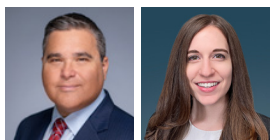


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Construction Industry Advisor

Think “Consequential Damages” for Escalation and Other Costs When Your Builder’s Risk Insurance Company Needlessly Delays Payment



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Key points:

Insurance companies routinely slow-walk claims under builder’s risk policies.

Delays in insurance recovery for property damage on a construction project are extremely costly.

Most states recognize consequential damages for insurance company payment delays under builder’s risk and other first-party property insurance policies.

The Cost of Slow Claims Handling

Significant property damage losses on a construction project from events like fires, explosions, and hurricanes can be devastating to the success of the project. As an owner or contractor, your singular focus in the wake of such an event is on restoring the project to its pre-loss condition and minimizing delays in completing the project. Owners and contractors commonly rely on their builder’s risk insurance to promptly provide the funds necessary to repair or replace the damaged property. Unfortunately, in an insurance claims setting, insurance companies’ interests are not aligned with those of their policyholders.

Builder’s risk insurance companies typically are in no hurry to part with millions of dollars from which they are enjoying interest income on a daily basis. Particularly in large, complex losses, builder’s risk insurance companies will “investigate” the loss to no end, often repeatedly asking for the same information even after the policyholder has provided it, and challenging whether damaged items require replacement instead of a less-costly repair.

Delays in insurance funding harm owners and contractors in a variety of ways, including the exacerbation of delay-in-opening losses and potentially increased financing costs. In the last few years, the construction industry has seen record-setting increases in costs of construction. That means that the project you priced to complete in 2021 or 2022 could now cost you 25% or more to finish after a covered loss. While the cost increases to repair the damaged portion of the project should be covered under your builder’s risk policy, what about the portion of the project that was unfinished at the time of the covered loss?

The increase in costs for that portion of the project is not covered under the builder’s risk policy, because the unfinished part of the project did not suffer a covered loss. But, if insurance company payment delays cause you to incur additional costs to complete the unfished portion of the project, those costs should be recoverable as extra-contractual, consequential damages, along with extended delay in opening losses and increased financing costs.



Consequential Damages for Insurance Company Payment Delays

Historically, depending on the jurisdiction, it could be difficult for a policyholder to recover for insurance company misconduct. The classic insurance company formula is to deny covered claims, hold the money owed to its policyholders, and accrue interest on that money until the insurance company is finally forced to pay up. In the past, insurance companies effectively had immunity or would get away with earning interest on money owed without the threat of being penalized. Indeed, for years insurance companies have reaped the benefits of this well-oiled formula, because there were little-to-no effective options available to wronged policyholders until states and judiciaries started recognizing abuses and started finding ways to provide relief.

Some states recognize the tort of bad faith or have a statutory scheme in place prohibiting certain defined unfair insurance claims practices, only some of which allow for a private right of action. There are [examples](#) of courts finding against insurance companies, especially

in particularly egregious instances, such as employing expensive and burdensome investigative tactics designed to wear out policyholders, falsifying investigative reports, and destroying evidence. Generally, claims of bad faith can be difficult to prove if there is no clear record of evidence accessible to the policyholder. Even worse, many states do not recognize these avenues of relief.

What can policyholders do to combat unjust treatment and the inherent power imbalance when facing their insurance companies? One way to change this dynamic is by seeking consequential damages in excess of policy limits.

Most states recognize consequential damages for insurance company payment delays under builder's risk and other first-party property insurance policies. Recovery of consequential damages is not based in tort or provided for under a statutory scheme. Instead, consequential damages sound in breach of contract. Under the terms of the policies they sell, insurance companies owe certain obligations to their policyholders, including the implied promise to act in good faith and deal fairly with their policyholders. Part of

that promise is to pay claims promptly, and if the insurance company breaches that promise, consequential damages may be available.

New York recognized recovery of consequential damages in first-party property insurance disputes starting with *Bi-Economy Market, Inc. v. Harleysville Ins. Co. of New York*, 10 N.Y.3d 187, 886 N.E.2d 127 (2008), which enables policyholders to seek both policy limits and consequential damages in excess of policy limits where insurance companies breach their duty of good faith and fair dealing. The *Bi-Economy* court held an insurance company liable for consequential damages arising out of improperly delaying payment of a covered first-party property claim.

Under *Bi-Economy* and its progeny, policyholders have to prove up the following elements in order to recover consequential damages against their insurance companies: “that (1) such consequential damages were a natural and probable consequence of the breach of contract, (2) were or should have been foreseeable, and (3) were reasonably contemplated by the contracting parties at the time the Policy was issued.” *Roman Cath. Diocese of Rockville Ctr. v. Gen. Reinsurance Corp.*, No. 16 CIV. 02063 (CM), 2016 WL 5793996, at *5 (S.D.N.Y. Sept. 23, 2016) (citing *Bi-Economy*, 10 N.Y.3d at 192)

Other jurisdictions may vary or deviate from the three elements enumerated above. Depending on the state, bad faith may or may not be required. For example, New Jersey requires a showing of bad faith in proving that consequential damages are warranted. See *Pickett v. Lloyd's*, 131 N.J. 457, 621 A.2d 445, 451 (1993). Under *Pickett*, policyholders can recover consequential damages in first-party property

cases where (1) the insurance company lacked a reasonable basis for denying coverage, (2) the insurance company knew or recklessly disregarded the lack of a reasonable basis for denying coverage, and (3) the consequential damages were reasonably foreseeable at the time the policy was issued. *Pickett*, 131 N.J. at 481.

In the context of builder's risk insurance, there are many opportunities for insurance companies to intentionally elongate the claims process and force the policyholder to incur needless additional costs. Insurance companies will sometimes use these tactics in an attempt to back the policyholder into a corner and encourage a more favorable settlement. Various consequential damages can arise from this type of conduct.

Consider the following hypothetical. An owner is building a mixed-use, mid-rise building that is destroyed by a fire when 70% of the construction was complete. The owner makes a builder's risk claim, expecting to recover and promptly resume the project. However, the insurance company needlessly extends the claims investigation and delays payment of the covered claim. Two years later — once the insurance company finally pays up — the owner still needs to complete the 30% of project that had been unfished at the time of the fire. Unfortunately, what was once estimated as \$15 million to complete the unfinished portion of the project will now cost \$20 – \$25 million thanks to record-setting escalation costs in the construction industry. Additionally, the owner's borrowing costs increased from 3% interest only to 8% interest only thanks to interest rate hikes aimed at curbing inflation.

While these costs are not “covered” under the four corners of the policy,

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they are the foreseeable result of insurance company conduct that unnecessarily prolongs the fair and equitable adjustment of a builder's risk insurance claim. Delay in opening losses that extend beyond policy limits as a result of insurance company delays also may be recoverable as consequential damages.

Prepare for Delays from the Outset

Policyholders should enter the claims process prepared to combat insurance companies' typical delays in settling builder's risk and other first-party property insurance claims. By letting insurance companies know early on that you are incurring consequential damages and that you plan to hold them

accountable for such damages in excess of policy limits, policyholders can often forestall — or at least mitigate — insurance companies' foot-dragging in processing a claim. ▲

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