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Good Faith, Bad Faith Issues Between Insureds / Additional Insureds and Their Insurers

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Insurers, generally speaking, owe a duty of good faith and fair dealing to their insureds. Any determination that an insurer has acted in bad faith will require a predicate determination that coverage existed for the loss in question. The relevant key questions for interested underwriters to consider in order to make certain they are not exposing themselves to a claim for bad faith, depending on substance of the underlying claim(s), are the following:

1. Does the policy provide coverage for the loss in question?
2. Does the insurer have a duty to indemnify the claim?
3. Does the insurer have a duty to defend the claim?
4. Is the insurer acting in the insured's best interest?

ADDITIONAL INSUREDS

As a practical matter, additional insureds are treated no differently than insureds under a given policy of insurance. Additional insureds take the policy of insurance as they find it and are subject to all of the same conditions, limitations and exceptions as the insured. See 12 Couch, Insurance 2d §§ 45:301, 45:307. In considering the rights of additional insureds, New York courts apply the "separability doctrine," whereby the insurer has separate and distinct obligations to the various insureds, both named and additional. See *Morgan v. Greater New York Taxpayers Mutual Ins. Ass'n*, 305 N.Y. 243, 249 (1953); see also*, Greaves v. Public Service Mutual Ins.*, 5 N.Y.2d 120, 124 (1959); *Pelych v. Potomac Insurance Co.,* 401 N.Y.S.2d 374, 377 (N.Y. Sup.

Ct. 1977). And, like an insured, an additional insured can tender their defense to the insurer and proceed against the insurer on the basis of bad faith. See *Yonkers Contracting Co., Inc. v. General Star National Ins. Co.*, 14 F.Supp.2d 365 (S.D.N.Y. 1998).

BASIC RULES OF POLICY CONSTRUCTION

It is well settled that insurance contracts must be interpreted to effectuate the intent of the parties at the time the contract was formed. An insurance contract must be read as a whole to determine what the parties reasonably intended by its terms. "The ascertainment of the substantial intent of the parties is the fundamental rule in the construction of all agreements." Madawick Contracting Co. v. Travelers Ins. Co., 307 N.Y. 111, 119, 120 N.E.2d 520, 524 (1954) (quoting People ex rel. New York Central & Hudson River Railroad Co. v. Walsh, 211 N.Y. 90, 105 N.E. 136 (1914).

As a general rule, the language of an insurance policy will be given its 'plain meaning,' and there will be no resort to any of the other rules of contract construction unless an ambiguity exists. Specifically, whenever there is any question of interpretation of a written insurance contract, the court will seek to determine "the intention of the parties as derived from the language employed." 4 Williston, Contracts Section 600, at 280 (3d ed.). Courts may not disregard clear provisions, which the insurers inserted in an insurance policy, and the insured accepted. Caporino v. Travelers Ins. Co., 62 N.Y.2d 234, 239, 465 N.E.2d 26, 28, 476 N.Y.S.2d 519, 521 (1984).

If there appears to be an ambiguity in a policy, a court may consider extrinsic evidence submitted by the parties to assist in determining the actual intent of the parties. McCostis v. Home Ins. Co., 31 F.3d 110 (2d Cir. 1994) (citing Ostrager & Newman, Handbook on Insurance Coverage Disputes Section 1.01{b} (4th ed. 1991)). However, any extrinsic evidence to be considered must relate to the mutual intent of the parties. Alfin, Inc. v. Pacific Ins. Co., 735 F. Supp. 11, 120 (S.D.N.Y. 1990). Extrinsic evidence of an undisclosed unilateral intent is immaterial to the interpretation of a contract. Lubrication & Maintenance, Inc. v. Union Resources, Co., 522 F. Supp. 1078, 1081 (S.D.N.Y. 1981). In legal terms, the "parol evidence rule"[1] will generally serve to preclude consideration of any extrinsic evidence concerning the meaning of an insurance contract unless the policy language is ambiguous. Garza v. Marine Transport Lines, Inc., 861 F.2d 23, 26-27 (2d Cir. 1988); McNeilab, Inc. v. North River Ins. Co., 645 F. Supp. 525, 543-45 (D.N.J. 1986), aff'd, 831 F.2d 287 (3d Cir. 1987). The determination of whether a provision in an insurance policy is ambiguous, and whether extrinsic evidence of intent is therefore admissible, "is a threshold question of law for the court." Garza v. Marine Transport Lines, Inc., supra. 861 F.2d at 27.

An ambiguity will be found to exist when a word or phrase is reasonably susceptible to more than one meaning. United States Fire Ins. Co v. General Reins. Corp., 949 F.2d 569, 572 (2d Cir. 1991) (holding "a provision in an insurance policy is ambiguous when it is reasonably

[1] It is well settled that where the parties have reduced an agreement to writing, and the writing is clear in its terms and purports to express the parties' entire agreement, evidence of a prior or contemporaneous communication between the parties that contradicts, varies or explains the agreement is generally barred by the parole evidence rule. Braten v. Banker Trust Co., 60 NY2d 155; Clark v. American Morgan Co., 268 App.Div. 209; 58 NY Jur. 2d 555.

susceptible to more than one reading"). The Courts will find an ambiguity only when each of the competing interpretations is objectively reasonable. A word or phrase is ambiguous when it is capable of more than a single meaning "when viewed objectively by a reasonably intelligent person who has examined the context of the entire integrated agreement and who is cognizant of the customs, practices, usages and terminology as generally understood in the particular trade or business."[2] Garza v. Marine Transport Lines, Inc., 861 F.2d 23, 27 (2d Cir. 1988).

An ambiguity may be either patent or latent. Garza v. Marine Transport Lines, Inc., supra. 861 F.2d at 27. A patent ambiguity exists on the face of the contract, while a latent ambiguity exists when the language becomes unclear in light of extrinsic or collateral circumstances. While such esoteric distinctions may be conceptually complex, perhaps the real practical questions for insurers to address are: What happens when: (1) the terms of a policy are ambiguous; and (b) the ambiguity may not be resolved by resort to extrinsic evidence of intent?

RULES OF CONSTRUCTION "AGAINST THE INSURER"

"The longstanding general rule is that where a policy of insurance is so framed as to leave room for two constructions, the words used should be interpreted most strongly against the insurer." Liverpool & London & Globe Ins. Co. v. Kearney, 180 U.S. 132, 135-36 (1901). The insurer has the responsibility of making its intention clearly known, and where an insurer attempts to limit liability by use of an ambiguously worded term which is subject to more than one reasonable construction, most courts will construe such an ambiguity strictly against the insurer.

The rationale for the contra-insurer rule was summarized long ago by the New York Court of Appeals, which held the following in Matthews v. American Central Ins. Co., 154 N.Y. 449, 456-59, 48 N.E. 751, 752 (1897);

> *The policy, although of the standard form, was prepared by insurers, who are presumed to have had their own interests primarily in view; and hence, when the meaning is doubtful, it should be construed most favorably to the insured, who had nothing to do with the preparation thereof.*

This 'contra-insurer rule' is based upon the doctrine of *contra proferentem*, which literally means "against the offeror" or drafter of the language. See generally Restatement (Second) of Contracts Section 206 (1981)("In choosing among the reasonable meanings of a promise or agreement or a term thereof, that meaning is generally preferred which operates against the party who supplies the words or from whom a writing otherwise proceeds.")

Contra-insurer rules of construction apply with particular force when there is an ambiguity in an exclusionary clause. Breed v. Insurance Co. of N. Am., 46 N.Y.2d 351, 353,

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[2] Custom or usage is not established by showing that an expert in the field would attach a particular meaning to the terms of the policy. See Encyclopaedia Britannica, Inc. v. SS Hong Kong Producers, 422 F.2d 7, 17-18 (2d Cir. 1969), cert. denied. 397 U.S. 964 (1970); Gelb v. Automobile Ins. Co., 168 F.2d 774, 775 (2d Cir. 1948).

385 N.E.2d 1280, 1282, 413 N.Y.S.2d 352, 354 (1978); Ingersoll Milling Mach. V. M/V Bodena, 829 F.2d 293, 306 (2d Cir. 1987), cert. denied, 484 U.S. 1042 (1988). Of course, exclusionary clauses never grant an insured coverage, but rather limit the scope of the basic protection statement. As such, the insurer has the duty to use precise language. American Home Assur. Co. v. Libbey-Owens-Ford Co., 786 F.2d 22, 26, 28 (1st Cir. 1986). It has long been held that exclusions are generally to be construed narrowly, while exceptions to exclusions are generally construed broadly to find coverage. Borg-Warner Corp. v. Insurance Co. of N. Am., 174 A.D.2d 24, 33, 577 N.Y.S.2d 953, 958 (3d Dep't), appeal denied, 80 N.Y. 2d 753, 600 N.E.2d 632, 587 N.Y.S.2d 905 (1992).

THE DUTY TO DEFEND VS. THE DUTY TO INDEMNIFY

It is well settled New York law that an insurer's duty to defend is broader than its duty to indemnify an insured. In fact, and insurer's duty to indemnify is "exceedingly broad" and is separate from and more expansive than the duty to indemnify. Plants and Goodwin, Inc. v. St. Paul Surplus Lines Ins. Co., 99 F.Supp.2d 293 (WDNY 2000); McCostis v. Home Ins. Co. of Ind., 31 F.3d 110, 112 (2d Cir. 1994); Colon v. Aetna Life & Cas. Ins. Co., 66 N.Y.2d 6, 494 NYS2d 688, 689, 484 N.E.2d 1040 (1985). An insurer must provide a defense to its insured in an action if the underlying complaint, liberally construed, sets forth any claim which can reasonably be said to fall within the coverage for the policy or if the carrier has actual knowledge of the facts which tend to establish the reasonable possibility of coverage. Continental Cas. Co. v. Rapid American Corp., 80 NYS2d 640, 648; Fitzpatrick v. American Honda Motor Co., Inc. 78 NY2d 61, 65; New York City Trans. Auth. v. Aetna Cas. & Sur. Co., 207 AD2d 389,390). If the complaint in an action brought against an insured upon its face alleges facts, which come within the coverage of the liability policy, the insurer is obligated to assume the defense of the action, even if those allegations are false or groundless. Frontier Ins. Co. v. State, 87 NY2d 864, 867; Seaboard Sur. Co. v. Gillette. Co., 64 NY2d 304, 310.

In order to illustrate the customary manner in which New York courts address questions concerning an insurers duty to defend and/or indemnify an insured, we summarize the decision of the New York Supreme Court, Kings County, in the matter captioned *Daily News, L.P. v. OCS Security Inc.*, *et al.* In this matter, the Supreme Court addressed a motion for summary judgment on the issue of whether an insurer had the duty to defend and/or indemnify an insured. Specifically, the insurance coverage dispute arose out of an underlying action for personal injuries, which was occasioned by an accident at a Daily News printing facility. The accident involved a man who was hit by a door of a freight elevator, which a security guard was allegedly operating. The security company was insured by the defendant insurer, however, by contract, the security company was required to name the Daily News as an additional insured. The Daily News moved for summary judgment and a declaration that defendant insurer had a duty to defend and indemnify it. The court ruled that, as the complaint in the underlying action contained some allegations against the Daily News for the conduct of a security employee, who was acting "on behalf of" the Daily News, and the policy clearly named the Daily News as an additional insured, the insurer had a duty to defend the Daily News as a matter of law.

Specifically, with respect to the duty to defend, the Court stated that if the alleged facts failed to bring the case within the policy coverage, the insurer would be free of such obligation. (*Citing* Allstate Ins. Co. v. Mueavero, 79 NY2d 153,159; Dana Enterprises. Inc. v. Twin City Fire Ins. Co., 215 AD2d 320, 321). Since an insurer's obligation to defend arises whenever a

complaint alleges facts and circumstances, some of which would, if proved, fall within the risk covered by the policy, the language of the relevant endorsement extended coverage for the underlying action. Thus, the Court found that the complaint alleged a potential basis for coverage, and, consequently, gave rise to a duty to defend. Accordingly, the portion of the motion seeking a declaration that the defendant insurance company was obligated to provide a defense for the Daily News was granted.

With respect to the duty to indemnify, the Court noted that pursuant to the language of the endorsement and the policy, defendant insurer was required to indemnify the Daily News for work or operations performed by the Daily News or on its behalf for which it would be found liable. However, the Court wrote "the acts for which the Daily News may ultimately be held liable can not be determined at this time. The issue of indemnity should await resolution of the underlying action and, accordingly, the portion of plaintiffs' motion seeking a declaration that defendant insurer was obligated to indemnify plaintiffs was denied."

Notwithstanding the foregoing, it must be noted, however, that an insurer's broad duty to defend is not without its' limits. An insurer can not be obliged to defend an insured if there is no legal or factual allegation in the underlying complaint for which the insurer might eventually have to indemnify the insured. McCostis, *supra,* at 112; Allstate Ins. Co. v. Mugavero, 79 NY2d 153, 581 NYS2d 142, 147, 589 N.E.2d 365 (1992); Commercial Union Assur. Co., PLC v. Oak Park Marina, Inc., 198 F.3d 55, 59 (2d Cir. 1999).

BAD FAITH
THE LAW OF NEW YORK

New York has modified the standard for actionable bad faith. In rejecting the previous requirement of "an extraordinary showing of a disingenuous or dishonest failure to carry out a contract," and in further rejecting the negligence standard recognized in several other states, the New York Court of Appeals held that:

> *In order to establish a prima facie case of bad faith, the plaintiff must establish that the insurer's conduct constituted a "gross disregard" of the insured's interests-that is, a deliberate or reckless failure to place on equal footing the interests of its insured with its own interests when considering a settlement offer. In other words, a bad-faith plaintiff must establish that the defendant insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the probability that an insured would be held personally accountable for a large judgment if a settlement offer within the policy limits were not accepted.*
>
> *The gross disregard standard...strikes a fair balance between two extremes by requiring more than ordinary negligence and less than a showing of*

dishonest motives.

Pavia v. State Farm Mut. Auto. Ins. Co., 82 N.Y.2d 445, 453-54, 626 N.E. 2d 24, 27-28, 605 N.Y.S.2d 208, 211-12 (1993); See also Soto v. State Farm Ins. Co., 83 N.Y.2d 718, 723, 635 N.E.2d 1222, 1224, 613 N.Y.S.2d 350, 354 (1994).

The law pertaining to bad faith claims in New York is well settled, and is premised upon time-honored principles of agency, (*i.e.* "because insurers typically exercise complete control over the settlement and defense of claims against their insureds, . . they may fairly be required to act in the insured's best interests.") Pavia, 82 NY2d at 452-453. An insurer's duty to act in good faith is also owed to excess insurance carriers. Pavia, 82 NY2d at 452; St. Paul Fire & Marine Ins. Co. v. United States Fid. & Guar. Co., 43 NY2d 977, 978-79, 404 NYS2d 552, 375 N.E. 2d 733 (1978). This duty of good faith reflects the inherent conflict between the primary insurer's duty to settle the claim for as little as possible and the excess insurer's desire to avoid a judgment exceeding the primary policy limit. Smith v. Gen. Accident Ins. Co., 91 NY2d 648, 653, 674 NYS2d 267, 697 N.E.2d 168 (1998).

Whether an insurer has acted in bad faith to settle is generally held to be a question of fact. DiBlasi v. Aetna Life & Casualty Ins.Co., 147 A.D.2d 93, 99, 542 N.Y.S.2d 187, 192 (2d Dep't 1989). Courts are reluctant to dismiss complaints sounding in bad faith since "bad faith 'is generally proven by evidence largely circumstantial in nature.`" Reifenstein v. Allstate Ins. Co., 92 A.D.2d 715, 716, 461 N.Y.S.2d 104, 106 (4th Dep't 1983). Kulak v. Nationwide Mut. Ins. Co., 40 N.Y.2d 140, 351 N.E.2d 735, 386 N.Y.S.2d 87 (1976); Knobloch v. Royal Globe Ins. Co., 38 N.Y.2d 471, 344 N.E.2d 364, 381 N.Y.S.2d 433 (1976); Town of Poland v. Transamerica Ins. Co., 53 A.D.2d 140, 385 N.Y.S.2d 987 (4th Dep't 1976).

FACTORS TO BE CONSIDERED IN DETERMING 'BAD FAITH'

Factors that enter into the bad faith equation include the likelihood of success on the liability issue in the underlying action, the potential magnitude of damages and the resulting financial burden each party may be exposed to as a result of a refusal to settle, and the information available to insurance carrier at the time the demand for settlement is made. Vecchione v. Amica Mut. Ins. Co., 274 A.D.2d 576, 711 NYS2d 186, (2000); Smith v. Gen. Accident Ins. Co., 91 NY2d 648; 14 Couch, Insurance Section 203:23[3d]. Also to be considered in making the determination is "any other evidence which tends to establish or negate the insurer's bad faith in refusing to settle." Smith v. Gen. Accident Ins. Co., 91 NY2d 648, 654; Pavia v. State Farm Mut. Auto. Ins. Co., *supra,* at 455.

To establish a prima facie case of bad faith refusal to settle, a plaintiff must demonstrate that the insurance carrier's conduct constituted a gross disregard of the policyholder's interests—that is, a deliberate or reckless failure to place on an equal footing its own interests and those of the policy holder when considering a settlement offer. Smith v. Gen. Accident Ins. Co., 91 NY2d 648, 652. In other words, a bad faith plaintiff must establish that the defendant insurer engaged in a pattern of behavior evincing a conscious or knowing indifference to the probability that an insured would be held personally accountable for a large judgment if a settlement offer within policy limits were not accepted. Vecchione v. Amica Mut. Ins. Co., 274 A.D.2d 576, 711 NYS2d 186, (2000). This gross disregard standard, like gross negligence and

reckless disregard, requires a higher level of culpability than ordinary negligence. Pavia v. State Farm Mut. Auto. Ins. Co., *supra,* at 453.

In New York, "bad faith" has been found in circumstances other than the traditional "failure to settle" context. In Oppel v. Empire Mutual Insurance Co., 517 F. Supp. 1305 (S.D.N.Y. 1981), the court stated:

> *Bad faith by the insurer...includes:*
> *(1) a failure to investigate;*
> *(2) a refusal to settle within the policy limits;*
> (3) *failure to inform the insured of a compromise offer; and*
> (4) *failure to induce the insured to contribute.*

In Cornwell v. Safeco Insurance Co. of America, 42 A.D2d 127, 346 N.Y.S.2d 59 (4th Dep't 1973), the court held that an automobile insurer, which undertook to defend two "additional" insureds pursuant to a policy with the named insured, and which failed to assert a defense that was available to the additional insureds, was liable for the verdict in excess of policy limits rendered against the additional insureds. The court also upheld an award of attorney's fees and damages to compensate the additional insureds for physical injury and mental anguish.

In Fredericks v. Home Indemnity Co., 101 A.D.2d 614, 474 N.Y.S.2d 870 (3d Dep't 1984), the court held that a primary insurer which was unaware of the amount of its coverage on the eve of trial was guilty of bad faith because the insurer's lack of knowledge frustrated meaningful settlement negotiations.

In Young v. American Casualty Co. of Reading, Pa., (CA2 NY) 416 F2d 906, the Court referred to the carrier's failure to negotiate as evidence of bad faith. Likewise, a refusal to make an offer of settlement unless a co-insurer and/or a co-defendant does may be found to be bad faith. Harris v. Standard Accident & Ins. Co., 191 F. Supp 538, rev'd on other grounds (CA2 NY) 297 F2d 627.

Finally, although, to date, no New York case has held that another factor to consider is an underwriters failure to accept its attorney's or adjustor's recommendation to settle, logic dictates inclusion of this factor, as well as various out-of-state authority. Keeton, Liability Insurance and Responsibility for Settlement, 67 Harv L Rev 1136.

COMPENSATORY DAMAGES IN NEW YORK BAD FAITH ACTIONS

It is well established in New York that "compensatory damages in excess of the policy limits may be recovered where an insurer, in violation of its implied obligation to act in good faith, has failed to make a reasonable settlement of a claim within policy limits." AFIA v. Continential Ins. Co., 140 A.D.2d 167, 168, 527 N.Y.S.2d 420, 421 (1st Dep't 1988). Where a primary insurer acts in bad faith by refusing a reasonable settlement demand within policy limits, and a verdict is rendered in excess of policy limits, damage to the insured is measured by the entire amount of excess liability. AFIA v. Continental Ins. Co., 140 A.D.2d 167, 169, 527 N.Y.S.2d 420, 422 (1st Dep't 1988). However, the rule is applied only where the evidence establishes that the case could have been settled without any contribution by the insured or its

excess insurers. United States Fidel. & Guar. Co., v. Copfer, 48 N.Y.2d 871, 873, 400 N.E.2d 298, 298, 424 N.Y.S.2d 356, 356 (1979); DiBlasi v. Aetna Life & Casualty Ins. Co., 147 A.D.2d 93, 103, 542 N.Y.S.2d 187, 194 (2d Dep't 1989). Where a settlement would have required contribution from either the insured or an excess insurer, the primary insurer is obligated to pay the difference between the amount ultimately paid by the insured or its excess insurer and what would have been paid if the primary insurer had offered its policy limit. Feliberty v. Damon, 129 A.D.2d 207, 209-10, 517 N.Y.S.2d 632, 634 (4th Dep't 1987), aff'd 72 N.Y.2d 112, 527 N.E.2d 261, 531 N.Y.S.2d 778 (1988) (cause of action sounding in bad faith will not lie where, contrary to insured's wishes, insurer settles claim within policy limits).

In United States Fidelity & Guaranty Co. v. Copfer, *supra*, the New York Court of Appeals held that the insurer breached its contractual duty to defend and indemnify, and could be held liable for expenses incurred in the defense and for any judgment up to the policy limits. However, since the insured failed to demonstrate that an actual opportunity to settle within policy limits was lost, the insurer was not held liable for any sums in excess of the policy limits. The court observed that "the insured's speculations that a satisfactory settlement might have ensued had the insurer sought out the injured party and attempted to negotiate on behalf of its insured are simply not sufficient to support a claim against the insurer for what are essentially excess liability damages." 48 N.Y.2d at 873, 400 N.E.2d at 298, 424 N.Y.S.2d at 357.

On the other hand, in State v. Merchants Insurance Co., 109 A.D.2d 935, 486 N.Y.S.2d 412 (3d Dep't 1985), the court upheld a "bad faith" judgment, noting:

> *The record before us supports the view that the defendant was well aware that its proposed $45,000 settlement figure was substantially lower than the liability it could reasonably expect to incur. The jury could reasonably have reached the conclusion that the defendant exercised bad faith in failing to protect the interest of its insured by coming forth with a reasonable and fair settlement offer, as it was contractually and statutorily required to do.*

109 A.D. 2d at 936, 486 N.Y.S.2d at 413 (citation omitted). See also Hartford Ins. Co. v. General Accid. Group Ins.Co., 177 A.D.2d 1046, 578 N.Y.S.2d 59 (4th Dep't 1991); Roldan v. Allstate Ins. Co., 149 A.D.2d 20, 37, 544 N.Y.S.2d 359, 370 (2d Dep't 1989) (holding, "...it is necessary for the plaintiff to prove that the rejection by the insurer of an offer of settlement within its policy limits constituted a deliberate, or at least reckless, decision to disregard the interests of its insured").

Damages recoverable when bad faith is found and the insured is solvent are the amount by which the tort judgment exceeds the policy limits. Gordon v. Nationwide Mut. Ins. Co., 30 NY2d 427; Peterson v. Allcity Ins. Co., (CA2 NY) 472 F2d 71. Since interest runs on the tort judgment from its date, CPLR 5003, should include interest on the excess. DiBlasi v. Aetna Life & Casualty Ins. Co., 147 AD2d 93, 542 NYS2d 187. The recoverable damages also include (as in any case where an insurer fails to provide a defense) expenses incurred by the insured in providing for his own defense. United States Fidelity & Guaranty Co. v. Copfer, 48 NY2d 871, 424 NYS2d 356, 400 NE2d 322.

PUNITIVE DAMAGES IN NEW YORK IN BAD-FAITH ACTIONS

New York permits punitive damages for breach of an insurance contract if the claim will vindicate a public as opposed to a merely private right. But the New York courts routinely dismiss claims for punitive damages against insurers when there has been no allegation or showing that the insurer, "in its dealings with the general public, had engaged in a fraudulent scheme evincing such a high degree of moral turpitude and...such wanton dishonesty as to imply a criminal indifference to civil obligations." Eccobay Sportswear, Inc. v. Providence Washington Ins. Co., 585 F. Supp. 1343 (S.D.N.Y. 1984) (emphasis added) quoting Buttignol Constr. Co. v. Allstate Ins. Co., 22 A.D.2d 689, 253 N.Y.S.2d 172 (2d Dep't 1964), aff'd, 17 N.Y.2d 476, 214 N.E.2d 165, 266 N.Y.S.2d 982 (1965). See Standard & Poor's Corp. v. Continental Casualty Co., 718 F. Supp. 1219, 1222 (S.D.N.Y. 1989); Leidesdorf v. Fireman's Fund Ins. Co., 470 F. Supp. 82 (S.D.N.Y. 1979); Philips v. Republic Ins. Co., 108 A.D.2d 845, 485 N.Y.S.2d 566 (2d Dep't), aff'd, 65 N.Y.2d 1000, 484 N.E.2d 664, 494 N.Y.2d 301 (1985); Royal Globe Ins. Co. v. Chock Full O'Nuts Corp., 86 A.D.2d 315, 449 N.Y.S.2d 740, (1st Dep't 1982), appeal dismissed, 58 N.Y.2d 800, 445 N.E.2d 649, 459 N.Y.S.2d 266 (1983); Catalogue Serv. v. Insurance Co. of N. Am., 74 A.D.2d 837, 425 N.Y.S.2d 635 (2d Dep't 1980); Granato v. Allstate Ins. Co., 70 A.D.2d 948, 418 N.Y.S.2d 108 (2d Dep't 1979).

Thus, in New York, allegations of breach of an insurance contract, without more, are insufficient to warrant the imposition of punitive damages. Carat Diamond Corp. v. Underwriters at Lloyd's, London., 123 A.D.2d 544, 506 N.Y.S.2d 708 (1st Dep't 1986); Jacobson v. New York Property Ins. Underwriting Ass'n, 120 A.D.2d 433, 501 N.Y.S.2d 882, 884 (1st Dep't 1986); Dawn Frosted Meats, Inc. v. Insurance Co. Of N. Am., 99 A.D.2d 448, 470 N.Y.S.2d 624 (1st Dep't), aff'd 62 N.Y.2d 895, 467 N.E.2d 531, 478 N.Y.S.2d 867 (1984); Reifenstein v. Allstate Ins. Co., 92 A.D.2d 715, 461 N.Y.S.2d 104 (4th Dep't 1983). Indeed, in Roldan v. Allstate Insurance Co., 149 A.D.2d 20, 544 N.Y.S.2d 359 (2d Dep't 1989), the Appellate Division wrote:

> *We conclude that the allegations that an insurance company is engaging in a persistent course of conduct involving fraud or unfair claims practices may more properly be evaluated and, if proved, be redressed by the Superintendent of Insurance, who is charged by law with the regulation of this industry, rather than by private litigants. The availability of punitive damages in private lawsuits premised upon unfair claim practices has been preempted by the administrative remedies available to the Superintendent of Insurance pursuant to Insurance Law Section 2601. Accordingly, the plaintiff's demand for punitive damages in the present case is stricken.*

Even though a breach may be willful and without justification, an isolated transaction will be insufficient unless it constitutes a "gross and wanton fraud upon the public." Fleming v. Allstate Ins. Co., 106 AD2d 426, 482 NYS2d 519 aff'd, 66 NY2d 838; Parks v. Cambridge Mut. Fire Ins. Co., 105 AD2d 1068, 482 NYS2d 382; Catalogue Service of Westchester, Inc. v. Insurance Co. of North America, 74 AD2d 837, 425 NYS2d 635; DiBlasi v. Aetna Life & Casualty Ins. Co., 147 AD2d 93, 542 NYS2d 187 (holding "in the absence of malice or intent to harm, he plaintiff is not entitled to punitive damages); AFIA v. Continental Ins. Co., 140 AD2d 167, 527 NYS2d 420 (holding "allegation of bad faith by insurer in failing to settle does not,

without more, support a claim for punitive damages). Absent evidence from which malice, as distinct from lack of good faith, can be found, punitive damages, therefore, should not be charged. Dano v. Royal Globe Ins. Co., 59 NY2d 827, 464 NYS2d 741, 451 NE2d 488; Cohen v. New York Property Ins. Underwriting Asso., 65 AD2d 71, 410 NYS2d 597.

In fact, in Hebert v. State Farm Mutual Automobile Insurance Co., 124 A.D.2d 958, 508 N.Y.S.2d 710 (3d Dep't 1986), appeal dismissed, 69 N.Y.2d 1038, 511 N.E.2d 89, 517 N.Y.S.2d 1030 (1987), the court declined to award punitive damages, holding that such damages:

> *. . are not awardable for an isolated transaction incident to a legitimate business, such as a breach of an insurance contract, even a breach committed willfully and without justification; accordingly, even if the allegations of the complaint herein are proven, a punitive award would be unwarranted.*

124 A.D.2d at 959, 508 N.Y.S.2d at 710 (citation omitted). See also Naja v. Pennsylvania Gen. Ins. Co., 144 A.D.2d 213, 213, 534 N.Y.S.2d 526, 527 (3d Dep't 1988) ("This court has continually denied awards of punitive damages for isolated breaches of insurance contracts even if the breaches were committed willfully and without justification...").

THE STATUTE OF LIMITATIONS FOR 'BAD-FAITH' ACTIONS

The governing statute of limitations governing actions based upon contractual indemnification and bad faith refusal to settle is six (6) years. *See CPLR 213(2); See also* Roldan v. Allstate Ins. Co., 149 AD2d 20, 544 NYS2d 359 (holding that "statute of limitations is tolled during period that judgment was vacated). The cause of action for breach of contract to indemnify accrues upon entry of the judgment in the underlying action, rather than when the insured pays that judgment. Roldan v. Allstate Ins. Co., *supra.* Similarly, the cause of action based on an insurer's bad faith refusal to settle accrues upon entry of the judgment in the underlying action. Henegan v. Merchants Mut. Ins. Co., 31 AD2d 12, 294 NYS2d 547.

THE SCOPE OF DISCOVERY IN BAD-FAITH ACTIONS

In general terms, a bad-faith action involves the manner in which an insurer handled a claim. Since the claims file reflects the unique history of the insurer's handling of the claim, there is no basis to withhold the claims file from discovery in a bad-faith action. Indeed, a number of courts have gone further and held that documents in the claims file reflecting the advice of counsel are not protected by the attorney-client privilege.

In Zurich Insurance Co. v. State Farm Mutual Automobile Insurance Co., 137 A.D.2d 401, 402, 524 N.Y.S.2d 202, 203 (1st Dep't 1988), the court held that in a bad-faith action by an excess insurer against the primary insurer for refusal to settle:

> *The insurer may not use the attorney-client or work product privilege as a shield to prevent disclosure which is relevant to the insured's bad faith action. Thus, the same principle obtains in a bad faith action between the excess insurer and the primary insurer.*

Additionally, the privilege and work product rules do not protect the carrier's file on the negligence action or the testimony of the attorney hired by the carrier to defend the prior action since the file was produced and the services were rendered in the interest of both the insured and the insurer. Colbert v. Home Indem. Co., 45 Misc2d 1093, 259 NYS2d 36, aff'd, 24 AD2d 1080, 265 NYS2d 893; Groben v. Travelers Indem. Co., 49 Misc.2d 14, 266 NYS2d 616, aff'd, 28 AD2d 650, 282 NYS2d 214.

CONCLUSION

The development of a cause of action for breach of the implied covenant of good faith and fair dealing has created a number of concerns for insurers, particularly in relation to liability for damages in excess of stated limits specified in the insurance contract. Multi million dollar bad faith awards against both domestic and foreign insurers are a reality, and in some jurisdictions, such awards are common place. The good news for New York insurers, who underwrite New York risks, is that New York maintains one of the most stringent standards, requiring an extraordinary showing of a disingenuous or dishonest failure to carry out a contract before bad faith liability can be imposed on an insurer. As a result, the efforts of dogged plaintiff's lawyers to recover extra-contractual damages from insurance companies have largely failed in New York. Notwithstanding, whenever a question as to what an insurer's contractual obligations are to their insured, it is always sound practice to engage counsel to render an opinion. Depending on the applicable law and jurisdiction governing the dispute, *"an ounce of prevention"* can certainly be better than *"a pound of cure,"* and at the very least, a lot cheaper.