Schneck v First Unum Life Ins. Co.
2018 NY Slip Op 31243(U)
June 18, 2018
Supreme Court, New York County
Docket Number: 155800/2012
Judge: Melissa A. Crane

SUPREME COURT OF THE STATE OF NEW YORK
COUNTY OF NEW YORK: IAS PART 15

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ERIC SCHNECK

Plaintiff,

-against-

FIRST UNUM LIFE INSURANCE COMPANY,

Defendant.

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Index No.: 155800/2012

Mot. Seq. No. 007 & 009

DECISION and ORDER

MELISSA A. CRANE:

In this insurance coverage dispute, plaintiff's second amended complaint (the "Second Amended Complaint") asserts four claims: breach of contract ("Count 1"); collateral estoppel ("Count 2"); equitable estoppel ("Count 3"); and breach of covenant of good faith and fair dealing ("Count 4"). On June 18, 2017, pursuant to CPLR § 3212, plaintiff moved for summary judgment on Counts 2 and 3 (Mot. Seq. No. 07). On August 9, 2018, defendant cross-moved for summary judgment on Counts 2, 3, and 4 (Mot. Seq. No. 09).

Once briefing was complete, on December 6, 2017, this court heard oral argument on plaintiff's and defendant's competing motions. The court, on the record, granted summary judgment in favor of defendant and dismissed Counts 2 and 3. The court, on the record, denied summary judgment on Count 4 asserting a claim for breach of the covenant good faith and fair dealing. However, the court reserved decision on the subject of the attorneys' fees encompassed in Count 4. This decision now addresses that issue.

BACKGROUND

Eric Schneck ("Plaintiff" or "Schneck") is an attorney and practiced law for about twenty years before suffering an injury in 2009. He contends this injury rendered him disabled and

unable to work as a lawyer (T.4).[1] In 2008, plaintiff purchased a long-term disability ("LTD") insurance policy ("LTD Policy" or "Policy") from First Unum Life Insurance Company ("Defendant" or "Unum") (Fried June 16, 2017 Affirmation ¶ 5, Ex. C). In May 2009, plaintiff submitted a claim to defendant for LTD benefits under the LTD Policy (Fried June 16, 2017 Affirmation, Ex. A, ¶ 14). In July 2009, Defendant approved the claim and began remitting benefit payments to plaintiff retroactive to May 24, 2009. (Fried June 16, 2017 Affirmation ¶ 3, Ex. A, ¶ 19).

The LTD Policy provides that plaintiff's monthly benefits under the policy will be reduced by the "amount of disability or retirement benefits under the United States Social Security Act" for which he is eligible (Fried June 16, 2017 Affirmation ¶ 5, Ex. C, Benefits ¶ 5). Defendant, through a letter dated July 19, 2009, approved plaintiff's disability claim, advised plaintiff of this provision in the LTD Policy, and requested plaintiff apply for Social Security Disability Insurance ("SSDI") (T.5). In January 2010, the Social Security Administration ("SSA") denied plaintiff's self-prepared application for SSDI benefits (Schneck December 18, 2014 Dep. at 267, Begos Aff., Ex. P). Subsequently, in August 2010, Plaintiff hired non-party GENEX, a company that specializes in assisting individuals applying for Social Security benefits, to help with his reapplication for SSDI benefits (T.5; Second Amended Complaint ¶ 31).[2]

In 2011, defendant ceased making LTD Policy benefit payments to plaintiff (Second Amended Complaint ¶ 21). In June 2012, despite GENEX's representation, the SSA again

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[1] The December 6, 2017, oral argument transcript for Mot. Seq. No. 007 & 009 will be citied as "T." followed by the page number.

[2] Defendant provided plaintiff with a referral to GENEX, and defendant paid for GENEX services (Schneck's Mot. Seq. No. 007 Memo at 3).

denied plaintiff's SSDI claim. In August 2012, plaintiff, as insured, commenced this action, alleging defendant breach of contract the terms of the LTD Policy. GENEX continued to represent plaintiff in his pursuit of SSDI benefits. In May 2014, the SSA approved plaintiff's SSDI claim following a hearing before an Administrative Law Judge (Second Amended Complaint ¶ 37). In December 2014, plaintiff filed an amended complaint ("Amended Complaint"), that, *inter alia*, sought to prevent defendant from asserting arguments contrary to the SSA's findings under the principles of collateral and equitable estoppel.[3]

In December 2015, plaintiff filed the Second Amended Complaint comprised of the four Counts mentioned above. Under Count 4 plaintiff demanded, *inter alia*, recovery of attorneys' fees because defendant "engaged in bad faith conduct by violating at least four provisions of a nationwide settlement agreement [the Regulatory Settlement Agreement or "RSA"] with state and federal insurance regulators, of which Schneck is a third— party beneficiary, while processing Schneck's claim for LTD benefits, and thereby breached the implied covenant of good faith and fair dealing in the LTD Policy" (Second Amended Complaint, ¶¶ 49-63; Schneck's Mot. Seq. No. 007 Memo at 3). The RSA stemmed from nationwide accusations that defendant maintained "'unfair claim settlement practices' involving their group and individual long-term disability insurance policies" (Second Amended Complaint, ¶ 54-58). Plaintiff alleges that defendant failed to evaluate his claim for LTD benefits in accordance with the RSA including the "Plan of Corrective Action" (the "PCA"), that outlines procedures defendant must follow when "making decisions as to whether or not to pay benefits to its then current and future policyholders of long term disability insurance policies" (Second Amended Complaint, ¶ 56).

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[3] On December 6, 2017, the court, on the record, dismissed plaintiff's claims for collateral estoppel and equitable estoppel (*see* Transcript).

This court, on the record, did not grant defendant's CPLR § 3212 motion on Count 4's breach of the implied covenant of good faith and fair dealing claim because of outstanding material issues of fact (T.57). Plaintiff now seeks to recover attorneys' fees he incurred in bringing this action (Second Amended Complaint, ¶ 61). Defendant argues that plaintiff cannot recover attorneys' fees as a matter of law (Unum's Mot. Seq. No. 007 Memo at 11).

DISCUSSION

Summary Judgment Legal Standard

CPLR 3212 provides that "[a]ny party may move for summary judgment in any action" to resolve claims that do not pose genuine issues of material fact necessitating a trial. The "proponent of a summary judgment motion must make a *prima facie* showing of entitlement to judgment as a matter of law, tendering sufficient evidence to demonstrate the absence of any material issues of fact" (*Alvarez v. Prospect Hosp.*, 68 NY2d 320, 324 [1986]). "Once this requirement is met. the burden then shifts to the opposing party to produce evidentiary proof in admissible form sufficient to establish the existence of a material issue of fact that precludes summary judgment and requires a trial" (*Ostrov v Rozbruch*, 91 AD3d 147, 152 [1st Dep't 2012]).

The Mighty Midgets and Sukup Exceptions to the American Rule

In New York (as in the rest of the country) the longstanding *American Rule* precludes the prevailing party from recouping legal fees "expended in the successful prosecution or defense of its rights" (*Mighty Midgets, Inc. v Centennial Ins. Co.*, 47 NY2d 12, 21–22 [1979]). Even if successful in the action, a party may only recover his attorneys' fees if the parties' contract, a statute, or a court rule authorizes this type of recovery (*Id*; *U.S. Underwriters Ins. Co. v City Club Hotel, LLC*, 3 NY3d 592, 597 [2004]).

"An insured may not recover the expenses incurred in bringing an affirmative action against an insurer to settle its rights under the policy" (*New York Univ. v Cont. Ins. Co.*, 87 NY2d 308, 324 [1995]). With two limited exceptions, "an insured has no right to recover counsel fees in connection with an action alleging a breach of contract" (*Cunningham v. Security Mut. Ins. Co.*, 260 AD2d 983, 985 [3d Dep't 1999]). The first exception, not applicable here, arises where the insured prevails in a declaratory judgment action brought by an insurance company (*Mighty Midgets, Inc.*, 47 NY2d 12, 21–22). The second exception arises when the insurer has conducted itself in bad faith (*Sukup v State*, 19 NY2d 519, 522 [1967]).

The first exception allows recovery of attorneys' fees when an insured "has been cast in a defensive posture by the legal steps an insurer takes in an effort to free itself from its policy obligations." (*Mighty Midgets Inc.*, 47 NY2d at 21). "The reasoning behind [this rule] is that an insurer's duty to defend an insured extends to the defense of any action arising out of the occurrence, including a defense against an insurer's declaratory judgment action" (*U.S. Underwriters Ins. Co.*, 3 NY3d 597-98). Thus, the *Mighty Midgets* holding is not so much an exception to the *American Rule*, as it is a right that "arises from th[e] contractual duty" to defend (*Chase Manhattan Bank, N.A. v Each Individual Underwriter Bound to Lloyd's Policy No. 790/004A89005*, 258 AD2d 1, 5 [1st Dept 1999]).

Two corollaries emerge from the *Mighty Midgets* decision. First, the exception only applies where an insurance company commences a declaratory judgment action against its insured seeking to disclaim coverage, but the insured prevails. Under these circumstances, the insured is entitled to reimbursement for its legal fees spent defending the insurance company's lawsuit (258 AD2d at 5). Second, the recovery of counsel fees "may not be had in an affirmative action by [the insured] to settle its rights" (*Mighty Midgets*, 47 NY2d at 21). Accordingly, the

Mighty Midget exception does not apply when "the insured itself" takes the offensive and initiates an action against an insurer (*Id* at 22).

The rationale of *Mighty Midgets* is that an insurer with a duty to defend must provide a defense (or reimburse the insured's litigation expenses) for any action arising out of the claim or occurrence that triggers the duty to defend, including a lawsuit brought by the insurer itself. That is, it is the contractual agreement to provide a defense that gives rise to the basis for attorneys' fees (*Liberty Surplus Ins. Corp. v Segal Co.*, 420 F3d 65, 69 [2d Cir 2005]).

"An insurer's duty to defend is broader than the duty to indemnify and arises whenever the allegations of the complaint against the insured, liberally construed, potentially fall within the scope of the risks undertaken by the insurer" (*Barkan v New York Schools Ins. Reciprocal*, 65 AD3d 1061, 1063 [2d Dept 2009]). This rationale developed in the context of primary insurers litigating a duty to defend that would have ripened upon the assertion of the underlying claims (*Liberty Surplus Ins. Corp.*, 420 F3d at 69). Failing to protect an insured cast into a defensive posture, because the insurance carrier wrongly neglected a duty to defend, may require the insurance carrier to reimburse the insured's litigation expenses (*Id*).

The duty to defend rationale is ordinarily applicable when an insured is cast into a defensive posture because of an insurer's failure to indemnify an insured during defensive litigation, and that controversy potentially falls "within the scope of the risks undertaken by the insurer" (including an action brought by the insurer, against the insured) (*Barkan*, 65 AD3d at 1063). Typically, the *Mighty Midgets* duty to defend exemption applies to personal insurance coverage (like disability insurance) when an insurer commences, and loses, an action to disclaim coverage (*see, U.S. Underwriters Ins. Co.*, 3 NY3d 597-98; *Mighty Midgets*, 47 N.Y.2d at 21).

Here, the duty to defend exception of *Mighty Midgets* and its progeny is inapplicable. It was plaintiff, not the defendant insurer, who commenced this action. Additionally, plaintiff does not allege he defended himself in any litigation, arguably stemming from an event the LTD policy covered. Defendant's request that plaintiff apply for Social Security Disability Insurance is consistent with the original terms of the LTD Policy. Defendant paid for GENEX's services, and therefore no breach of any obligation to provide legal assistance occurred. (Schneck's Mot. Seq. No. 007 Memo at 3).

Accordingly, plaintiff cannot recover attorneys' fees under the *Mighty Midgets* exception because he initiated this action against defendant (*see*, *Chase Manhattan Bank, N.A*, 258 AD2d 1, 5. ["where an insurer improperly disclaims coverage, it is liable for the attorneys' fees incurred by the insured in defending a suit by the insurer to establish the insurer's nonliability for the underlying claim as well as in the liability action, *but not for the fees expended in suing the insurer to establish coverage*"] [emphasis added]; *see West 56th Street Assoc. v. Greater N.Y. Mut. Ins. Co.*, 250 AD2d 109 [1st Dept 1998], [a successful plaintiff insured in a declaratory judgment action was not entitled to attorneys' fees because it was the insured that cast the defendant insurer, in a defensive posture by commencing the declaratory judgment action]; *see. Stein, LLC v Lawyers Tit. Ins. Corp.*, 100 AD3d 622 [2d Dept 2012]; *Lauder v OneBeacon Ins. Group, LLC*, 31 Misc 3d 379 [Sup Ct 2011]; *Ebasco Constructors, Inc. v Aetna Ins. Co.*, 260 AD2d 287, 291 [1st Dept 1999]). Here, similar to *Chase Manhattan* and *West 56th Street*, plaintiff commenced this action against his insurer to establish its alleged liability for the underlying claim. Therefore, without more, plaintiff cannot recover attorneys' fees (*see. New York Univ.*, 87 NY2d at 324; *Mighty Midgets*, 47 NY2d at 21).

The Assessment of the Sukup Exemption is Premature

Nevertheless, material issues of fact as to whether defendant insurer acted in bad faith when denying plaintiff's claim preclude granting of summary judgment in favor of plaintiff or defendant insurer at this time (T.57). In *Sukup*, the Court of Appeals found that while an insured cannot recover his legal expenses in a controversy with an insurance carrier over coverage merely because the carrier is held responsible for the loss, or where the dispute is an arguable difference of opinion, an insured can recover these costs upon an "extraordinary showing" the insurer denied coverage in bad faith (*Sukup*, 19 NY2d at 521). This standard sets a high bar. To obtain an award of attorney's fees, an insured must make "a showing of such bad faith in denying coverage that no reasonable carrier would, under the given facts, be expected to assert" the denial of coverage (*Id* at 522

In *Sukup*, an insurer denied coverage under a worker's compensation policy. Subsequently, the insured sought recovery alleging, *inter alia*, that the denial was in bad faith (*Id* at 520–21). The *Sukup* Court ultimately determined the insurer should not have denied the disputed claim, but that the denial of coverage was not made in bad faith (*Id*). Even when viewed in a light most favorable to plaintiff, unresolved factual issues prohibit this court from assessing whether plaintiff will be able to prove that defendant had no arguable basis to challenge his claim and can further show that no reasonable carrier would, under the given facts, challenge the claim (19 NY2d at 522; *Wurm v Commercial Ins. Co. of Newark, N.J.*, 308 AD2d 324, 329-330 [1st Dept 2003]; *Greenburgh Eleven Union Free School Dist. v National Union Fire Ins. Co. of Pittsburgh, PA*, 304 AD2d 334, 336-337 [1st Dept 2003]).

Defendant argues that *St. George Tower v Ins. Co. of Greater New York* (139 AD3d 200 [1st Dept 2016]) indicates an abandonment of *Sukup*. In *St. George Tower*, the First Department

confirmed the dismissal of the insured's attorneys' fees claim because "allegations that defendant's denial of coverage was not in good faith were insufficient to entitle plaintiff to reimbursement of its attorneys' fees" (*St. George Tower*, 139 AD3d at 207). Recent case law does not support defendant's contention that *Sukup* is no longer reliable precedent (*see e.g.*, *Quick Response Commercial Div., LLC v Cincinnati Ins. Co.*, 2018 WL 2209203 [NDNY 2018]; *Desiderio v. Geico General Ins. Co.*, 2016 WL 10539507 [NY Sup 2016]; *United States Fire Ins. Co. v Nine Thirty FEF Investments, LLC*, 132 AD3d 413, 416 [1st Dept 2015]). Rather, "courts since *Sukup* have acknowledged a cause of action for extra-contractual damages for a bad faith denial of coverage, but have generally found that the plaintiff was unable to meet the high standard to prevail on such a claim" (*Utica Mut. Ins. Co. v Fireman's Fund Ins. Co.*, 238 F Supp 3d 314, 329-330 [NDNY 2017]). Thus, the fact that *Sukup* exception is carefully applied is not dispositive.

Here, defendant's, not plaintiff's, motion for summary judgment seeks to dispose of Count 4 (Mot. Seq. No. 09). Accordingly, accepting all of plaintiff's allegations as true, especially given the allegations that defendant repudiated the terms of the RSA and ceased making LTD Policy benefit payments to plaintiff in bad faith, the Second Amended Complaint "sufficiently alleges a claim for the recovery of plaintiff's attorneys' fees in prosecuting this action" (Second Amended Complaint, ¶ 54-59; *D.K. Prop., Inc. v Natl. Union Fire Ins. Co. of Pittsburgh, PA*, 59 Misc 3d 714, 721 [NY Sup 2018]). Although there is a strong presumption against a finding of bad faith, here, given the facts at issue, the existence of bad faith cannot be decided as a matter of law at this stage (T.57; *Quick Response Commercial Div.*, 2018 WL 2209203 at 2).

Plaintiff's Reliance on Bi–Economy Mkt. and Panasia Estates is Misplaced

Bi–Economy and *Panasia* do not abrogate the *Mighty Midgets* doctrine. The Court of Appeals in *Bi–Economy Mkt., Inc. v. Harleysville Ins. Co. of N.Y.* (10 NY3d 187 [2008]) and *Panasia Estates, Inc. v. Hudson Ins. Co.* (10 NY3d 200 [2008]) held, for the first time, that "consequential damages resulting from a breach of the covenant of good faith and fair dealing may be asserted in an insurance coverage dispute, so long as the damages were 'within the contemplation of the parties as the probable result of a breach at the time of or prior to contracting'" (*Panasia Estates, Inc.*, 10 NY3d 200, quoting *Bi–Economy Mkt., Inc.*, 10 NY3d at 192). "However, nothing in Bi–Economy or Panasia alters the common-law rule that, absent a contractual or policy provision permitting the recovery of an attorneys' fee, 'an insured may not recover the expenses incurred in bringing an affirmative action against an insurer to settle its rights under the policy'" (*Stein, LLC v Lawyers Tit. Ins. Corp.*, 100 AD3d 622 [2d Dept 2012], quoting *New York Univ.*, 87 NY2d at 324).

To hold that the *Bi-Economy* rule augments the *Mighty Midgets* exception and applies anytime an insured alleges that insurance company rejected a policy claim in bad faith, essentially amounts to a rule that an insurance company "contemplates" whenever it terminates a policy benefit. Such a ruling would drastically increase litigation expenses, motivate frivolous actions against insurers, and unfairly force insurance companies to consider settling baseless claims because of looming plaintiff legal bills. Similarly, it would be inappropriate to impose a reciprocal mandate on insureds, forcing insured plaintiffs to remunerate well-capitalized insurance companies for their legal fees defending against affirmative policyholder actions.

CONCLUSION AND ORDER

For the foregoing reasons, it is premature to resolve whether defendant acted with the requisite bad faith to warrant an award of attorney's fees. The court, therefore, denies that part of defendant's motion to dismiss the claim for attorneys' fees without prejudice.

Accordingly, it is

ORDERED that that part of defendant's motion to dismiss the Second Amended Complaint's fourth cause of action's demand for attorneys' fees and other legal costs is DENIED without prejudice to renewal upon the close of discovery.

Dated: June 18, 2018
New York, New York

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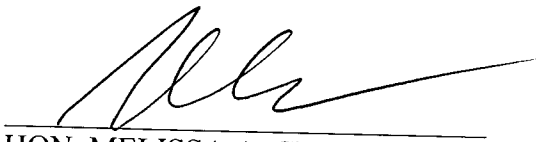

HON. MELISSA A. CRANE, J.S.C.

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