

CONSTRUCTION
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Sureties' Exposure to Consequential Damages in New York

Bi-Economy Market, Inc. v. Harleysville Ins. Co. of NY, 856 N.Y.S.2d 525 (Court of Appeals Feb. 2008)

Bi-Economy sued Harleysville for failing to pay the full amount of Bi-Economy's business interruption claim under a property policy. Among the several counts in the lawsuit was one for consequential damages due to the collapse of Bi-Economy's business.

Even though this case concerns a property policy, it is instructive to sureties and contractors concerning consequential damages, which are frequently misunderstood and are a hot topic in the current forms of standard construction contracts.

By way of defining consequential damages, the court stated:

It is well settled that in breach of contract actions the non-breaching party may recover general [also known as "actual"] damages which are the natural and probable consequence of the breach...

Special or consequential damages which do not so directly flow from the breach are also recoverable under limited circumstances.

In order to recover consequential damages:

Such unusual or extraordinary damages must have been brought within the contemplation of the parties as the probable result of a breach at the time of, or prior to contracting ...The party breaching the contract is liable for those risks foreseen or which should have been foreseen at the time the contract was made...

To determine whether consequential damages were reasonably contemplated by the parties, courts look to the nature, purpose and particular circumstances of the contract known by the parties.

Of course proof of consequential damages cannot be speculative or conjectured...[they] must be proven with reasonable certainty and be capable of measurement based upon known reliable factors without undue speculation.

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In this case, the contractual duty in its policy that Harleysville was found to have breached was its implied obligation of good faith and fair dealing, which the court described saying:

As in all contracts, implicit in contracts of insurance [which includes surety bonds] is a covenant of good faith and fair dealing, such that a reasonable insured would understand that the insurer [surety] promises to investigate in good faith and pay covered claims.

The court held that Harleysville breached this duty of good faith and fair dealing, and as a result concluded:

Bi-Economy's claim for consequential damages including the demise of its business, was reasonably foreseeable and contemplated by the parties, and thus cannot be dismissed on summary judgment.

Current forms of contracts published by the AIA, ConsensusDOCS and EJCDC very broadly define consequential damages to include what otherwise might be considered to be actual damages. Therefore sureties should not fear exposure to consequential damages arising merely out of its principal's breach of contract.

However, performance and payment bonds themselves do not exclude consequential damages. Therefore, consequential damages are a potential liability to sureties if they are held in breach of their bond.

As an aside, the court also held that Bi-Economy's claim for consequential damages was not to be confused with a claim for punitive damages, which it has repeatedly held are not available for a mere breach of contract. As the court said:

Consequential damages, [are] designed to compensate a party for reasonably foreseeable damages ... Punitive damages, by contrast, are not measured by the pecuniary loss or injury of the plaintiff as a compensation, but are assessed by way of punishment to the wrongdoer and example to others.

Unlike consequential damages, which are quantifiable, there is no rigid formula by which the amount of punitive damages is fixed, although they should bear some reasonable relation to the harm done and the flagrancy of the conduct causing it.

Although the burden is very high in New York, under certain circumstances sureties may be held liable for punitive damages. See *Spancrete Northeast v. Travelers*, 477 NYS2d 502 (3 Dep't 1984). ■

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