likely pay more for those policies. But it would be voluntary, and they would never be burdened with post-storm fees, also called assessments, which can hit unsuspecting residents and businesses in the pocket-book.

Proctor's bill is one of many moving through the Legislature. It probably won't pass, observers say, but others that raise rates almost surely will.

Here's why: Citizens is almost broke. The public corporation has more than 1 million policies and about \$450 billion in exposure to loss. And although there have been no major hurricanes in Florida since 2005, the program has only accumulated about \$3 billion in surplus.

"Any kind of significant storm event would, or could, wipe that out in a few short hours," James Malone, chairman of Citizens, said in February.

The House Insurance Committee approved a bill last week that would raise Citizens' rates 20 percent a year until they match the real risk of living in the path of big storms. A Senate committee this week adopted 10 percent hikes annually.

"Florida is clearly beginning to recognize the extremely vulnerable position it put itself in over the past several years," said Robert Hartwig, president and chief economist of the Insurance Information Institute.

Politicians still gain from low rates

Florida is the United States' test tube on climate change. More than a dozen coastal states are experimenting with ways to insure shoreline properties as seas rise, winds strengthen and storm surges penetrate deeper inland. Nowhere is the danger greater than in Florida. The state is home to one-quarter of the country's insured coastal property, worth \$2.5 trillion in 2007.

"If the price of living along the coast more accurately reflects the risk of living along the coast, as reflected in the cost of insurance, that will potentially slow coastal development," Hartwig said.

The moves in Tallahassee seem to represent a blow to the public insurance model in Florida, critics argue, noting that politicians too often seek to please constituents rather than impose far-sighted policies.

"The Legislature has typically swarmed around an issue du jour," said Florida state Sen. Garrett Richter, a Republican and the author of the bill raising rates 10 percent a year. "The previous decisions were short-term decisions to address the political issue at that time."

While the rate hikes proposed by lawmakers might seem high, they're designed to soften explosive spikes that could otherwise come. When the rate freeze expires in January, the law requires Citizens to charge policyholders "actuarial sound" premiums. Translated: The rates must reflect the real risk of living in Hurricane Alley. No more subsidies.

That could mean an instant 55 percent hike for the riskiest policyholders. "That is probably low," admitted John Kuczanski, a Citizens spokesman.

Praying for no hurricanes

Supporters of the legislation say incremental hikes could provide a smooth "glide path" on the way to actuarial sound rates. Annual rises would continue until that target is met.

But some lawmakers wonder when -- or if -- the price hikes will stop. They warn that residents are increasingly allowing their policies to lapse, even as bigger weather risks brew.



Continued on page 51

Florida waking up to failures...

Continued from page 50

Despite the frailty of Citizens, some officials are pushing for an extension of the rate freeze. But the alternative to raising rates, it seems, is left to luck.

"Hopefully, we won't have hurricanes this year ... and we'll be able to build up the reserves, so the increase won't be as necessary," said state Rep. Richard Steinberg, a Democrat from Miami Beach. "In the middle of a recession is not the time for the state to impose an increase in insurance rates."

The legislation also takes aim at the state's reinsurance catastrophe fund. Two years ago, lawmakers doubled its capacity to \$28 billion, vastly increasing the risk to state

policyholders. Now, lawmakers want to shed some of that exposure by shrinking the fund by \$12 billion over six years. That means Citizens and private insurers would have to find expensive private reinsurance to fill the gap, an increase that would likely be passed down to policyholders.

State Farm: a bad neighbor?

But there's little choice; the fund is unable to issue bonds and is facing a \$17 billion shortfall. With hurricane season on the horizon, state officials are asking the federal government for a line of credit to cover the gap.

"There is an acknowledgment that we no longer can bury our head in the sand," said Sam Miller, executive vice president of the Florida Insurance Council.

A grim backdrop is coloring every move in the state. State

Farm Insurance, the second-largest insurer in Florida, announced in January that it will stop writing homeowners policies there. Reagan, the speaker pro tem, believes about half of the company's customers -- or about 400,000 -- could end up with Citizens. That would increase the state's exposure.

"That's the exact opposite of where we need to go," Reagan said.

State Farm's decision came after state regulators prohibited the company from raising its rates 47 percent.

Hartwig, of the Insurance Information Institute, said the pullout underscores the state's "disease" related to "suppressed" insurance rates.

"By building up its own resources, [Florida] will nurse itself eventually back to some better state of health, presumably," he said. "It's going to do that by raising rates for its policyholders."



IT'S A MELTDOWN IN FLORIDA

Floridians are all but taking to the streets because of the mess created by the legislature. Florida Senators and House members are feverishly fielding angry

constituent and media calls and bloggers are having a field day.

Everyone from the Governor down is doing the backstroke on campaign promises to reel in spiraling insurance rates.

Count on POA to follow and report on the Florida meltdown fest.

Meanwhile, here are some useful links that will give you some insight into what caused the meltdown:

- [Database: Political donations from the insurance industry](#)
- [Property insurance bills proposed by Florida legislators](#)
- [Complete coverage: Florida's insurance crisis](#)

Insurance rates going up

WTHR.com Indianapolis, IN April 20, 2009

Indianapolis - From groceries to appliances, prices are going up. You can now add insurance premiums to that list.

It's the sort of rate hike that quickly raises the ire of insurance policy holders. Insurance companies, watching their own profits and portfolios fall, are passing the buck to consumers. Americans can expect to pay higher premiums for auto, home and life insurance.

In Indiana, industry experts expect hikes to be company specific in a state where consumers pay some of the lowest premiums for home and auto coverage in the nation.

"In Indiana, on the property-casualty side, we have some of the lowest rates nationwide, so relative to what everyone else is paying, consumers are getting a pretty good deal," said Stephen Williams, Insurance Institute of Indiana.

According to a report in USA Today, the Insurance Information Institute says that the cost of a typical auto insurance policy is expected to jump four percent to \$875 this year, on top of a three-percent

increase last year. Homeowners insurance will jump three percent to an average \$841. Term life rates are expected to jump five to ten percent.

The price hikes couldn't come at a worse time for policy holders who've seen their own household wealth shrink, home values fall and high unemployment.

Insurance companies invest part of the typical premium in bonds and stocks, and like every other investor, has seen a volatile market. Now insurance companies are passing those losses to consumers trapped in a deep recession.

"For this to happen also, it's like there's no relief anywhere at the moment," said Joyce Sultzer, policy holder.

"I just think there's got to be a better way or maybe they should look at their own front office and take pay cuts like everyone else has had to do," said Dave Crockett, Plainfield.

While there's never a great time to hike insurance rates, the industry, also hurt in this economy, couldn't have picked a worse time.

According to the Insurance Information Institute, Indiana policy holders pay an average \$631 for auto insurance and \$639 in homeowners premiums annually, both far below the national average.



Car insurance rates, along with other types of insurance, are expected to rise this year.



In Montana, insurers are celebrating the defeat of a "bad faith" bill that would have punished business as usual.

Montana Legislature Defeats 'Bad Faith' Legislation

Insurance Journal
March 30, 2009

Montana legislators recently defeated [House Bill 345](#), "An act revising the law governing the damages that may be awarded because of an insurance company's violation of certain prohibited insurance claim settlement practices."

According to the bill text, "Montana law has traditionally sought to protect insurance consumers from harmful claims settlement practices used by some insurance companies." The state Legislature has enacted statutes to hold an insurance company accountable if the company fails to properly investigate a claim or adjust and settle a claim in good faith, and "it is the intent of the Legis-

lature to authorize damages for all detriment, including attorney fees, caused when an insurance company engages in certain prohibited insurance claim settlement practices." In the past, the Montana Supreme Court has denied claims for attorney fees because they were not specifically provided for by the Legislature, the bill text explains.

The [Property Casualty Insurers Association of America](#) expressed opposition to the bill, and applauded its defeat.

"PCI strongly opposed this bill, and the vote was a win for Montana consumers," said Kelly Campbell, PCI regional manager. "Montana already has unfair claims handling laws and regulations on the books, and the competitive nature of the insurance industry places strong pressure on insurers to deliver good customer service when a claim must be settled. This was an unnecessary amendment that would have done nothing to help consumers."

Campbell said the bill, if passed, would have allowed trial lawyers to expand their ability to bring lawsuits and absorb more fees on disputed insurance claims, the price of which ultimately would have been passed onto consumers.

The state Senate Business and Labor Committee earlier had voted down the measure by a 10-1 margin.

Sources: [Montana Legislature](#), PCI

Consequential Damages: New Developments In New York Case Law Regarding An Insured's Right To Recover Extra Contractual Damages

April, 2009

By Laurie A. Kamaiko and Steven P. Nassi

One of the more significant developments of 2008 in New York insurance law came courtesy of two companion decisions by the state's highest court which held that, in addition to recovering policy proceeds, policyholders may recover consequential damages resulting from an insurer's breach of a policy, at least in certain circumstances where the insurer is found to have breached its duty of good faith and fair dealing and the damages were foreseeable and quantifiable; *Bi-Economy v. Harleysville Ins. Co. of N.Y.* and *Panasia Estates v. Hudson Ins. Co.*¹

Consequential damages resulting from a breach of contract have previously been available to parties under traditional contract principles, to the extent they were a foreseeable result of the breach and "within the contemplation of the parties" at the time of contracting. Until recently, however, recovery of consequential damages was not a remedy generally available to policyholders for an insurer's breach of its policy under New York law.²

With *Bi-Economy* and *Panasia*, insureds have gained strong grounds to recover – or at least plead – consequential damages in addition to policy proceeds where the insurer's denial of policy benefits allegedly breaches the covenant of good faith and fair dealing and the consequential damages were foreseeable at the time of contracting. The decisions are significant because New York does not recognize the independent tort of bad faith for an insurer's breach of the policy so as to support an award for extra-contractual damages, absent a pattern of egregious conduct warranting punitive damages.³ These decisions provide a potential new avenue for recovery of extra-contractual damages from insurers.⁴

Setting The Stage: *Bi-Economy* and *Panasia*

The New York Court of Appeals set the stage for the pleading of consequential damages claims by insureds against insurers in its *Bi-Economy* decision. *Bi-Economy* dealt with an insurer's breach of the insured's right to prompt adjustment and payment of first party business interruption coverage under a commercial property insurance policy. In upholding the insured's right to assert a claim for consequential damages, the Court set forth specific requirements that an insured would need to meet in order to plead and prevail on such a claim.

The Court held that an essential factor of a consequential damages claim is that the risk was foreseen, or should have been foreseen, at the time of contracting. This does not mean the insurer has to foresee the breach or the particular way the loss occurred, but that loss from a breach was "foreseeable and probable." To satisfy this requirement, it must be determined whether consequential damages were "reasonably contemplated by the parties," and to do so "courts must look to the nature, purpose and particular circumstances of the contract known by the parties."⁵



The nature of the coverage in issue was a significant factor in *Bi-Economy*. The Court reasoned that the "very purpose" of business interruption coverage "would have made [the insurer] aware that if it breached its obligations under the contract to investigate 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."⁶ The Court further held that proof of consequential damages cannot be "speculative or conjectural," and must be proved with "reasonable certainty and be capable of measurement based upon known reliable factors without undue speculation."⁷ While the plaintiff had asserted a cause of action for bad faith claims handling, the right to plead consequential damages was based on the Court's holding that implicit in a contract of insurance is a covenant of good faith and fair dealing that includes a promise to investigate in good faith and pay covered claims.

The majority opinion distinguished consequential damages from punitive damages, noting that the purpose of consequential damages was not a punishment to the insurer but "to give the insured its bargained-for-benefit," whereas punitive damages are intended to punish the breaching party.⁸ The Court viewed the prompt payment of business interruption losses to be a bargained-for-benefit, as the purpose of business interruption coverage is to receive money promptly and avoid collapse of the business. Thus, failure to provide that benefit rendered additional damages foreseeable.

There was a strong dissent, which argued that the bargained-for-benefit of an insurance contract is coverage up to the policy limits, and that the parties to a policy generally do not contemplate consequential damages or, if they did, it would be rejected by the insurer.⁹ The dissent considered the majority to be simply re-labeling punitive damages as consequential damages, and essentially allowing recovery of punitive damages without the requisite showing of a pattern of egregious conduct directed at the public.

In the companion case of *Panasia*, the Court relied on its opinion in *Bi-Economy* to uphold an insured's right to recover consequential damages for an insurer's alleged breach of the covenant of good faith and fair dealing in failing to promptly investigate, adjust and pay a claim made under builders risk coverage included in a commercial property insurance policy. However, the Court noted that the court below had failed to consider whether the consequential damages sought were foreseeable as the result of the insurer's breach, and thus remanded the case. *Panasia* confirmed that the question of whether a plaintiff's consequential damages were a reasonably foreseeable result of the breach and within the contemplation of the parties at the time of contracting is a question of fact, dependent on the circumstances and the nature and purpose of the insurance contract at issue.¹⁰

Continued on page 55

RIGHT TO RECOVER ABOVE POLICY LIMITS

Continued from page 54

Application of *Bi-Economy* and *Panasia* by Lower Courts and the Extension to Third Party Liability Coverage

Policyholders have been quick to assert the right to plead consequential damages in the wake of *Bi-Economy* and *Panasia*. The subsequent caselaw suggests that the effect of these decisions may be more expansive than the Court of Appeals perhaps intended.

In *Hoffman v. Unionmutual Stock Life Ins. Co. of N.Y.*,¹¹ a New York appellate court relied on *Bi-Economy* to allow an insured's allegations of bad faith claims handling to be incorporated into its claim for wrongful denial to pay disability benefits, thereby opening the door for the insured to seek consequential damages. Significantly, while the court dismissed the tort cause of action for a breach of the duty of good faith, it held that allegations of breach of good faith were incorporated into the breach of contract claim, and that was a sufficient basis for seeking consequential damages.

An insured's right to seek consequential damages for the "distress, aggravation and inconvenience" purportedly caused by its insurer's alleged refusal to adjust, settle, compromise or pay a first party claim under a homeowner's policy was upheld in *Chaffee v. Farmers New Century Ins.*¹² There, the claim arose from an insurer's alleged failure to pay a claim for fire losses under a homeowner's policy. Although the court found that the insureds' claim for consequential damages is properly part of its breach of contract claim and not a separate cause of action, it also noted allegations that the insurer violated the implied covenant of good faith. Thus, the decision underscores that the right to seek consequential damages requires more than just ordinary breach of contract without associated improper conduct.

Courts have also relied upon *Bi-Economy* and *Panasia* to sustain an insured's right to seek consequential damages in the context of third party coverage.

In *Silverman v. State Farm Fire & Casualty Co.*,¹³ the court sustained an insured's right to seek consequential damages based on the insurers' alleged improper failure to provide third party liability coverage for an assault claim under general, business owners and homeowners liability policies. The trial court dismissed plaintiffs' claim for punitive damages, but allowed them to amend their complaint to seek consequential damages, noting that such a claim is available if the failure to provide coverage flows from a breach of the covenant of good faith and fair dealing. The court also noted that defendants could still move to dismiss the claim after discovery.

In *Handy & Harman v. AIG*,¹⁴ the insured sought consequential damages as part of its claim for breach of an environmental pollution liability policy, which provided coverage for cleanup costs and third party liability. The court noted that the nature of that policy was to ensure that the insured had the finances to conduct the remediation and pay third party claims, and that the insured had purchased the policy when it agreed to remediate its property in conjunction with its sale to avoid the financial pressure of remediation on its on-going business. Thus, the court found that "the particular circumstances" of the case and the nature and purpose of the policy supported the foreseeability of consequential damages. Significantly, the court required that there be allegations of breach of the

covenant of good faith in plaintiff's breach of contract claim to support the request for consequential damages.

Conclusion

Bi-Economy and *Panasia* have provided insureds with a means to seek extra-contractual damage where there is foreseeable and quantifiable damage proximately resulting from an insurer's improper conduct.

To date, decisions have focused on an insured's right to plead consequential damages, rather than on upholding a recovery. It remains to be seen whether courts will continue to limit the right to plead consequential damages to those situations in which there are allegations of improper insurer conduct beyond simple breach of contract, and whether they will limit the right to recover by enforcing the burden of proof on insureds to demonstrate that such damages are quantifiable rather than speculative, and were foreseeable at the time the insurance was placed.

Footnotes

1 10 N.Y.3d 187 (2008) and 10 N.Y.3d 200 (2008), respectively.

2 The 2001 decision by an intermediate appellate court in *Acquista v. N.Y. Life Ins. Co.*, 285 A.D.2d 73 (1st Dept. 2001) opened the door for policyholders to seek consequential damages apart from policy proceeds as a result of an insurer's breach of an insurance contract, at least in the first party disability insurance context. The court (with a strong dissent) rejected the traditional view of New York court law up to that point that the remedy for an insurer's breach of contract was limited to recovery of policy proceeds. The court's reference to consequential damages being available was in the context of the insurer's denial or dilatory payment being without a reasonable basis. The ruling in *Acquista*, however, was generally rebuffed by New York courts. See, *Eurospark Indus. v. Mass. Bay Ins. Co.*, 288 B.R. 177, 186 (E.D.N.Y. 2003) (acknowledging that "[t]he *Acquista* decision has been met with disapproval").

3 See *Rocanova v. Equitable Life Assur. Soc.*, 83 N.Y.2d 603, 615 (1994) (holding that insured may recover contractual damages for insurer's breach, but not punitive damages unless insured could show "egregious tortious conduct" directed at the insured demonstrating a "pattern of similar conduct directed at the public generally."); see also *New York Univ. v. Continental Ins. Co.*, 87 N.Y.2d 308, 316 (1995).

4 This article does not address the issue of an insured's right to recover excess of policy limits when its liability insurer improperly fails to settle a claim within policy limits in gross disregard of the insured's interests. See, e.g., *Pavia v. State Farm Mut. Ins. Co.*, 82 N.Y. 2d 445 (1993).

5 *Bi-Economy*, 10 N.Y. 3d 187, 193 (2008).

6 *Id.* at 195.

7 *Id.* at 193 (citations and quotations omitted).

8 *Id.* at 195.

9 *Id.* at 198.

10 In both *Bi-Economy* and *Panasia*, and in a recent decision by the Fourth Department in *Stern v. Charter Oak Fire Ins. Co.*, 2009 NY Slip. Op. 00729 (N.Y. App. Div. Feb. 6, 2009) (reversing its prior holding issued before the Court of Appeals decided *Bi-Economy*), the courts also rejected the insurers' attempt to rely on a policy's "consequential loss" exclusion to bar an insured's "consequential damages" claim against its insurer. *Bi-Economy* determined that the term "consequential loss" as used in the exclusion refers to loss stemming from the conduct of the insured or third parties, while "consequential damages" concerns damages incurred by the insured as a result of the insurer's misconduct. *Bi-Economy*, 10 N.Y. 3d 187, 195.

11 857 N.Y.S.2d 680 (App. Div., 2nd Dep't 2008).

12 2008 WL 4426620 (N.D.N.Y. 2008).

13 867 N.Y.S.2d 881 (N.Y. Sup. Ct. 2008).

14 2008 NY Slip. Op. 32366 (N.Y. Sup. Ct. 2008).

This article was first published in of the March 2009 issue of Edward Angell Palmer & Dodge's quarterly 'Insurance and Reinsurance Review'



Senate Democrats block key insurance legislation

By JAY ROOT Associated Press, April 8, 2009

AUSTIN, Texas — Senate Democrats moved Wednesday to block key insurance legislation as they push for more consumer protections and lower homeowner rates.

Using filibuster rules, Democrats refused to allow debate on a bill that authorizes the Texas Department of Insurance to continue operations. They're pushing for amendments that would give regulators more rate oversight.

"Democrats are fighting to ensure that Texans are no longer required to pay the highest rates in the nation, and are insisting that the legislation reflects a Department of Insurance that will protect consumers," said Sen. Leticia Van de Putte of San Antonio, leader of the Senate Democrats.

Texans pay the highest homeowner rates in the nation. According to the National Association of Insurance Commissioners, the most common homeowner policy cost Texans \$1,409 a year on average, compared to a national average of \$804.

The sponsor of the legislation, Sen. Glenn Hegar, R-Katy, said he was working on a compromise — possibly to be unveiled next Tuesday — but vowed to resist proposals that would give state regulators prior approval of insurance rates.

He said the current regulatory structure, which allows companies to immediately raise rates after notifying the state insurance department, would encourage competition and should be given a chance to work.

"We need to create a stable market in Texas," Hegar said. "There's no magic panacea to fixing rates."

Jerry Johns, president of the Southwestern Insurance Information Service, said his industry objects to giving regulators the ability to pre-approve rates.

"If people want to step back 20 years and have a one size fits all insurance policy and a lack of product choices then prior approval is answer," Johns said.

The maneuver by Democrats took aim at the insurance "sunset" bill — legislation that allows the department to continue operations after a careful overview of its policies and procedures. Without specific approval from the Legislature, the department would cease to exist after September 2010.

Hegar said he expected his legislation keeping the department alive would be approved, probably next week.

The legislative session ends June 1.

In another vote affecting Texas insurance policy, the Senate unanimously approved legislation that would rein in the often eye-popping commissions paid to insurance agents who sell questionable or bogus financial products to elderly Texans.

The industry, including representatives of maligned insurance giant American International Group, Inc., has been fighting hard against increased regulation. In some cases, commissions worth tens of thousands of dollars are being paid to agents who sell annuities that often bilk senior citizens out of much of their retirement nest eggs, officials say.

The bill by Sen. Rodney Ellis, D-Houston, would for the first time allow Texas insurance regulators to limit commissions on annuity sales when companies have demonstrated a pattern of alleged abuse and after officials hold public hearings into the matter.

The legislation would also put limits on annuities with fixed maturity dates. Under current law, the policies can be written so that no benefits are paid until a person reaches up to 115 years of age. To get out of the contract, the elderly citizens then face huge contract surrender charges.

—

The insurance sunset bill is SB1007

The annuities bill is SB961

In related news on April 21st, the Texas Senate approved a measure that allows the continued operation of the Texas Department of Insurance. The bill now heads to the Texas House for approval.

The Senate-passed bill modifies the current insurance gouging system from the ridiculous process by which insurers file rate increases with the TDI then implement those rates while the TDI is reviewing the request. If passed, the new bill allows the commissioner to place the insurer under a prior approval system and would require the commissioner to approve or disapprove the rate hike within 30 days.

The bill also penalizes insurers who drag out the approval process through lengthy appeals.

Lawmakers debate windstorm insurance

By KELLEY SHANNON Associated Press Writer
April 7, 2009

operation of the windstorm insurance association is not just a coastal concern.

Rep. Craig Eiland, a Galveston Democrat, put forth another windstorm association bill

AUSTIN, Texas — Texas legislators jumped into debate Tuesday over how to improve the troubled windstorm insurance system that serves as a last resort for hurricane protection along much of the Gulf Coast.

Tuesday, as did Insurance Commission Chairman John Smithee, an Amarillo Republican. Smithee said he wants to ensure the solvency of the Texas Windstorm Insurance Association and make sure it operates on sound business principles.

The House Insurance Committee, watched closely by coastal residents and insurance executives, began considering a slate of bills that propose changes to the system. It's widely agreed the Texas Windstorm Insurance Association needs an update, especially after the financial toll of last year's Hurricane Ike.

The fund faces more problems than it did last session, when lawmakers failed to pass a reform bill.

Smithee noted that this year several hundred million dollars the windstorm association had in its trust fund are gone because of hurricane claims; that bonding is not as easy because of the national economy; and reinsurance — a backup insurance policy for insurance companies — is now likely to be more expensive.

Gov. Rick Perry declared reform of the windstorm association an emergency item this legislative session, which ends June 1, just as the next hurricane season is beginning.

Insurance companies that pay into the windstorm system can recoup some of their assessments through state tax credits over several years, ultimately affecting the state budget.

Lee Otis Zapp of Galveston, representing the Coastal Windstorm Insurance Coalition, told House members his group proposes to "keep it simple." He outlined several ideas, including assessing insurance companies in a way that motivates more of them to return to voluntarily writing property policies along the coast.

"We're from Texas, one Texas," Zapp said. "We need help."

Revamping the windstorm fund has been on the minds of legislators since private companies began pulling away from offering property policies on the Texas coast after hurricanes Katrina and Rita in 2005. The state-chartered fund — replenished in large part by payments from private insurers — has become the only windstorm insurer for homes and businesses in 14 counties.

At times, lawmakers sparred over how to spread risk around the state to pay for coastal damage. Smithee said currently TWIA policy holders with homes on the coast are not bearing the financial risk for claims that are paid for their damages, other than through their policy premiums, but residents in other parts of the state are.

The Texas Coalition for Affordable Insurance Solutions, a group backed by some insurance companies, said it wants to see TWIA immediately replenished in preparation for the 2009 storm season, but it also wants creation of intermediate funding for the next two to eight years and longterm comprehensive reforms.

Rep. Todd Hunter, a Corpus Christi Republican, laid out proposals on assorted ways to potentially fund the windstorm insurance system. Among the ideas are general state revenue, federal economic stimulus money, the state's Rainy Day Fund or assessments and fees on insurers or policy holders.

"To me, it's a statewide issue," he said, emphasizing his view that

Some of the windstorm insurance bills are HB3640, HB3648, HB3853 and HB4733.



Texas high court rules against insurance company

By LINDA STEWART BALL Associated Press April 17, 2009

recently moved from Fredericksburg, Texas, to Utah, must return to court to get a damage amount awarded, the high court's ruling means Nationwide will cover it, Cotton said.

DALLAS — The Texas Supreme Court ruled Friday that an insurance company must pay a family's claim over a child critically injured by a truck that was fleeing from police.

The child's parents, Greg and Maribel Tanner, sued the speeder, who was insured by Nationwide Mutual Fire Insurance Co. But the company claimed motorist Richard Gibbons violated his policy by being involved in a high-speed police chase that was certain to end in a wreck.

Although a jury ruled in favor of the family, finding that Gibbons did not intentionally cause the Tanners' injuries, the trial judge overruled that verdict, saying Nationwide didn't have to defend the driver or cover him.

An appeals court also sided with Nationwide, but the state's high court in Austin ruled that the jury's verdict should stand, stating that Nationwide didn't prove "as a matter of law that Gibbons believed his conduct was substantially certain to injure the Tanners."

Calling the high-speed chase "not merely reckless but reprehensible," the high court said it could have ended any number of ways, including with Gibbons rolling his pickup truck, hitting a fixed object, with police stopping his truck or even discontinuing their pursuit instead of crashing into the Tanners.

"I'm really pleased. I think it's a very well-reasoned opinion," said the Tanners' attorney, Don Cotton. "I'm very happy obviously for my clients."

Although the Tanners, who

Nationwide spokesman Eric Hardgrove said in a statement the company intends to honor the court's ruling.

"We're glad the high court has resolved the issue of whether a high-speed chase falls within the 'intentional acts' exclusion in Texas," Hardgrove said.

Gibbons, whose speed at times topped 100 mph, collided with the Tanners' family car as it rolled into an intersection in a rural area outside San Marcos in 1999. Gibbons slammed on his brakes but couldn't avoid the crash.

All four Tanners were hurt, but 7-year-old Roney Tanner sustained the most serious injuries to his head, shoulder and arm, Cotton said.

In a coma-like state for several days, Roney endured a monthlong hospital stay and years of physical therapy.

When the boy's parents sued Gibbons, they hoped his \$300,000 policy through Columbus, Ohio-based Nationwide would pay for their son's medical bills. The company refused to pay the Tanners, saying Gibbons violated his insurance contract when he led police on a chase that was foreseeable to end in a wreck.

At issue was how to interpret Gibbons' insurance policy, which included a standard intentional acts exclusion. The clause voids coverage if the driver deliberately causes an accident.

Gibbons bought his policy in Ohio, a state that has a wider definition of "intentional" than Texas. Ohio's exclusion voids coverage for "willful acts" that the driver "ought to know" will result in an accident.

Nationwide contended Gibbons should have known that disregarding traffic signals and signs during a police chase would eventually lead to a serious accident.



This one belongs in the "RIPLEY'S BELIEVE IT OR NOT" file.

Senate keeps controversial insurance rate system

By JIM VERTUNO Associated Press April 20, 2009

AUSTIN, Texas — Brushing aside Democrats who wanted greater consumer protections, the Texas Senate voted Monday to renew the state Department of Insurance and a system that allows companies to raise homeowner rates and start collecting before regulators review them.

It was a major victory for insurance companies who say the so-called "file-and-use" system encourages competition for the best prices. Democrats have complained it has not lowered rates or increased competition to promised levels.

Texans pay the highest homeowner rates in the nation. According to the National Association of Insurance Commissioners, the most common homeowner policy cost Texans \$1,409 a year on average, compared to a national average of \$804.

"The insurance industry in Texas historically has gone hog wild," said Sen. Rodney Ellis, D-Houston. "That's why their rates are so high."

The department and the file-and-use system are under scrutiny in a process called "sunset," in which lawmakers periodically review operations of government departments.

insurance department regulates companies that do business in Texas, their rates, forms and licensing of agents. It is due to be abolished on Sept. 1 unless renewed by the Legislature.

The bill now goes to the House.

Democrats wanted companies to get prior approval from regulators before changing rates. They had managed to block the bill from coming up for a vote last week but hard-core resistance melted away over the weekend.

Many attempts to add consumer protections were batted down along party lines. Republicans hold a 19-12 Senate majority and knocked down calls for prior approval, to ban companies from using credit scores to set rates and to replace the appointed insurance commissioner with an elected one.

Sen. Glenn Hegar, the Katy Republican who authored the bill, said the bill protects consumers by clarifying the file-and-use system that he says has been inconsistent in recent years.

Once an insurance

company files a rate and starts collecting, the insurance commissioner must act within 30 days if he intends to reject it. The commissioner could file two 30-day extensions to review the rate.

Democrats were allowed to amend the bill to hit companies with large penalties if they continue to fight for rate increases that are judged to be improper.

Hegar said 29 new companies have started writing policies in Texas since 2003. Rates have actually increased only slightly compared to a housing market that saw home values jump 35 percent in recent years, he said.

"We need to remember there is no magic formula for lowering insurance rates," Hegar said.

Jerry Johns of the industry trade group Southwestern Insurance Information Service, said prior-approval systems kill incentives for companies to compete for the best prices and products.

"Unfortunately, things are not first rate for Texas consumers but we are moving forward," Johns said. "If people want to step back 20 years and have a one size fits all insurance policy and a lack of product choices then prior approval is the answer."

Texas Watch, a consumer group that tracks insurance issues, said the bill doesn't help homeowners.

"The Texas Senate has missed a once a decade opportunity to rein in insurance abuses," Texas Watch said in a statement.

In other insurance-related matters, the Senate passed a bill that gives Texans a few days after purchasing an annuity a chance to back out and get a refund.

Supporters said the so-called "free look" periods allow consumers who buy annuities, often seniors citizens, a chance to consult with family, friends and financial advisers about whether the long-term investment is right for them.

Some states allow up to 45 days. Hinojosa's bill allow a free look period for 15 days. The window goes up to 30 days if the purchaser is 65 or older or if the agreement is done by mail.

—
The insurance sunset bill is CSSB1007.

The annuity bill is CSSB1168.



Special time lapse photography has enabled us to show you the length of time one Texas homeowner waited for her rebate check.



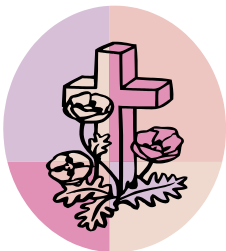
Born on same day Texas Dept. of Insurance announces refunds (for overcharges) will be issued.



Insurer exhausts appeals on sweet sixteenth birthday



On 65th birthday, Insurance Commissioner puts his best people on it!



She's dead and gone, still no check; heirs begin cycle of waiting for refund.

\$117 million in Farmers refunds for Texas policyholders has been in limbo 7 years

March 8, 2009

By TERRENCE STUTZ / The Dallas Morning News

.AUSTIN – It's becoming known as the case of the missing insurance refunds.

Back in the fall of 2002, Farmers Insurance and state regulators agreed to resolve allegations that the company had overcharged customers with a \$117 million settlement that included refunds and lower rates for nearly half a million policyholders.

Shortly after the agreement was announced, it was challenged by a group of Farmers policyholders, who insisted it was a bad deal for them. Although a state judge upheld the settlement, his decision was overturned by an appeals court and then taken to the Texas Supreme Court – which sent the legal dispute back down for further deliberations.

And so the case sits unresolved – going on seven years – and Farmers customers are still waiting for their money.

"Farmers has worked closely with the Texas Department of Insurance and remained ready to implement the agreed-on settlement for several years," said Michelle Levy, a spokeswoman for Farmers in Texas. "We're ready to take action, but there's nothing we can do until the courts have decided this."

'No longer viable'

Joe Longley, attorney for the Farmers policyholders, said the amount is a slap at policyholders.

"The settlement amount was a fraction of what Farmers took from their customers in Texas and what they are continuing to take. Refunds should be as much as 10 times" the \$117 million settlement, he insisted.

The case was sent back to the 3rd Texas Court of Appeals in Austin in April 2007 and has been sitting there since.

Longley said he believes the case should be sent back to trial court because all the deadlines and conditions of the original settlement have long passed.

For a lot of reasons, he said, the settlement is "no longer viable" and must be redone.

The attorney general's office, meanwhile, is trying to have the settlement certified as a class action representing all Farmers customers in the state.. Such a certification could invalidate other claims against the company.

Mold beginnings

The agreement came after the company had threatened to pull out of the Texas home insurance market because of massive mold losses. Company officials also were stinging from repeated attacks by Gov. Rick Perry, who made Farmers his favorite target in his 2002 race for governor.

Perry's appointed insurance commissioner at the time, Jose Montemayor, hammered out the agreement with Farmers, apparently without consulting the governor, who was unhappy with the terms.

In the years since, Farmers has stayed on the good side of the insurance department, even winning approval from current Commissioner Mike Geeslin last month to increase rates by double-digit percentages for hundreds of thousands of customers.

Farmers is now the third-largest property insurer in Texas behind State Farm and Allstate, providing coverage to about 714,000 homeowners.

Alex Winslow of Texas Watch, a consumer group active in insurance issues, said the stalled Farmers settlement is an example of the flawed system of regulation in Texas.

Continued on page 61

Farmers refunds ...

Continued from page 60

"Due process is a right for everybody, including insurance companies. But seven years is too long," Winslow said.

He compared the Farmers settlement to the "sweet deal" that Allstate received from the state last year when it settled allegations of overcharges in homeowners insurance. Allstate agreed to refund \$51.6 million to its customers but was let off the hook for another \$19.2 million by Geeslin, who defended the settlement as a "positive step" for ratepayers and the Texas insurance market.

Texas Watch is backing legislation filed by Democrats in the Senate and House that would require prior state approval of insurance rate increases. Currently, companies can raise rates once they notify the insurance department, which has the right to review those rates and decide whether they are justified.

Industry's stance

The insurance industry opposes prior government approval of rate increases.

"Instead of chasing the short-sighted goal of artificial price fixing, we should stick with the goal of creating a well-regulated competitive marketplace that can handle our state's tough climate efficiently and still attract companies and capital," said Beaman Floyd of the Texas

Coalition for Affordable Insurance Solutions, an industry group.

Levy of Farmers emphasized that her company agreed to pay refunds to its customers and has been blocked from doing so by the class action intervention filed by Longley, an Austin attorney.


"They have left Farmers unable to implement the settlement, including retrospectively reducing rates and adjusting certain rating factors," she said.

Longley contends that the company's rates are still too high, which Levy disputed.

Longley also has a separate class action case against Farmers pending in federal court in Oklahoma City. That suit centers on management fees charged by Farmers that are reflected in premiums paid by customers in Texas and several other states.

The state's other long-running dispute over insurance rates, involving State Farm, is scheduled to go before the insurance commissioner at a March 30 hearing.

State Farm was accused by the state of overcharging customers and ordered to lower rates by 12 percent in the fall of 2003. The case has been in the courts since then, and State Farm has won some key victories. But the company is on the hook for more than \$650 million in overcharges and penalty interest dating back nearly six years.

A photograph of a longhorn cow in a field. The cow is reddish-brown with long, curved horns. It is standing in a grassy field with a blue sky in the background. A speech bubble with a purple border is positioned to the right of the cow, containing the text: "I thought all Texans could spot bull from a mile away!"

I thought all Texans could spot bull from a mile away!