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New York Court Green-Lights Bad Faith Claim in Alleged Breach of Duty to Defend

By Mark Garbowski

Bad faith claims against insurance companies rarely survive motion challenges in New York State, so it is noteworthy when a state Supreme Court ruling allows such a claim to proceed. That just happened in February of this year in *Estee Lauder Inc. v. OneBeacon Insurance Group, LLC*, when the policyholder Estee Lauder sought leave to amend its complaint against OneBeacon by adding two counts for bad faith: one concerning a bad faith coverage denial regarding the duty to defend, and another involving a bad faith duty to pay undisputed defense costs.

The Appellate Division of the Supreme Court's different treatment of the two claims highlights just how difficult it still is to plead bad faith in New York, while underlying the evergreen truth that the defense obligation can be a policyholder's most potent weapons in a dispute with its insurance company.

The specifics concerning the bad faith denial of the coverage claim are complex, but the theory is simple. The insurance company fought coverage based on a disputed provision of a missing policy. After Estee Lauder prevailed on the point, it sought to add a claim for bad faith. Essentially, Estee Lauder argued that, given the facts of the case and the burden of proof under New York law, it was bad faith for the insurance company to have

argued the point at all. The court refused to allow Estee Lauder to amend to add this bad faith claim, stating that although the Appellate Division ultimately ruled in favor of Estee Lauder regarding the missing policy, it was not bad faith for the insurance company to have argued and litigated the point.

In contrast, the court allowed Estee Lauder to amend and add a count for bad faith for failure to pay defense costs for three actions after Estee Lauder won summary judgment regarding two of the actions, and the insurance company acknowledged its defense obligation regarding the third. Despite those circumstances, the insurance company refused to pay because it maintained that some of the defense costs went toward defending an uninsured entity, and because some of the costs were unreasonable. It refused to pay anything until those issues were resolved. Estee Lauder's second bad faith claim was based on the idea that the refusal to pay any costs at all under those circumstances constituted bad faith. The court allowed this claim to go forward.

In sum, this decision does little to dispel the standard notion that New York courts are hostile to bad faith claims against insurance companies. The case was in an unusual situation, in that it had already been up on appeal over summary judgment decisions, so the decision

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of whether to allow the new claims to go forward was made on a fairly developed record. Nevertheless, the refusal to allow the first bad faith claim to proceed indicates that the court believed that there was no set of possible facts that would support a bad faith claim based upon an unreasonable coverage position.

Where the court did allow the bad faith claim to proceed, there was already a decision in favor of coverage and a subsequent refusal to pay. This will not be true for most policyholders hoping to allege bad faith in New York going forward.

What the case does emphasize, however, is the continued importance of the defense obligation and the classic policyholder strategy of filing early summary judgment motions on the issue of the duty to defend or to pay defense costs. Once Estee Lauder won its defense cost motion it moved to a position of strength from one of weakness, while the options facing its insurance company were restricted. The ruling makes it clear that insurance companies cannot use even potentially legitimate disputes over the amount of defense costs as an excuse to pay no defense costs.▲

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