

# RESTATING OR RESHAPING THE LAW?: A CRITICAL ANALYSIS OF THE RESTATEMENT OF THE LAW, LIABILITY INSURANCE

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## INTRODUCTION

The American Law Institute (ALI) published its first-ever Restatement on the subject of liability insurance in 2019.<sup>1</sup> The project's completion ended an eight-year saga within the ALI for what proved to be one of the most controversial work products in the organization's nearly 100-year history.<sup>2</sup> The controversy surrounding this ALI Restatement of Law, both then and now, is the charge that the work product fails to faithfully "restate" prevailing liability insurance rules, and instead represents an effort to reshape the contours of liability insurance law through novel recommended rules for courts to adopt.<sup>3</sup> Adding to the controversy is the charge that the Restatement's novel rule formulations consistently operate to enhance the potential liability of insurers, a result that may signal a project bias against insurers.<sup>4</sup>

Even before the ALI issued its final published version of this

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1. See RESTATEMENT OF THE LAW, LIAB. INS. (AM. LAW INST. 2019) (recommending common law liability insurance rules).

2. See *infra* Part II; see also Stephen Pate, *The ALI's Restatement of the Law on Liability Insurance*, LAW.COM (May 29, 2018) (recognizing that the RLLI "encountered a storm of controversy").

3. See, e.g., Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi, ALI President, and Roberta Cooper Ramo, ALI Council Chair (Jan. 8, 2018) (on file with author) (providing "section-by-section explanation of the core areas of concern together with proposed changes to the black-letter rules" and appendix of submissions urging changes to the RLLI); Peter Y. Solmssen, Statement Regarding Revisions Since the 2017 Omnibus Motion to Recommit Restatement of the Law, Liability Insurance (presented at 2018 ALI Annual Meeting) (detailing in appendix novel RLLI sections); Peter Y. Solmssen et al., Omnibus Motion to Recommit Sections of Restatement of the Law, Liability Insurance (presented at 2017 ALI Annual Meeting) (requesting, in a motion by 20 ALI members, revisions to numerous RLLI sections and including appendices providing case law support for requested changes); Letter from 27 General Counsel to ALI President David F. Levi (Dec. 1, 2017) (on file with author) (expressing fundamental concerns with RLLI); see also *infra* Part III.

4. See sources cited *supra* note 3; Jeff Sistrunk, *5 Controversial Rules in the ALI's Insurance Law Project*, LAW360 (May 18, 2018, 5:02 PM) (discussing several controversial RLLI provisions); Laura Foggan, *ALI Restatement Should Not Reflect Aspirational Proposals*, LAW360 (May 17, 2018) (arguing that the RLLI should reflect settled insurance law rather than aspirational proposals); A. Hugh Scott, *Why Criticism of ALI's Insurance Restatement Is Valid*, LAW360 (May 10, 2017) (suggesting that the RLLI will affect insurance law in ways that may adversely impact liability insurers).

Restatement, backlash against the project was brewing in state legislatures. In 2018, Ohio and Michigan enacted prophylactic laws stating that the Restatement of the Law, Liability Insurance (RLLI) does not constitute the public policy of the state and should not be relied upon by courts.<sup>5</sup> In 2019, prior to the RLLI's final publication, North Dakota and Arkansas enacted similar laws.<sup>6</sup> Other states have also adopted resolutions or considered legislation with the same basic objective.<sup>7</sup> At the same time, a growing volume of media coverage,<sup>8</sup> articles,<sup>9</sup> symposiums,<sup>10</sup> judicial education programs,<sup>11</sup> and legal scholarship<sup>12</sup> have examined aspects of the RLLI.

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5. S.B. 239, 132d Gen. Assemb., Reg. Sess. (Ohio 2018) (codified at OHIO REV. CODE ANN. § 3901.82 (West 2018)); H.B. 6520, 2018 Leg., Reg. Sess. (Mich. 2018) (codified at MICH. COMP. LAWS ANN. § 500.3032 (West 2020)).

6. H.B. 1142, 66th Leg., Reg. Sess. (N.D. 2019) (codified at N.D. CENT. CODE § 26.1-02); S.B. 565, 92d Gen. Assemb., Reg. Sess. (Ark. 2019) (codified at ARK. CODE ANN. § 23-60-112 (2019)).

7. *See, e.g.*, H.R. Con. Res. 62, 121st Leg., Reg. Sess. (Ind. 2019) (enacted) (stating that the RLLI does not reflect state law or state public policy and should not be afforded recognition by courts as an authoritative reference regarding established rules and principles of insurance law); S.R. 149, 2019 Leg., Reg. Sess. (La. 2019) (enacted) (stating that the RLLI does not constitute state public policy to the extent it is inconsistent or in conflict with Louisiana law); H.R. 222, 2018 Gen. Assemb., Reg. Sess. (Ky. 2018) (enacted) (urging courts not to rely on the RLLI as an authoritative reference); *see also* Idaho S.B. 1176, 65th Leg., Reg. Sess. (Idaho 2019) (providing that the RLLI is not a source of state law and “shall not be recognized”).

8. *See, e.g.*, Daniel Fisher, *Beware of Even the Fine Print, Attorneys Warn of ALI's Insurance Law Restatement*, PA. REC. (Apr. 8, 2019), <https://pennrecord.com/stories/512412749-beware-of-even-the-fine-print-attorneys-warn-of-ali-s-insurance-law-restatement> [<https://perma.cc/PFQ8-WE56>] (discussing University of Connecticut Law School conference focused on RLLI); *'That Can't Be Right': Group Defending Disputed Insurance Law Project Gets Judges Involved*, FORBES (Feb. 20, 2019), <https://www.forbes.com/sites/legalnewsline/2019/02/20/that-cant-be-right-group-defending-disputed-insurance-law-project-gets-judges-involved/#15105c52581b> [<https://perma.cc/K2J6-Q9RH>] (discussing ALI sponsored judicial education program in Houston, Texas about the RLLI).

9. *See* sources cited *supra* note 4.

10. *See, e.g.*, University of Connecticut School of Law, “The ALI’s Restatement of the Law, Liability Insurance: Was the World Turned Upside Down?” (Apr. 5, 2019) (presented jointly by the Insurance Law Center at University of Connecticut School of Law, The Connecticut Bar Association’s Insurance Law Section, and Rutgers Center for Risk and Responsibility).

11. *See, e.g.*, Kim Marrkand, *ALI Shouldn't 'Teach' Insurance Restatement in a Courthouse*, LAW360 (Feb. 11, 2019) (discussing ALI judicial education program for federal judges in Texas regarding the RLLI).

12. *See, e.g.*, Michael F. Aylward & Vanita M. Banks, *The Fight for Plain Meaning: How the ALI Renounced the “Plain-Meaning” Rule for Insurance Policies Before Finally Embracing It (but Did They Really?)*, 13 IN-HOUSE DEF. Q. 6 (2018) (arguing that the RLLI’s approach to the “plain meaning” rule will lead to legal disputes); Michael Menapace, *Going Beyond the Four Corners to Deny a Defense: A Critique of Section 13(3)*

This article provides a comprehensive analysis of the RLLI to answer the basic question of whether the controversy and criticisms surrounding the project are well founded or are overstated. The article's objective is to assist judges and others unsure of what to make of this Restatement a lens through which to evaluate the project objectively. Part I discusses the ALI's traditional mission and development process for a Restatement, as well as the unique history of the RLLI's development. This background provides important context on the RLLI's overall design and evolution, which culminated in a controversial final work product. Part II examines ten of the RLLI's most contentious topics and provisions, explaining how a number of them depart from prevailing common law rules in novel ways. Part III provides an overall assessment of the RLLI and its combination of novel recommended rules and rules with very limited legal support, and the project's potential to significantly augment the liability insurance landscape if adopted by courts.

The article concludes that courts should view the RLLI with caution because the final work product is plainly not a pure "restatement" of existing common law. Rather, the RLLI contains various aspirational provisions that would increase insurers' liability and costs if adopted by courts. The RLLI also recommends adoption of various minority rules, which although not improper for inclusion in a Restatement, would likewise increase insurers' liability and costs. Thus, when viewed in totality, the RLLI proposes dramatic changes to liability insurance law that would, with few exceptions, disadvantage insurers. The comparatively one-sided nature of the project lends support to criticisms by ALI members, insurers, and others that the RLLI should not carry the same level of influence with courts as other ALI Restatements of Law.

## I. PROCESS CONSIDERATIONS

The ALI is the most influential private organization in the development of American law.<sup>13</sup> Its influence is due to a reputation cultivated over nearly a century for presenting carefully considered,

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*of the Restatement of Liability Insurance*, 53 TORT TRIAL & INS. PRAC. L.J. 795 (2018) (analyzing and proposing alternative language for the RLLI); George L. Priest, *A Principled Approach Toward Insurance Law: The Economics of Insurance and the Current Restatement Project*, 24 GEO. MASON L. REV. 635 (2017) (expressing the view that the RLLI fails to properly consider economic implications of proposed rules).

13. See *About ALI*, ALI, <https://www.ali.org/about-ali/> [<https://perma.cc/AB9T-Q8AC>] ("The American Law Institute is the leading independent organization in the United States producing scholarly work to clarify, modernize, and otherwise improve the law.").

balanced legal rules and policy.<sup>14</sup> The organization leverages the collective expertise of a membership comprised of many of the nation’s most distinguished judges, law professors, and practitioners to develop a variety of work products with different objectives and audiences.<sup>15</sup> The ALI is perhaps best known for developing Restatements of Law addressed to judges to assist their development of the common law. Courts in every state have, at some point, relied upon an ALI Restatement of Law when developing state common law.<sup>16</sup>

#### A. Overview of Restatement Development Process

Restatements are supposed to set forth “clear formulations of common law . . . as it presently stands or might appropriately be stated by a court.”<sup>17</sup> The ALI’s guidelines for developing Restatements expressly state that the organization, as an unelected body, “has limited competence and no special authority to make major innovations in matters of public policy.”<sup>18</sup> Accordingly, recommended “[w]ild swings [in law] are inconsistent with the work of . . . a Restatement.”<sup>19</sup> Restatement authors (called “Reporters”), who are law professors selected by the ALI, are directed to

14. See *id.* (stating that the organization was founded in 1923 and that its projects are “enormously influential in the courts and legislatures, as well as in legal scholarship and education”); see also Victor E. Schwartz & Christopher E. Appel, *The American Law Institute at the Cross Road: With Power Comes Responsibility*, 2 NAT’L FOUND. FOR JUD. EXCELLENCE, May 22, 2017 (discussing the ALI’s influence).

15. The ALI publishes three basic work products: (1) Restatements; (2) Model Laws; and (3) Principles. Each work product has a specific purpose and audience for the development of the law. See *supra* note 13; see also Charles W. Wolfram, *Bismarck’s Sausages and the ALI’s Restatements*, 26 HOFSTRA L. REV. 817, 817 (1998) (expressing the view of Chief Reporter for the Restatement of the Law Governing Lawyers that “the composite wisdom of many fine minds who have cared deeply about the quality of [ALI] products has created an organization that may, for its time and in this place, work about as well as is realistically imaginable.”).

16. See, e.g., Dominick Vetri, *The Integration of Tort Law Reforms and Liability Insurance Ratemaking in the New Age*, 66 OR. L. REV. 277, 284 n.34 (1987) (“After the American Law Institute adopted section 402A in the Restatement (Second) of Torts, virtually every state has adopted some version of strict products liability.”). The proliferation of the doctrine of strict products liability provides just one example, albeit a major one, of the influence of ALI Restatements. Other examples include the ALI’s Restatement multi-edition projects on contracts, property, agency, and trusts.

17. AM. LAW INST., CAPTURING THE VOICE OF THE AMERICAN LAW INSTITUTE: A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 3 (rev. ed. 2015) [hereinafter “ALI STYLE MANUAL”].

18. *Id.* at 6.

19. *Id.*

adhere to four “principal elements” in developing a Restatement.<sup>20</sup> These elements include instructions to: 1) “ascertain the nature of the majority rule” on a topic; 2) “ascertain trends in the law”; 3) choose the “specific rule [that] fits best with the broader body of law and therefore leads to more coherence in the law”; and 4) “ascertain the relative desirability of competing rules.”<sup>21</sup> Rules put forth by the Reporters “are constrained by the need to find support in sources of law.”<sup>22</sup>

To assist Reporters in developing a Restatement, the ALI convenes an Advisers Committee of appointed ALI members who possess expertise in the subject area to be restated, as well as a Members Consultative Group (MCG) of ALI members with an interest in the project.<sup>23</sup> These committees meet periodically to discuss project drafts prepared by the Reporters; each draft typically deals with a portion of the project. Drafts discussed at the committee level are then revised and presented to the ALI’s governing Council for a vote of approval, and to the general membership at the ALI’s annual meeting for a vote of tentative approval.<sup>24</sup> Once the ALI Council and general membership approve all of a Restatement’s installment drafts, the entire project is voted upon for final approval by the membership.<sup>25</sup>

For most of the ALI’s history, this vetting process has resulted in balanced, authoritative work products that educate judges on prevailing common law rules.<sup>26</sup> Modern Restatements, however, have increasingly come under criticism for departing from the ALI’s mission to promote clarity and uniformity in the law to instead advocate for legal system reform through aspirational rules.<sup>27</sup> The late U.S. Supreme Court Justice Antonin Scalia recognized this trend in 2015, stating:

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20. *Id.* at 13.

21. *Id.*

22. *Id.* at 6.

23. See ALI, RULES OF THE COUNCIL 10–12 (2017), [https://www.ali.org/media/filer\\_public/2c/cc/2ccc0569-8893-454e-a197-9f33a15ff31e/council-rules-2017-10.pdf](https://www.ali.org/media/filer_public/2c/cc/2ccc0569-8893-454e-a197-9f33a15ff31e/council-rules-2017-10.pdf) [<https://perma.cc/TW2L-VRRN>] (discussing steps to assist Reporters in developing a Restatement).

24. See *id.* at 12. (discussing the ALI committees).

25. See *id.* (setting forth the steps for approving a Restatement draft).

26. See Norman L. Greene, *The American Law Institute: A Selective Perspective on the Restatement Process*, 62 HOWARD L. REV. 511, 520 (2019) (noting ALI’s “impressive vetting process,” but recommending changes to improve voting process for Restatements).

27. See David A. Logan, *When the Restatement Is Not a Restatement: The Curious Case of the “Flagrant Trespasser,”* 37 WM. MITCHELL L. REV. 1448, 1481–82 (2011) (examining a novel land possessor duty of care recommended in the Restatement (Third) of Torts: Liability for Physical and Emotional Harm); Keith N. Hylton, *The Economics of the Restatement and of the Common Law*, 79 BROOK. L. REV. 595, 603–04 (2014) (stating “it is an open question whether the Restatements will . . . unify and improve the common law”).

[M]odern Restatements . . . are of questionable value, and must be used with caution. The object of the original Restatements was ‘to present an orderly statement of the general common law.’ Over time, the Restatements’ authors have abandoned the mission of describing the law, and have chosen instead to set forth their aspirations for what the law ought to be.<sup>28</sup>

Justice Scalia added that where Restatement provisions endeavor to revise rather than restate existing law, they “should be given . . . no more weight regarding what the law ought to be than the recommendations of any respected lawyer or scholar.”<sup>29</sup>

Enter the RLLI. In 2010, the ALI initiated its first-ever project on the topic of insurance. This project, which was also the ALI’s first work product directed at a specific industry, began as a “Principles of Law” project to assist judges, legislators, and other policymakers in their development of liability insurance law.<sup>30</sup> ALI Principles projects, unlike Restatements, do not require a grounding in existing case law.<sup>31</sup> Rather, the Reporters have latitude to develop rules and principles in line with their policy preferences of what the law “should be” on a particular topic. This ALI foray into insurance law proceeded as a Principles project for four years, during which time thirty-four sections of liability insurance law “principles”—comprising more than half of the entire project—were approved by the ALI Council and ALI membership.<sup>32</sup>

Near the end of 2014, the ALI’s leadership announced that the Principles of the Law, Liability Insurance would be changed into a Restatement (i.e. the RLLI).<sup>33</sup> This decision to convert a pending Principles project into a Restatement was unprecedented in the ALI’s

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28. *Kansas v. Nebraska*, 135 S. Ct. 1042, 1064 (2015) (Scalia, J., concurring and dissenting in part) (citations omitted).

29. *Id.*

30. See PRINCIPLES OF THE LAW, LIAB. INS. introductory cmt. at ix (AM. LAW INST., Tentative Draft No. 1, Apr. 9, 2013) (proposing initial chapter on “Basic Liability Insurance Contract Principles”); see also Victor E. Schwartz & Christopher E. Appel, *Encouraging Constructive Conduct by Policyholders in the Restatement of the Law of Liability Insurance*, 68 RUTGERS L. REV. 455, 455 (2015) (discussing early versions of the RLLI).

31. See ALI STYLE MANUAL, *supra* note 17, at 13–15 (discussing how Principles projects differ from Restatements).

32. See PRINCIPLES OF THE LAW, LIAB. INS., introductory cmt. at ix (AM. LAW INST., Tentative Draft No. 2 (revised), July 23, 2014) (discussing the ALI’s foray into liability insurance law).

33. See RESTATEMENT OF THE LAW, LIAB. INS. at xiii (AM. LAW INST., Preliminary Draft No. 1, Mar. 2, 2015) (stating that the draft RLLI contains revisions of the original Principles of the Law); see also Schwartz & Appel, *supra* note 30, at 458–59 (discussing project conversion).

history.<sup>34</sup> The decision appeared motivated at least in part to address broad and mounting concerns by members of the insurer community—including the withdrawal of an appointed insurer liaison to the project—regarding numerous Principles project “innovations” that threatened to disrupt longstanding liability insurance law practices and dramatically expand insurers’ liability.<sup>35</sup> Recasting the project as a Restatement offered a potential means to revisit some of the controversial, and potentially unworkable, aspirational provisions of the Principles project that had been approved previously by the ALI Council and ALI membership.<sup>36</sup>

A pervasive problem throughout the four-year development of the Principles project, which continued throughout the RLLI’s development, was a lack of subject matter expertise on the part of many ALI members. Unlike other subjects that have been restated, such as contract law, torts or property, which every attorney at least learns in law school, most ALI members possess no specialized knowledge of insurance law. As a result, the traditional checks and balances for vetting an ALI work product likely suffered because comparatively fewer ALI members possessed the requisite knowledge of insurance law to appreciate the nuances and potential novelty of proposed liability insurance rules. This lack of specialized expertise may have resulted in greater-than-usual deference given to the project Reporters with respect to proposed rules.

The change from a Principles project, which permits aspirational rules, to the RLLI, which is designed to “restate” only existing common law rules, moved the ALI into uncharted territory. Prior votes approving the project’s first two chapters (i.e. more than half of the project) were discarded so that the project could be evaluated anew under the more rigorous scrutiny traditionally applied to a Restatement.<sup>37</sup> The initial draft

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34. The ALI leadership also approved a project conversion in the opposite direction. The ALI’s Restatement of Data Privacy Principles project, which was unique in including both the “Restatement” and “Principles” labels, was changed into a Principles project in 2014 and relabeled the Principles of the Law, Data Privacy. *RESTATEMENT OF DATA PRIVACY PRINCIPLES* (AM. LAW INST., Preliminary Draft No. 1, 2014). This Principles project was completed in 2019.

35. See *PRINCIPLES OF THE LAW, LIAB. INS.*, at xvii (AM. LAW INST., Tentative Draft No. 1, Apr. 9, 2013) (noting that “Chapter 2 does contain some innovations”); see also Priest, *supra* note 12, at 636 (stating that the project was changed to Restatement for “reasons that are not totally clear”).

36. See Letter from Laura Foggan, RLLI Insurer Liaison, and other insurer counsel to RLLI Reporters (Dec. 22, 2014) (providing appendix detailing sections of prior Principles project without legal authority).

37. See *ALI STYLE MANUAL*, *supra* note 17, at 4, 8 (stating that guidelines for Restatement “aim to ‘restate’ legal propositions as precisely and coherently as possible” in comparison to Principles projects which may cover “an area [which] is so new that there is

of the newly minted RLLI, however, retained many of the novel provisions that had generated major concerns.<sup>38</sup> This first draft of the RLLI, issued in March 2015, was also scheduled for a vote to reapprove the project's first two chapters as Restatement provisions at the ALI's Annual Meeting in May 2015, a mere two months after the entire work product was ostensibly recast in part to shore up the project's common law foundation.<sup>39</sup> The ALI leadership ultimately postponed the vote to allow additional consideration of the project by the Reporters and the membership.

The RLLI's development continued for the next three years under a cloud of controversy.<sup>40</sup> Insurers, whose interests were represented in part by a new insurer liaison appointed to the project, objected to numerous provisions, discussed below, on the basis that the RLLI's proposed rule formulations failed to reflect existing law.<sup>41</sup> A number of ALI members with expertise in liability insurance law expressed similar concerns.<sup>42</sup> They

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little established law”).

38. See RESTATEMENT OF THE LAW, LIAB. INS., at ix (AM. LAW INST., Preliminary Draft No. 1, Mar. 2, 2015) (summarizing the few “significant changes” to the first two chapters of the RLLI compared to the previous Principles).

39. See *id.*; RESTATEMENT OF THE LAW, LIAB. INS., at xiii (AM. LAW INST., Discussion Draft, Apr. 30, 2015) (stating that Chapters 1 and 2 are to be discussed by the Reporters at the 2015 ALI Annual Meeting); see also Letter from Laura Foggan, RLLI Insurer Liaison, to RLLI Reporters (Apr. 20, 2015) (on file with author) (urging Reporters not to present draft Restatement for vote at 2015 ALI Annual Meeting based on concerns with project).

40. See *supra* notes 3–12 (expressing the controversy surrounding the RLLI); Victor E. Schwartz, Motion to Postpone Final Vote or Alternatively Recommit Sections of Proposed Final Draft of Restatement of the Law of Liability Insurance (presented at 2017 ALI Annual Meeting) (proposing to postpone project vote based on novel RLLI provisions); Letter from Laura Foggan, RLLI Insurer Liaison, to ALI Council Members and Emeriti regarding Restatement of the Law, Liability Insurance (Oct. 14, 2015) (on file with author) (urging ALI Council to defer any final vote on Chapters 1 and 2 in light of pervasive concerns); *infra* Part 0.

41. See, e.g., Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi, ALI President, and Roberta Cooper Ramo, ALI Council Chair (Jan. 8, 2018) (on file with author) (describing basic concerns with draft RLLI); Letter from Laura Foggan to David F. Levi, ALI President and Roberta Cooper Ramo, ALI Council Chair (Apr. 27, 2017) (on file with author) (stating that there remain many important sections of the Proposed Final Draft No. 2 of the RLLI that do not reflect the law); Letter from Laura Foggan, RLLI Insurer Liaison, to RLLI Reporters regarding Chapters 1 and 2 (Sept. 18, 2015) (on file with author) (articulating several major insurer concerns about the RLLI in Chapters 1 and 2).

42. See sources cited *supra* note 3; Letter from Harold Kim, ALI Member, to ALI Council regarding “Concerns with Council Draft No. 5 of the Restatement of the Law, Liability Insurance” (Apr. 8, 2018) (on file with author) (discussing RLLI provisions lacking common law support); Michael Aylward, Proposed Amendment to Restatement of the Law, Liability Insurance (motion presented at 2018 ALI Annual Meeting) (May 17, 2018) (proposing changes to RLLI's plain meaning rule in § 3); Joanne M. Locke, Motion to Recommit to Amend Provision Referencing “Mandatory Rules” (presented at 2017 ALI

were joined by other stakeholders external to the ALI, including insurer trade associations and several current and former heads of state insurance departments.<sup>43</sup> In spite of such objections, the ALI membership approved most of the RLLI's first three chapters at the organization's 2016 Annual Meeting.<sup>44</sup> A vote to approve the RLLI's fourth and final chapter, and complete the entire project, was scheduled to take place at the 2017 Annual Meeting, but in another unprecedented decision, the ALI leadership postponed the vote on the eve of the meeting.<sup>45</sup> No express reason was given, although the decision likely stemmed from the continuing controversy surrounding the alleged aspirational nature of many of the project's recommended "black letter" insurance law rules and comments.<sup>46</sup> For example, the general counsel of twenty-seven major corporations, many of whom stood to benefit from the RLLI's proposed rules in their capacity as policyholders, submitted a joint letter to the ALI leadership stating that they shared fundamental concerns that the project did not

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Annual Meeting) (May 23, 2017) (stating that RLLI's references to "mandatory rules" represents a new insurance law concept that lacks common law support); Vanita Banks, *The Restatement Draft Should Not Change the Well-Established Majority Rule that an Insurance Policy Is Interpreted According to Its Plain Meaning, and if a Policy Term Is Unambiguous, Extrinsic Evidence Is Not Admissible* (motion presented at 2017 ALI Annual Meeting) (May 23, 2017) (arguing that the RLLI's proposed departure from the well-settled plain meaning rule will result in uncertainty and increased litigation).

43. See Letter from Dean L. Cameron, Dir. of Idaho Dep't of Ins., to Richard Revesz, Dir. (Apr. 5, 2017) (on file with author) (requesting delay of vote to approve project to allow "state regulators the opportunity to weigh in on important issues raised by the proposed Restatement"); Letter from Patrick M. McPharlin, Dir. of Mich. Dep't of Ins. & Fin. Servs. (May 15, 2017) (on file with author) (stating concerns that the proposed RLLI could significantly alter the environment in which insurance contracts are interpreted in a way that would create instability for insurers and higher prices for consumers); Letter from Jennifer Hammer, Dir. of Ill. Dep't of Ins., to Director Richard Revesz (May 19, 2017) (on file with author) (requesting that a decision to finalize the RLLI be postponed in order to allow time for further research to be conducted); see also Eric J. Dinallo & Keith J. Slattery, *ALI's Restatement of the Law Liability Insurance: Synopsis of Regulatory Considerations*, NAT'L ASS'N MUTUAL INS. COMPANIES (Jan. 17, 2017), [https://www.namic.org/pdf/insbriefs/ali\\_synopsis.pdf](https://www.namic.org/pdf/insbriefs/ali_synopsis.pdf) [<https://perma.cc/NY8W-2EHR>] (expressing basic concerns with the RLLI).

44. See *RESTATEMENT OF THE LAW, LIAB. INS.*, at ix (AM. LAW INST., Preliminary Draft No. 3, Sept. 12, 2016) (stating that all but a few sections of Chapters 1, 2, and 3 were approved by the membership at the 2016 ALI Annual Meeting).

45. See Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi, ALI President, and Roberta Cooper Ramo, ALI Council Chair (Apr. 27, 2017) (on file with author) (summarizing major project concerns and urging deferral of project vote of approval).

46. See *supra* notes 34–45 and accompanying text (discussing persistent concerns about novel provisions throughout the RLLI's development).

faithfully “restate” liability insurance law.<sup>47</sup>

After another year of consideration, in which some significant changes to the project (discussed below) were made, the ALI membership voted to approve the final part of the RLLI and complete the project at the organization’s 2018 Annual Meeting.<sup>48</sup> Final approval of the project was similarly controversial, as various ALI members and stakeholders highlighted provisions they believed did not comport with existing law.<sup>49</sup> In the aftermath of the RLLI’s membership approval, the ALI decided to reexamine the scholarship of the project’s Reporters’ Notes before publishing the work product in an effort to ensure the case law cited stood for the propositions asserted. This exercise and subsequent editing resulted in the final publication of the RLLI in the summer of 2019, more than a year after the project’s approval by the ALI membership.<sup>50</sup>

The final published version of the RLLI contains fifty sections of recommended common law liability insurance rules that span four chapters. Chapter 1, titled “Basic Liability Insurance Contract Rules,” covers the topics of: 1) Interpretation; 2) Waiver and Estoppel; and 3) Misrepresentation. Chapter 2, titled “Management of Potentially Insured Liability Claims,” covers the topics of: 1) Defense; 2) Settlement; and 3) Cooperation. Chapter 3, titled “General Principles Regarding the Risks Insured,” covers the topics of: 1) Coverage; 2) Conditions; and 3) Application of Limits, Retentions, and Deductibles. Finally, Chapter 4, titled “Enforceability and Remedies,” covers the topics of: 1) Enforceability, as it pertains to implied-in-law terms, liabilities involving aggravated fault, and known liabilities; and 2) Remedies, as it pertains to a breach of an insurance agreement and possible bad faith.

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47. Letter from 27 General Counsel to David F. Levi, ALI President (Dec. 1, 2017); *see also* sources cited *supra* note 3 (expressing concerns regarding the RLLI).

48. *See* Press Release, Am. Law Inst., The American Law Institute Approves Restatement of the Law, Liability Insurance (May 22, 2018), <https://www.ali.org/news/articles/american-law-institute-approves-liability-insurance> [<https://perma.cc/6LMA-Z9XY>] (expressing the ALI’s approval of the RLLI); *see also* Jeff Sistrunk, *Top Insurance Legislation & Regulation Stories of 2018*, LAW360 (Dec. 13, 2018) (listing the ALI’s approval of the RLLI among the most significant insurance-related events of 2018).

49. *See* sources cited *supra* notes 3, 4, 40–41 (stating the concerns among several parties regarding the RLLI).

50. *See* RESTATEMENT OF THE LAW, LIAB. INS. (AM. LAW INST. 2019) (recommending common law liability insurance rules for courts to adopt).

*B. Process Successes (and Near Misses)*

The RLLI's unique history culminated in a work product in which insurers are clearly dissatisfied, as evidenced by many project submissions over the better part of a decade and subsequent state legislative efforts to prevent judicial adoption of the entire RLLI.<sup>51</sup> Do insurers have legitimate reasons for this reaction or is their opposition sour grapes because the RLLI did not incorporate rules *they* preferred? To help answer that question, it is useful to examine some of the key battlegrounds where members of the insurer community opposed RLLI provisions and successfully convinced the ALI to make a course correction through the organization's internal processes. Stated another way, what provisions might have been included in the RLLI if members of the insurer community opted not to engage with the ALI?

Many of the insurer criticisms with the RLLI were expressed in written submissions by the project's insurer liaison, a non-member of the ALI who took over this role around a year after the original liaison to the prior Principles project withdrew over concern of unfair treatment and project bias against insurers.<sup>52</sup> Significantly, the numerous, research-driven submissions by the insurer liaison to the RLLI Reporters during the project's final four years did not focus on debating which existing common law rules the RLLI adopted; they focused primarily on alleged novel rule formulations.<sup>53</sup> Below are several prominent examples.

1. Plain Meaning Rule

A basic rule of insurance contract interpretation is that unambiguous policy terms are interpreted according to their "plain meaning."<sup>54</sup> This rule

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51. See Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi, ALI President, and Roberta Cooper Ramo, ALI Council Chair (Jan. 8, 2018) (on file with author) (including multi-volume appendix with more than 1,200 pages of materials submitted throughout the RLLI's development).

52. See Letter from Stephen Zielezienski, AIA Insurer Liaison, to Lance Liebman, ALI Dir., regarding "American Insurance Association's Liaison to the ALI's Principles of the Law of Liability Insurance Project" (Jan. 31, 2014) (withdrawing AIA insurer liaison); see also sources cited *supra* note 41 (stating insurer liaison concerns regarding the RLLI).

53. See *supra* note 51.

54. See STEVEN PLITT ET AL., COUCH ON INSURANCE § 21:1 (3d ed. 2010) (describing the analytical steps courts take in ascertaining the meaning of terms and conditions in an insurance policy and stating that a court will first determine whether the terms at issue are defined in the policy or have a meaning that is plain on its face); see also Aylward & Banks, *supra* note 12 (arguing that the RLLI's approach to the "plain meaning" rule will lead to legal disputes).

has long been applied throughout the United States to preclude the introduction of evidence extrinsic to the insurance agreement of other proposed interpretations of a policy term where that term's meaning is already clear "on its face."<sup>55</sup> The "plain meaning" rule thus promotes predictability and consistency in the interpretation of insurance agreements, and serves to avoid costly and unwarranted disputes.<sup>56</sup>

The RLLI recommended a new approach to the traditional plain meaning rule called the "plain-meaning presumption."<sup>57</sup> Under this approach, a policyholder<sup>58</sup> would be permitted to introduce extrinsic evidence of a policy term's "plain meaning," and overcome a presumption against allowing consideration of extrinsic evidence, whenever the "extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning."<sup>59</sup> The proposed "black letter" liability insurance law rule additionally stated that the different plain meaning proffered needed to be "more reasonable" in light of the extrinsic evidence, and needed to be "a meaning to which the language of the term is reasonably susceptible."<sup>60</sup>

Insurers, among others, objected to the proposed rule on the basis it did not reflect the law of any state.<sup>61</sup> The RLLI's comments supporting the rule argued that variations in how strictly courts apply the plain meaning rule meant there was no "majority" rule, although conceded that "there are more jurisdictions with some version of the plain-meaning rule than there are jurisdictions that openly embrace a contextual approach" that permits a broader introduction of extrinsic evidence.<sup>62</sup> The Reporters' Notes stated

55. STEVEN PLITT ET AL., *supra* note 54.

56. See RESTATEMENT OF THE LAW, LIAB. INS. § 3 cmt. a (AM. LAW INST. 2019) ("The plain-meaning approach promotes consistency of interpretation of insurance policies . . ."); see also J. Walker, Jr., *Judicial Tendencies in Statutory Construction: Differing Views on the Role of the Judge*, 58 N.Y.U. ANN. SURV. AM. L. 203, 238 (2001) (stating that the plain meaning rule encourages both judicial restraint and predictability in interpretation).

57. RESTATEMENT OF THE LAW, LIAB. INS. § 3 (AM. LAW INST., Proposed Final Draft, Mar. 28, 2017).

58. The term "policyholder" is used throughout this article to refer to a person or entity who has obtained liability insurance or may be covered under a liability insurance policy. The term "insured" may be the legally correct term in certain contexts, but policyholder is used in an effort to aid the reader in readily distinguishing the two principal parties to an insurance agreement.

59. RESTATEMENT OF THE LAW, LIAB. INS. § 3(2) (AM. LAW INST., Proposed Final Draft, Mar. 28, 2017) (endorsing "plain meaning presumption" in proposed final draft of the RLLI).

60. *Id.*

61. See sources cited *supra* notes 41–42 (expressing several parties' concerns regarding the RLLI).

62. RESTATEMENT OF THE LAW, LIAB. INS. § 3 cmt. a (AM. LAW INST., Proposed Final

that the proposed rule represented “a middle point” between two “sharply differentiated interpretive camps,” but did not expressly characterize the rule as an innovation in law or note that such a rule had not been adopted by any court.<sup>63</sup>

In addition to the novelty of the RLLI’s proposed “Presumption in Favor of the Plain Meaning,” insurers, ALI members, and others with insurance law expertise pointed out the unsound public policy of a “plain meaning” rule that essentially allowed for multiple plain meanings of a policy term.<sup>64</sup> Such an approach, they argued, was counterintuitive and threatened to allow the introduction of extrinsic evidence in almost any case, eviscerating the predictability and consistency that the plain meaning rule is designed to provide.<sup>65</sup>

The battle over this basic insurance policy interpretation provision in Chapter 1 waged for years.<sup>66</sup> It was not until April 2018, only a month before the ALI membership’s final approval of the RLLI at the organization’s 2018 Annual Meeting, that a draft removing this proposed rule and replacing it with a comparatively straightforward formulation of the plain meaning rule was unveiled to the membership.<sup>67</sup> The project Reporters made this major last-minute change at the behest of the ALI Council, which had previously approved the novel plain-meaning presumption rule but appeared to reverse course based on the strong criticisms the proposed rule generated.<sup>68</sup> If left included in the RLLI, this novel and untested approach could have turned the analysis of a policy

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Draft, Mar. 28, 2017) (discussing court treatment of plain meaning rule governing insurance agreements).

63. *Id.* at Reporters’ Note a.

64. See sources cited *supra* notes 41–42 (expressing the concerns of several parties’ regarding the RLLI); Letter from Harold Kim, ALI Member, to ALI Council regarding “Fundamental Concerns with Council Draft No. 4 of the Restatement of the Law, Liability Insurance” (Jan. 5, 2018), at 2 (on file with author) (stating that § 3 “appears predicated on the assumption that there may be multiple ‘plain meanings’ of a policy term when the plain meaning rule exists to refer to *the* plain meaning of a policy term”); Letter from Alan Rutkin, ALI Member, to RLLI Reporters (Jan. 2, 2018) (on file with author) (criticizing the RLLI’s rejection of the plain meaning rule); Letter from Jackson & Campbell, P.C. to RLLI Reporters regarding § 3 (Sept. 6, 2017) (expressing concern regarding the way in which the RLLI addresses the concept of latent ambiguity).

65. *Id.*

66. See Michael F. Aylward, *Should the American Law Institute Restate or Rewrite the Rules of Interpreting Insurance Policies?*, FOR DEF., Sept. 2017, at 22, 23–29 (discussing the history of the debate over the interpretation of § 3).

67. RESTATEMENT OF THE LAW, LIAB. INS. § 3 (AM. LAW INST., Proposed Final Draft No. 2, Apr. 13, 2018).

68. See *id.* at Reporters’ Memorandum, xxi (stating the plain meaning rule in § 3 “is one of the four most significant revisions” compared to the first Proposed Final Draft).

term's "plain meaning" on its head and created a new basis for litigation over countless policy provisions.<sup>69</sup>

## 2. Misrepresentation Doctrine

The RLLI's initial treatment of the topic of misrepresentation in Chapter 1 similarly created a potential to upend existing liability insurance doctrine. Misrepresentation refers to the situation where a policyholder makes an incorrect statement of fact on his or her insurance policy application or renewal agreement.<sup>70</sup> Under the common law, an insurer is generally permitted to void or rescind an insurance agreement *ab initio*, or "from the beginning," when a policyholder has supplied false information and that information is material to the insurance agreement.<sup>71</sup> For example, if a policy application for health insurance asked whether the applicant was a smoker and the applicant, an occasional smoker, either negligently or intentionally answered he was not, the insurer would have a basis to rescind the policy for that misrepresentation.<sup>72</sup>

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69. Letter from Harold Kim, ALI Member, to ALI Council, *supra* note 64; Aylward, *supra* note 66; Aylward & Banks, *supra* note 12; *see also* Schwartz & Appel, *supra* note 14 (stating that earlier version of the RLLI "adopts a novel, litigation-enhancing approach to the traditional rule that insurance policy terms are interpreted according to their 'plain meaning'").

70. RESTATEMENT OF THE LAW, LIAB. INS. § 7 (AM. LAW INST., Discussion Draft, Apr. 30, 2015); RESTATEMENT (SECOND) OF CONTRACTS §§ 159–173 (AM. LAW INST. 1981); *see also* Schwartz & Appel, *supra* note 30, at 460–65 (discussing novel approach to misrepresentation doctrine in earlier version of the RLLI).

71. RESTATEMENT OF THE LAW, LIAB. INS. § 7 cmt. d (AM. LAW INST., Discussion Draft, Apr. 30, 2015) ("[I]f a policy is rescinded, it is as if the policy had never been written; the policy does not provide coverage for any claims. . . . If the insurer rescinds the policy, it must return all premiums collected from the policyholder for that policy."); *see also* Jones-Smith v. Safeway Ins. Co., 174 So. 3d 240, 241 (Miss. 2015) ("For more than one hundred and thirty years, this Court has held that an insurance company may void a policy when the insured made material misrepresentations during the application process."); *see also* Rutgers Cas. Ins. Co. v. LaCroix, 946 A.2d 1027, 1030 (N.J. 2008) ("We hold that the . . . material misrepresentation entitled the insurer to rescission of the insurance contract . . ."). Numerous state statutes also permit rescission based on any material misrepresentation by a policyholder. *See, e.g.*, ALA. CODE § 27-14-7 (2018); *see also* Alfa Life Ins. Corp. v. Lewis, 910 So. 2d 757, 762 (Ala. 2005) ("Under § 27-14-7, it is not necessary that the insured have made the misrepresentation with an intent to deceive; even if innocently made, an incorrect statement that is material to the risk assumed by the insurer or that would have caused the insurer in good faith not to issue the policy in the manner that it did provides a basis for the insurer to avoid the policy.").

72. The same rationale applies to other types of insurance policies. *See, e.g.*, Foster v. Auto-Owners Ins. Co., 703 N.E.2d 657, 658 (Ind. 1998) ("We hold, as we have before, that an insurance company may void coverage based on a material misrepresentation in the

The RLLI's initial approach, which was carried over from the prior Principles project, recommended limiting an insurer's rescission remedy only to situations where the policyholder's misrepresentation was committed intentionally or recklessly.<sup>73</sup> Therefore, if a policyholder was negligent in providing information to apply for or renew a policy, the insurer would not be able to rescind the agreement and instead "must pay the claim" of the negligent policyholder.<sup>74</sup> In the prior Principles project, the RLLI Reporters proposed a "quasi-reformation" remedy in this situation whereby the insurance contract would be reformed so the insurer paying the negligent policyholder's claim could recoup some higher premium for the increased risk it would have undertaken had the policyholder supplied the correct information when asked.<sup>75</sup> If the insurer would not have issued a policy at all had the policyholder provided the correct information, the insurer would then be entitled to some "reasonable additional premium for the increased risk" after paying the negligent policyholder's claim.<sup>76</sup> The RLLI never expressly addressed what the proposed remedy would be in the case of a policyholder's negligent misrepresentation.

In addition to limiting rescission to only intentional or reckless misrepresentations, the RLLI placed further limits on the application of this remedy. It defined an intentional misrepresentation as a statement in which the policyholder knew or believed to be false at the time it was made, placing a difficult practical burden on an insurer to prove a policyholder's subjective intent when making the misrepresentation.<sup>77</sup> The project defined a reckless misrepresentation as one in which the policyholder was "willfully indifferent to whether the statement is true or false," placing a similar burden on an insurer to establish the policyholder's subjective

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[property insurance] application."); *see also* *Van Horn v. Atl. Mut. Ins. Co.*, 641 A.2d 195, 200 (Md. 1994) (recognizing insurer's common law right to void *ab initio* an insurance policy, but holding that this right was abrogated in the context of auto insurance by the state's compulsory motor vehicle insurance law); *see also* *Webb v. Am. Family Mut. Ins. Co.*, 493 N.W.2d 808, 813 (Iowa 1992) (allowing insurer to rescind policy based on material misrepresentation in homeowners' policy application).

73. RESTATEMENT OF THE LAW, LIAB. INS. § 7 (AM. LAW INST., Preliminary Draft No. 1, Mar. 2, 2015); PRINCIPLES OF THE LAW, LIAB. INS. § 7 (Tentative Draft No. 1 (revised), Jan. 4, 2014).

74. PRINCIPLES OF THE LAW, LIAB. INS. § 11 (Tentative Draft No. 1 (revised), Jan. 4, 2014).

75. *Id.* § 11 cmt. a; *see also id.* § 7 cmt. b (stating that the misrepresentation rule in § 7 and "associated quasi-reformation remedy [in § 11] are incremental law reforms").

76. *Id.* § 11(2).

77. *Id.* § 8(1).

mindset.<sup>78</sup>

Each aspect of this recommended approach to misrepresentation doctrine threatened to impair the ability of insurers to void an agreement in which a policyholder misrepresented material information. The project Reporters acknowledged that this approach was an “innovation.”<sup>79</sup> They modified subsequent versions of the RLLI to remove the “quasi-reformation” remedy because, as stakeholders observed, it plainly had no legal support.<sup>80</sup> The Reporters ultimately set forth an approach more in line with the existing common law rule entitling insurers to rescind a policy based on any policyholder material misrepresentation.<sup>81</sup> They continued, however, to express dissatisfaction with existing common law in the RLLI’s comments, citing “strong fairness and efficiency objections” to the rule adopted (perhaps begrudgingly) in the RLLI.<sup>82</sup>

### 3. Breach of the Duty to Defend

Another major topic of insurance law that generated strong opposition before significant changes were made to the RLLI involved the consequences of an insurer’s breach of the duty to defend its policyholder.<sup>83</sup> In many liability insurance agreements, insurers promise to provide the policyholder with a defense in any litigation arising under the policy, regardless of the legal merits of a particular claim against the policyholder.<sup>84</sup> Chapter 2 of the RLLI recommends a number of “black letter” rules regarding an insurer’s duty to defend, including the effect of an insurer’s breach of this duty.<sup>85</sup> The RLLI’s initial approach recommended that an insurer that breached the duty to defend would: 1) lose the right to

78. *Id.* § 8.

79. *Id.* § 7 cmt. b (“The rule limiting rescission and claim denial to intentional and reckless misrepresentations is an innovation.”).

80. See Schwartz & Appel, *supra* note 30, at 460–65 (discussing evolution of the RLLI’s approach to misrepresentation doctrine).

81. *Id.*; RESTATEMENT OF THE LAW, LIAB. INS. §§ 7–9 (AM. LAW INST. 2019).

82. RESTATEMENT OF THE LAW, LIAB. INS. § 7 cmt. j (AM. LAW INST. 2019); see also RESTATEMENT OF THE LAW, LIAB. INS. § 7 cmt. j (AM. LAW INST., Discussion Draft, Apr. 30, 2015) (expressing view of the “harshness” and “unfairness” of the traditional common law misrepresentation rule and stating “there is not yet sufficient common-law authority” to adopt a different approach).

83. RESTATEMENT OF THE LAW, LIAB. INS. § 19 (AM. LAW INST. 2019) (addressing consequences of the breach of the duty to defend).

84. See *id.* §§ 13–14 (discussing conditions in which an insurer must defend a claim and the insurer’s basic obligations in providing a defense).

85. See *id.* §§ 13–23 (addressing various topics implicating the management of potentially insured liability claims and the duty to defend).

control the defense or settlement of the claim; 2) lose the right to contest coverage for the claim—in essence, a complete forfeiture rule where the insurer must pay the claim asserted; and 3) be responsible for damages, including the amount of any judgement against or settlement entered by the policyholder, subject to the policy's limits, reasonable defense costs incurred by the policyholder, and any other damages recoverable for the breach of a liability insurance contract.<sup>86</sup>

This rule was challenged as too extreme and one-sided against insurers because it would strip an insurer of any ability to challenge the lack of coverage for a claim, effectively holding the insurer strictly liable for what might be a very minor or technical breach of the duty to defend.<sup>87</sup> The draconian nature of the rule also threatened to significantly increase insurance costs and potentially create unsound incentives for policyholders to manufacture breach claims.<sup>88</sup> The RLLI Reporters defended this “forfeiture-of-coverage-defense” rule, stating it “discourages insurers from attempting to convert a duty-to-defend policy into an after-the-fact defense-cost-reimbursement policy.”<sup>89</sup> They acknowledged the rule “may increase the cost of liability insurance,” but felt an increase would be justified “by increasing the certainty that insurers will defend [insureds] from liability claims.”<sup>90</sup> Insurers countered that the rule presented a solution in search of a problem, noting a lack of any evidence suggesting insurers systematically disregard the duty to defend.<sup>91</sup>

The RLLI Reporters subsequently proposed a novel limited forfeiture rule as a “middle ground” approach.<sup>92</sup> Under this rule, an insurer that

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86. See RESTATEMENT OF THE LAW, LIAB. INS. § 19 (AM. LAW INST., Discussion Draft, Apr. 30, 2015).

87. See Letter from Laura Foggan, RLLI Insurer Liaison, to RLLI Reporters regarding Restatement of the Law, Liability Insurance (Sept. 18, 2015) (stating § 19 “creates a problem of disproportionate outcomes, by lacking any nexus between the ‘remedy’ of losing the right to contest coverage and the actual harm demonstrated, if any”).

88. *Id.*; Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding “Concerns about Scope of Insurer Duty to Defend (§ 13) Based on New Language in Council Draft No. 1” (Sept. 25, 2015) (discussing how “errant policyholders” could abuse § 13 to manufacture breach claims, “which pursuant to § 19 could implicate the forfeiture of all coverage defenses”).

89. RESTATEMENT OF THE LAW, LIAB. INS. § 19 cmt. a (AM. LAW INST., Discussion Draft, Apr. 30, 2015).

90. *Id.*

91. See Letter from Laura Foggan, *supra* note 87 (“Section 19 seems to be based on the erroneous premise that an insurer may intentionally seek to escape its defense obligations rather than fulfill them. That faulty premise of a universal bad actor cannot justify a forfeiture rule.”).

92. RESTATEMENT OF THE LAW, LIAB. INS. § 19 cmt. c (AM. LAW INST., Tentative Draft No. 1, Apr. 11, 2016).

breached the duty to defend “without a reasonable basis” was required to provide coverage for the legal action for which the policyholder sought a defense.<sup>93</sup> Insurers and others objected to this “black letter” rule on a familiar basis: the proposed rule was an innovation of the RLLI Reporters and had not been adopted by any court.<sup>94</sup>

In spite of the rule’s novelty and insurers’ objections, the rule was included in the project’s initial Proposed Final Draft scheduled for a vote of approval by the ALI membership at the organization’s 2017 Annual Meeting (a vote that, as discussed previously, was postponed on the eve of the Annual Meeting).<sup>95</sup> The limited forfeiture rule was ultimately jettisoned in the months leading up to the 2018 Annual Meeting, where the project obtained final approval, as part of the same group of ALI Council requested changes that included the major revision to the RLLI’s plain meaning rule.<sup>96</sup> The amended rule addressing the consequences of a breach of the duty to defend in the RLLI’s final publication tracks the majority common law rule in which a breaching insurer loses its right to assert any control over the defense or settlement of the action, but can still assert coverage defenses.<sup>97</sup> Had the novel limited forfeiture rule remained in the RLLI, it could have significantly increased insurers’ liability and costs where adopted by courts by creating new incentives for policyholders to sue over the alleged “reasonableness” of an insurer’s conduct in providing an agreed upon defense.

#### 4. Prejudice Requirement to Enforce Policy Conditions

The treatment of policy conditions in a liability insurance agreement became another area where the RLLI proposed major innovations in the law that were ultimately rejected. A policy condition refers to an event that either must occur, or must not occur, before performance under the policy

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93. *Id.* § 19(2).

94. Letter from Laura Foggan, RLLI Insurer Liaison, to RLLI Reporters regarding § 19 (Feb. 26, 2016); *see also* Letter from Judge Sarah S. Vance to RLLI Reporters regarding § 19 (Oct. 26, 2015), at 2 (stating that the RLLI “does not adequately support the proffered rationale for adopting the draft’s ‘limited-forfeiture rule’”).

95. RESTATEMENT OF THE LAW, LIAB. INS. § 19 (AM. LAW INST., Proposed Final Draft, Mar. 28, 2017).

96. *See* RESTATEMENT OF THE LAW, LIAB. INS. § xxiv (AM. LAW INST., Proposed Final Draft No. 2, Apr. 13, 2018) (detailing how some of the language of the limited forfeiture rule in § 19 addressing the consequences of the breach of the duty to defend was incorporated into the RLLI’s discussion of insurer “bad faith” in § 50).

97. RESTATEMENT OF THE LAW, LIAB. INS. § 19 (AM. LAW INST. 2019).

becomes due.<sup>98</sup> Most insurance policies contain numerous conditions that articulate the parties' responsibilities, such as a policyholder's duty to notify the insurer of a claim and cooperate with the insurer and the insurer's obligation in various situations in which coverage under the policy may be implicated.<sup>99</sup> For example, if a policyholder was sued and consented to a settlement of the claim before notifying his or her insurer of the lawsuit, an insurer would not be required to provide coverage where a policy condition expressly required timely notice of the suit. Ordinarily, a party need only show that the policy condition was, or was not, satisfied to enforce it.<sup>100</sup>

Chapter 3 of the RLLI, which includes the topic of "Conditions,"<sup>101</sup> proposed adding a new requirement that an insurer must show it suffered "substantial prejudice" to enforce *any* policy condition under the policyholder's control.<sup>102</sup> This novel approach sought to extend case law requiring an insurer to demonstrate prejudice to enforce a narrow set of policy conditions, namely 1) a notice-of-claim condition, 2) a voluntary payments condition, and 3) a cooperation condition.<sup>103</sup> No court, however, has adopted a blanket rule with respect to the enforcement of all conditions under a policyholder's control that the policyholder failed to satisfy.<sup>104</sup>

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98. *Id.* § 34.

99. *See id.* § 34 cmt. a (stating that "almost all insurance policy provisions would be understood to contain conditions").

100. *See* LEE R. RUSS & THOMAS F. SEGALLA, COUCH ON INSURANCE § 196:2 (3d ed. 2012) ("[B]reach of a true condition precedent bars recovery without regard to prejudice.").

101. *See* RESTATEMENT OF THE LAW, LIAB. INS. §§ 34–36 (AM. LAW INST. 2019) (providing a general discussion of policy conditions (§ 34), a specific discussion of notice and reporting conditions (§ 35), and a discussion of assignment of rights under a liability insurance policy (§ 36)).

102. RESTATEMENT OF THE LAW, LIAB. INS. § 35(3) (AM. LAW INST., Preliminary Draft No. 2, Oct. 9, 2015).

103. *See id.* § 35 cmt. c-h; Letter from Kim V. Marrkand to RLLI Reporters regarding §§ 34–35 (Jan. 20, 2016), at 4 (stating that § 35's proposed universal prejudice requirement "is without precedent") (on file with author); Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding "Treatment of Conditions in Chapter 3 of the Restatement of the Law of Liability Insurance" (Dec. 17, 2015) [hereinafter Treatment of Conditions in Chapter 3 Letter] (discussing various concerns with RLLI provisions on enforcement of policy conditions) (on file with author).

104. *See* sources cited *supra* note 103. *Woznicki v. Geico Gen. Ins. Co.*, 115 A.3d 152, 171 (Md. 2015) ("The prejudice rules apply where an insurer disclaims coverage as a result of the insured's noncompliance with a condition contained in the insurance policy *requiring notice or cooperation.*") (emphasis added); *RTE Corp. v. Md. Cas. Co.*, 247 N.W.2d 171, 179 (Wis. 1976) ("This court has consistently treated the rule established in the [notice-prejudice] statute as an exception to the general rule [that insurers need not show prejudice to bar coverage] and has refused to extend the exception beyond its terms."). Examples of conditions under the control of a policyholder include medical examination provisions,

The proposed “substantial prejudice” requirement also marked the most extreme standard applied by courts recognizing an insurer prejudice rule in the narrow, aforementioned set of policy conditions.<sup>105</sup> Most states either apply an ordinary prejudice standard or do not require a showing of prejudice at all with respect to these specific policy conditions.<sup>106</sup> Hence, the RLLI recommended turning an exception to the general enforcement rule for policy conditions, whereby courts have imposed an insurer prejudice requirement in only a few distinct situations, into the new “general rule,” and recommended adopting the most burdensome minority standard for insurers to satisfy this new rule.<sup>107</sup>

Over time, the RLLI Reporters jettisoned this novel approach, first downgrading the “substantial prejudice” standard to an ordinary prejudice standard and later modifying the universal prejudice rule to apply only to conditions governing a policyholder’s notice of a claim and cooperation.<sup>108</sup> As with other aspirational proposals discussed, the inclusion of this rule in the final RLLI could have profoundly impacted insurers’ ability to enforce the terms of an insurance policy. Such a rule would have created new

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exhaustion provisions, and insurance maintenance provisions, see *Custer Med. Ctr. v. United Auto. Ins. Co.*, 62 So. 3d 1086, 1098 (Fla. 2010), *McArthur v. State Farm Mut. Auto. Ins. Co.*, 274 P.3d 981, 989 (Utah 2012), and *Ins. Co. of N. Am. v. Kayser-Roth Corp.*, 770 A.2d 403, 418 (R.I. 2001), respectively, among others.

105. See Treatment of Conditions in Chapter 3 Letter, *supra* note 103, at 3–5 (noting that few jurisdictions adopt a “substantial prejudice” requirement beyond the notice context).

106. See *Atl. Cas. Ins. Co. v. Greytak*, 350 P.3d 63, 66 (Mont. 2015) (“A majority of the states have adopted the notice-prejudice rule in insurance coverage disputes, requiring that the insurer demonstrate that it was materially prejudiced by not having received prompt notice or notice as soon as practicable of an event that could trigger coverage.”); *Prince George’s Co. v. Local Gov’t Ins. Tr.*, 879 A.2d 81, 93–94 (Md. 2005) (recognizing notice prejudice rule as majority approach); *but see* *Midwest Emp’rs Cas. Co. v. E. Ala. Health Care*, 695 So. 2d 1169, 1172 (Ala. 1997) (“[A] primary insurer need not demonstrate prejudice in order to use untimely notice as a bar to coverage”); *DeFrain v. State Farm Mut. Auto. Ins. Co.*, 817 N.W.2d 504, 506 (Mich. 2012) (“We hold that an unambiguous notice-of-claim provision . . . is enforceable without a showing that the failure to comply with the provision prejudiced the insurer.”); *State Farm Fire & Cas. Co. v. Scott*, 372 S.E.2d 383, 385 (Va. 1983) (“When a violation of the notice requirement is substantial and material, the insurer is not required to show that it has been prejudiced by the violation.”).

107. See Treatment of Conditions in Chapter 3 Letter, *supra* note 103, at 3–5 (“[S]ubstantial prejudice is the most extreme approach, and appears to be a minority approach . . .”).

108. Compare RESTATEMENT OF THE LAW, LIAB. INS. § 35(3) (AM. LAW INST., Preliminary Draft No. 2, Oct. 9, 2015) (incorporating “substantial prejudice” rule), and RESTATEMENT OF THE LAW, LIAB. INS. § 35(3) (AM. LAW INST., Council Draft No. 2, Dec. 28, 2015) (maintaining general prejudice rule) with RESTATEMENT OF THE LAW, LIAB. INS. § 35(3) (AM. LAW INST., Tentative Draft No. 1, Apr. 11, 2016) (eliminating general prejudice rule).

incentives for policyholders to flout or ignore policy conditions under their control if they were aware that their insurer would, as a practical matter, need to show substantial prejudice in every circumstance just to enforce contract terms. Insurance costs would also likely increase to account for insurers needing both to develop evidence establishing substantial prejudice (or even ordinary prejudice) to safeguard their ability to enforce policy conditions, as well as to provide coverage in those situations where a policy condition clearly excluded coverage but substantial prejudice could not be shown.

#### 5. Other Significant Changes

In addition to the novel liability-enhancing RLLI rules discussed, which were created by the Reporters yet defeated within the ALI, a handful of other proposed rules with *at least some* support in the common law were rejected. These rules are noteworthy not because they stray explicitly from the ALI's instruction to "restate" existing law, but rather because they paint a more complete picture of what the RLLI was on the verge of becoming if the Reporters were left to their own devices. A proposed collection of minority approaches to key liability insurance issues promised to expand dramatically the potential liability of insurers.

##### *a. One-Way Attorney Fee Shifting*

For years, the RLLI recommended one-way attorney fee shifting as a generally available common law remedy in liability insurance disputes.<sup>109</sup> Several "black letter" rules proposed to depart from the "bedrock" common law "American Rule" that each party is responsible for his or her own attorney's fees unless a statute or contract provides otherwise.<sup>110</sup> The RLLI Reporters proposed one-way attorney fee shifting in the specific context of liability insurance even though attorney fee shifting is not intrinsically an insurance issue; rather, it is a significant public policy issue that has been debated for decades, perhaps most notably by Congress and state legislatures.<sup>111</sup>

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109. See RESTATEMENT OF THE LAW, LIAB. INS. §§ 47(4), 48(3), 50(1) (AM. LAW INST., Council Draft No. 4, Dec. 4, 2017); RESTATEMENT OF THE LAW, LIAB. INS. §§ 49(3), 50(3), 52(1) (AM. LAW INST., Preliminary Draft No. 3, Sept. 12, 2016).

110. *Baker Botts L.L.P. v. ASARCO LLC*, 135 S. Ct. 2158, 2164 (2015) (quoting *Hardt v. Reliance Standard Life Ins. Co.*, 560 U.S. 242, 252–53 (2010)).

111. See Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding "Chapter 4's Derogation of the 'American Rule' to Permit One-Way Attorney Fee

The ALI had never before endorsed attorney fee shifting in a Restatement, let alone one-sided fee shifting in which a prevailing policyholder could recover his or her attorney's fees but a successful insurer could not.<sup>112</sup> Although a minority of states have adopted exceptions to the American Rule as a matter of common law,<sup>113</sup> the ALI Council resolved not to go down the path of recommending broad attorney fee shifting for most types of liability insurance disputes. The RLLI's proposed "black letter" rules endorsing one-way attorney fee shifting against an insurer for a prevailing party in a declaratory judgment action and any action for breach of the policy agreement were removed just a few months before the 2018 ALI Annual Meeting where the RLLI received final approval.<sup>114</sup> The RLLI retained fee shifting in the context of insurance bad faith.<sup>115</sup>

*b. Liabilities Involving Aggregated Fault*

The final version of the RLLI includes a section addressing insurance of liabilities involving "aggregated fault."<sup>116</sup> This section refers to insurance policies that provide coverage for legal actions such as a criminal prosecution or an action seeking fines, penalties, or punitive damages related to alleged intentional harm.<sup>117</sup> Whether a jurisdiction permits insurance coverage for liabilities involving aggregated fault is a public policy determination typically made by a legislature, or regulatory body acting pursuant to legislative authority, not a common law court.<sup>118</sup> The RLLI, however, proposed a "black letter" rule broadly endorsing judicial

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Shifting" (Nov. 7, 2016) (examining the RLLI's treatment of one-way attorney fee shifting) (on file with author).

112. See Letter from Harold Kim, ALI Member, to ALI Council regarding "Fundamental Concerns with Council Draft No. 4 of the Restatement of the Law, Liability Insurance" (Jan. 5, 2018), at 4 (on file with author) (stating that the RLLI's fee shifting proposal is an "ill-advised departure from prevailing common law").

113. See RESTATEMENT OF THE LAW, LIAB. INS. § 47 Reporters' Note c (AM. LAW INST. 2019) (citing cases that have allowed attorney fee shifting in certain situations).

114. See RESTATEMENT OF THE LAW, LIAB. INS. at xxiii (AM. LAW INST., Proposed Final Draft No. 2, Apr. 13, 2018) (stating that attorney fee shifting "is one of the four most significant revisions" compared to the first Proposed Final Draft).

115. See RESTATEMENT OF THE LAW, LIAB. INS. § 50(1) (AM. LAW INST. 2019); see also *infra* Part II.0.

116. RESTATEMENT OF THE LAW, LIAB. INS. § 45 (AM. LAW INST. 2019).

117. *Id.*

118. See *id.* § 45 cmt. a (adopting broad definition of "legislation" that includes statutes, constitutions, local ordinances, and administrative regulations).

recognition of insurance coverage for conduct involving aggregated fault.<sup>119</sup>

The proposed rule was met with backlash both for its alleged intrusion upon legislative authority and conflict with existing statutes and court decisions.<sup>120</sup> For instance, the RLLI noted that courts “in nearly half the states have held that liability insurance for directly assessed punitive damages contravenes the public policy of the state.”<sup>121</sup> The RLLI’s rule was eventually changed to be agnostic on this issue, stating that “[e]xcept as barred by legislation or judicially declared public policy” the insurability of liabilities involving aggregated fault should be enforceable.<sup>122</sup>

*c. Punitive Damages Standard for Bad Faith*

Similar concerns about the RLLI overstepping into legislative policy setting arose when the Reporters recommended a punitive damages standard for courts to adopt in insurance bad faith cases.<sup>123</sup> This proposed “black letter” rule stated that punitive damages could be awarded where the “insurer intentionally, maliciously, knowingly, wantonly, or with reckless disregard of its obligations engaged in a course of outrageous or repeated conduct that disregarded the rights of the insured.”<sup>124</sup> By setting a “reckless disregard” minimum conduct standard for awarding punitive damages, the rule endorsed a minority approach permitting awards of punitive damages where an insurer had no intent to harm the economic interests of a policyholder.<sup>125</sup>

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119. See RESTATEMENT OF THE LAW, LIAB. INS. § 34 (AM. LAW INST., Council Draft No. 2, Dec. 28, 2015) (stating “[i]t is not against public policy for a liability insurance policy to cover defense costs incurred in connection with any claim . . . involving aggravated fault,” and “[i]t is not against public policy for a liability insurer to pay damages to a third-party claimant for the civil liability of the insured for intentionally caused harm, punitive damages, fraud, criminal acts, or other conduct involving aggravated fault.”).

120. See Letter from Kim V. Marrkand to RLLI Reporters regarding §§ 34–35 (Jan. 20, 2016), at 2–3 (on file with author) (stating that § 34’s proposed rule “runs squarely against established law in numerous jurisdictions” and “does away with the public policy determination of state legislatures and courts that have concluded that insurance coverage for punitive damages is against public policy”).

121. RESTATEMENT OF THE LAW, LIAB. INS. § 34 cmt. j (AM. LAW INST., Tentative Draft No. 1, Apr. 11, 2016).

122. RESTATEMENT OF THE LAW, LIAB. INS. § 45 (AM. LAW INST. 2019).

123. See RESTATEMENT OF THE LAW, LIAB. INS. § 53 (AM. LAW INST., Preliminary Draft No. 3, Sept. 12, 2016).

124. *Id.*

125. See Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding “Punitive Damages Standard in § 53 of the Restatement of the Law of Liability Insurance” (Oct. 28, 2016) (on file with author) (examining the RLLI’s standard for awarding punitive damages for insurance bad faith and surveying case law).

The Reporters put forth this common law rule despite conceding that “almost every state requires proof of greater wrongdoing than that required for a finding of bad faith” to award punitive damages, and that in “many if not most states there is a statute that provides the legal standard for awarding punitive damages.”<sup>126</sup> The comments supporting the proposed RLLI rule contained no acknowledgement of the fact the rule had relatively little common law support, or that it conflicted with the law in numerous jurisdictions that do not allow punitive damages at all for a bad faith breach of an insurance contract.<sup>127</sup> Thus, on balance, this proposed RLLI rule represented a permissive minority rule on the extreme end of the spectrum of punitive damage standards. Although this rule—and entire section—was later scrapped, it provides another powerful example of a proposed RLLI “black letter” rule poised to dramatically expand insurers’ liability.

## II. CONTROVERSIAL PROVISIONS IN THE PUBLISHED RESTATEMENT

The final version of the RLLI retains a number of provisions that insurers, ALI members, and other stakeholders challenged as novel departures in liability insurance law.<sup>128</sup> As mentioned previously, the published RLLI consists of fifty sections setting forth recommended common law liability insurance rules. Most of these sections have generated some level of concern with respect to either the recommended “black letter” rules or the comments elaborating how the rules may be applied.<sup>129</sup> Hence, in spite of key positive changes (discussed in the

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126. RESTATEMENT OF THE LAW, LIAB. INS. § 53 cmt. c, Reporters’ Notes c (AM. LAW INST., Preliminary Draft No. 3, Sept. 12, 2016).

127. See *supra* note 125. Jurisdictions that do not allow punitive damages for bad faith breach of an insurance contract include: Maine, Michigan, Nebraska, New Hampshire, Tennessee, Virginia and Washington, and the District of Columbia. See *Heil Co. v. Evanston Ins. Co.*, 690 F.3d 722, 728 (6th Cir. 2012) (applying Tennessee law); *Stull v. First Am. Title Ins. Co.*, 745 A.2d 975, 981 (Me. 2000); *Casey v. Auto Owners Ins. Co.*, 729 N.W.2d 277, 286 (Mich. Ct. App. 2006), *review denied*, 731 N.W.2d 746 (Mich. 2007); *Miller v. Kingsley*, 230 N.W.2d 472, 474 (Neb. 1975); *Jarvis v. Prudential Ins. Co. of Am.*, 448 A.2d 407, 410 (N.H. 1982); *Kamlar Corp. v. Haley*, 299 S.E.2d 514, 518 (Va. 1983); *Fisher Prop., Inc. v. Arden-Mayfair, Inc.*, 726 P.2d 8, 23 (Wash. 1986); see also N.H. Rev. Stat. § 507:16 (“No punitive damages shall be awarded in any action, unless otherwise provided by statute.”); TENN. CODE ANN. § 56-7-105 (2008) (establishing the exclusive remedy for an insurer’s bad faith and not permitting punitive damages).

128. See sources cited *supra* note 3 (expressing concerns over the ramifications of the RLLI departing from established liability insurance law).

129. See, e.g., sources cited *supra* notes 3, 40–42 (discussing the RLLI’s departure from established liability insurance law).

previous section) made during the RLLI's development process, the final work product did not end the controversy surrounding it.

This section examines ten RLLI topics that generated significant controversy during the project's development. The objective of this analysis is twofold. First, the analysis seeks to identify RLLI rule formulations that are novel or otherwise inconsistent with the four "principal elements" of a Restatement because such a determination would validate (or at least give some credibility to) claims that the project proposes to reshape rather than restate existing law.<sup>130</sup> Second, the analysis looks at the effect of proposed novel rules, as well as provisions with very limited common law support, with respect to the claim that the RLLI lacks balance and exhibits an overall bias against insurers.

### 1. Misrepresentation Revisited

The RLLI's final approach regarding misrepresentation doctrine provides a helpful starting point in evaluating the project's contours. As discussed in Part I, the RLLI initially proposed an entirely new approach to misrepresentation that limited an insurer's rescission remedy to intentional or reckless policyholder misrepresentations, requiring the insurer to pay the claims of policyholders who negligently misrepresented information.<sup>131</sup> The project further proposed a "quasi reformation" remedy in which the insurer that paid the negligent policyholder's claim could recover some amount of additional increased premium to account for the increased risk had the policyholder provided the correct information when asked.<sup>132</sup> While these novel provisions were ultimately removed from the RLLI, what took their place also incorporates some novel elements.

Sections 7, 8 and 9 of the RLLI address the topic of misrepresentation. Section 7 sets forth the longstanding common law rule permitting an insurer to rescind a policy based on a misrepresentation.<sup>133</sup> The application of the rule, however, is subject to a determination that the policyholder's misrepresentation was both "material" (section 8) and that the insurer "reasonably relied" on the misrepresentation in issuing or renewing the policy (section 9).<sup>134</sup> Materiality under the RLLI requires a showing that "a reasonable insurer in this insurer's position would not have issued the

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130. See *supra* notes 17–22 and accompanying text (describing the Restatement development process).

131. *Supra* Part I.B.2.

132. *Id.*

133. RESTATEMENT OF THE LAW, LIAB. INS. § 7 (AM. LAW INST. 2019).

134. *Id.* §§ 8–9.

policy or would have issued the policy only under *substantially different terms*.”<sup>135</sup>

Significantly, this “substantiality” requirement, whereby an insurer must demonstrate that it would have only issued a policy under “substantially different terms” as opposed to simply “different terms,” does not appear as a standard in the case law.<sup>136</sup> A comment supporting the RLLI’s materiality rule glosses over this fact, acknowledging that “courts have not often used this precise expression” while arguing the approach “best gives effect” to the purpose of the materiality requirement.<sup>137</sup> The Reporters’ Notes supporting the approach similarly concede that “[m]ost courts have not used the phrase ‘substantially different policy terms.’”<sup>138</sup> Only two cases are cited as “support” for the requirement, neither of which establishes a liability insurance rule that an insurer can demonstrate materiality only if it would have issued the policy under “substantially different terms.”<sup>139</sup> Rather, both cases relied upon involve the application of Connecticut law and quote the same Connecticut Supreme Court case from 1929 that happens to include the term “substantially” in discussing when a fact may be material.<sup>140</sup>

The distinction between “substantially different terms” and “different terms” may appear minor or even “nitpicky,” but the change is novel to misrepresentation doctrine. If adopted by courts, it could significantly limit insurers’ common law rescission remedy. It could require insurers to devote significant resources, for example by having to hire experts, to prove just how different their underwriting processes might have been had a policyholder not lied to them or otherwise acted unreasonably in

135. *Id.* § 8 (emphasis added).

136. *Id.* § 8 cmt. e (noting the dearth of case law employing the precise expression “substantially different terms”); *see also* Letter from Kim V. Marrkand to RLLI Reporters regarding § 8 (June 14, 2017) (on file with author) (stating that “well-settled and longstanding law does not impose a ‘substantiality’ requirement in determining whether a material misrepresentation by an insured may result in the denial of a claim or rescission of a policy”).

137. RESTATEMENT OF THE LAW, LIAB. INS. § 8 cmt. e (AM. LAW INST. 2019).

138. *Id.* § 8 Reporters’ Note e.

139. *See id.* Reporters’ Note e cites *Pinette v. Assur. Co. of Am.*, 52 F.3d 407, 411 (2d Cir. 1995), and *Principal Nat’l Life Ins. Co. v. Coassin*, 884 F.3d 130, 135–36 (2d Cir. 2018), as support for the “substantiality” requirement. Both cases apply Connecticut law and quote the same sentence in *Davis Scofield Co. v. Agric. Ins. Co.*, 145 A. 38, 40 (Conn. 1929), that a fact is material to the consideration of an insurance contract “when, in the judgment of reasonably careful and intelligent persons, it would so increase the degree or character of the risk of the insurance as to substantially influence its issuance, or substantially affect the rate of premium.”

140. *See supra* note 139 and accompanying text.

providing the information the insurer used to price a policy.

The separate reliance element for an insurer to rescind a policy based on a misrepresentation also incorporates this substantiality language.<sup>141</sup> Reliance under the RLLI requires a showing that “the insurer would not have issued the policy or would have issued the policy only with substantially different terms” and that this action would have been reasonable under the circumstances.<sup>142</sup> Here, no case or other source is cited in the RLLI as support for the inclusion of the substantiality requirement as it relates to an insurer’s detrimental reliance. The Comments and Reporters’ Notes to section 9 discuss various aspects of requiring an insurer to show reliance to prevail on a misrepresentation claim, which is an approach followed in some states, but omit discussion of the case law basis of the proposed “black letter” rule language.<sup>143</sup> The result is a novel rule formulation for an insurer to demonstrate reasonable reliance, which, similar to the materiality requirement, would limit an insurer’s rescission remedy for misrepresentation if adopted by courts.

## 2. Liability of Insurer for Conduct of Defense

The RLLI’s treatment of the relationship between an insurer and an attorney it hires to defend a policyholder has garnered some of the strongest criticisms of any recommended “black letter” liability insurance rule.<sup>144</sup> This is because section 12 of the RLLI, which addresses an insurer’s potential liability for the negligent acts or omissions of counsel hired to defend a policyholder, does not “restate” the law of any jurisdiction.<sup>145</sup> Section 12 sets forth two novel bases for an insurer to be

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141. See RESTATEMENT OF THE LAW, LIAB. INS. § 9(1) (AM. LAW INST. 2019).

142. *Id.* § 9(1)–(2).

143. *Id.* § 9 cmt. c-f, Reporters’ Note a, d.

144. See, e.g., Brackett Denniston & Harold Kim, Proposed Amendment to Section 12(1) of Restatement of the Law Liability Insurance Proposed Final Draft No. 2 (motion presented at 2018 ALI Annual Meeting) (May 18, 2018) (on file with author) (proposing deletion of section 12(1), “which creates a rule which no court or legislature has adopted imposing liability on insurers for the independent negligence of defense counsel they selected to defend their insureds”); Letter from DRI – The Voice of the Defense Bar to RLLI Reporters (May 18, 2018) (on file with author) (arguing Section 12(1) “has no place in a Restatement”); Letter from Illinois Association of Defense Trial Council to RLLI Reporters (May 15, 2018) (on file with author) (“Section 12 offers a solution for a problem that does not exist.”); Letter from Kim V. Marrkand to RLLI Reporters regarding § 12, at 1 (Dec. 28, 2017) (on file with author) (stating that the section 12 approach “continues to ignore the essential nature of legal practice as established in existing law and to misconstrue the nature of the tripartite relationship among insurers, defense counsel and insureds”).

145. See sources cited *supra* note 144 and accompanying text.

subject to liability for the negligence of the counsel it hires: 1) where the insurer fails to take reasonable care in selecting counsel to defend a legal action; and 2) where the insurer directs the conduct of the counsel in a manner that “overrides the duty of the counsel to exercise independent professional judgment.”<sup>146</sup>

With regard to the first liability theory, the RLLI proposes that courts recognize a duty “that turns on the insurer’s efforts to assure that the lawyer has adequate skill and experience in relation to the claim in question.”<sup>147</sup> The rule appears to envision a new policing function on the part of insurers, separate from the state bar associations that exercise oversight over the practice of law in a jurisdiction.<sup>148</sup> Under this approach, an insurer’s failure to adequately screen for signs of job impairment, for example missed court appearances or unreliability due to an attorney’s substance abuse, would give rise to direct liability for any negligent acts or omissions by the attorney within the scope of that risk.<sup>149</sup> What other signs of inadequate attorney skill or experience that might fall within this proposed insurer oversight role is left unanswered.

The RLLI also explicitly references an insurer’s selection of an attorney with “inadequate professional liability insurance” as another potential basis for triggering direct liability for the selected attorney’s negligence.<sup>150</sup> A comment supporting section 12 suggests “a court *could* find that an insurer’s decision to select defense counsel who does not have adequate liability insurance constitutes a form of negligent selection” under the RLLI’s proposed rule, but that the RLLI “takes no position on this issue, because no court has yet addressed it.”<sup>151</sup> In addition, the RLLI, after identifying this potential application and leaving the issue open, provides little insight on what might constitute “adequate” malpractice insurance.<sup>152</sup> A Reporters’ Note opines that the question should be decided by a trier of

146. RESTATEMENT OF THE LAW, LIAB. INS. § 12 (AM. LAW INST. 2019).

147. *Id.* § 12 cmt. b.

148. *Id.*

149. *Id.* § 12 cmt. b ill. 1–3. The illustrations provided in earlier RLLI drafts each related to attorney substance abuse issues. See RESTATEMENT OF THE LAW, LIAB. INS. § 12 cmt. b ill. 1–3 (AM. LAW INST., Proposed Final Draft No. 2, Apr. 13, 2018). The final RLLI expressly recognizes that the “subsequent revision of the Illustrations to remove the references to substance abuse does not represent a judgment by the Institute regarding the implications of retaining an impaired attorney to represent an insured.” RESTATEMENT OF THE LAW, LIAB. INS. § 12 Reporters’ Note b (AM. LAW INST. 2019).

150. RESTATEMENT OF THE LAW, LIAB. INS. § 12 cmt. c (AM. LAW INST. 2019).

151. *Id.* (emphasis added).

152. See RESTATEMENT OF THE LAW, LIAB. INS. § 12 cmt. c, Reporters’ Note c (AM. LAW INST. 2019).

fact;<sup>153</sup> an approach that could create a potential jury question over the adequacy of a selected attorney's professional liability insurance in any case an attorney is alleged to have committed malpractice, so that liability for negligence might be shifted to the insurer. The Reporters' Note further envisions a determination by a jury or other trier of fact of whether the insurer owes a "continuing duty to monitor that adequate coverage remains in force throughout the term of the defense counsel's representation."<sup>154</sup>

The RLLI cites no case law adopting such open-ended liability rules. The comments supporting section 12 also include no direct acknowledgment of the rule's novelty, and may incorrectly suggest to readers that the rule enjoys clear common law support.<sup>155</sup> Buried in section 12's Reporters' Notes, though, is the acknowledgement that "there are no judicial decisions that have held an insurer liable in tort for negligent selection of counsel."<sup>156</sup> Nevertheless, the Reporters argue that "some courts have suggested the possibility of such a cause of action" and that other considerations support the RLLI's proposed approach.<sup>157</sup> Notably, the few cases relied upon for this inferential proposition each expressly reject finding an insurer liable for the negligence of counsel it retains.<sup>158</sup> The result is that the RLLI obscures the basic fact that no jurisdiction follows the common law liability rule proposed in section 12.

The second liability theory, in which an insurer may be deemed negligent for overriding the independent judgment of its hired counsel,<sup>159</sup> is

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153. See *id.* § 12 Reporters' Note c (stating that "what constitutes adequate liability insurance coverage is a question of fact" that turns on several factors).

154. *Id.*

155. See *id.* § 12 cmt. a, b (stating affirmatively that "[w]hen a defense counsel selected by an insurer to represent an insured commits professional malpractice, the insured may recover from that attorney for any harm that results"). Section 12 Reporters' Note b, for instance, begins the explanation of the negligent selection rule by stating, "As a general matter in the law of torts, an actor who hires an independent contractor to perform the original actor's duty may be held liable for negligently selecting the independent contractor, when the negligent selection causes harm." *Id.* § 12 Reporters' Note b.

156. *Id.* § 12 Reporters' Note b.

157. *Id.* Section 12 Reporters' Note b cites the following two cases as supporting the "possibility of such a cause of action": *Brown v. Lumbermens Mut. Cas. Co.*, 369 S.E.2d 367, 372 (N.C. Ct. App. 1988) and *Evans v. Steinberg*, 699 P.2d 797, 799 (Wash. Ct. App. 1985). Two Kansas cases are also cited as a "see also," namely, *Hackman v. W. Agric. Ins. Co.*, 275 P.3d 73, at \*16–17 (Kan. Ct. App. 2013) (unpublished disposition) and *Progressive N.W. Ins. Co. v. Gant*, No. 15-9267-JAR-KGG, 2016 WL 4430669, at \*4 (D. Kan. Aug. 22, 2016).

158. *Id.*

159. See *id.* § 12(2) ("An insurer is subject to liability . . . when the insurer directs the conduct of the counsel with respect to the negligent act or omission in a manner that overrides the duty of the counsel to exercise independent professional judgment.").

likewise novel. This rule appears predicated on “general principles of agency and tort law”;<sup>160</sup> however, a Reporters’ Note supporting this provision concedes “no cases were found holding a liability insurer liable for the torts of counsel on a theory of apparent authority or negligent supervision.”<sup>161</sup> Nevertheless, the Reporters surmise “this dearth of cases likely has to do with the special professional obligations owed by attorneys to their clients.”<sup>162</sup> They argue that because attorneys hired by insurers to represent policyholders “are not understood to be agents of the insurers” under courts’ current thinking, “vicarious, apparent-authority, and negligent-supervision liability claims would not make sense.”<sup>163</sup> They theorize that if “an insurer were to take steps to override the normal professional independence of defense counsel, this prevailing presumption against vicarious and direct liability of the insurer would be overcome” and the rule of section 12 would be justified.<sup>164</sup>

Regardless of the veracity of any part of this rationale, it is pure conjecture. And it is being used to prop up a rule in a Restatement of Law that no jurisdiction has adopted as a matter of common law. Both of the novel liability theories put forth in section 12’s “black letter” rule also plainly disadvantage insurers by proposing unprecedented expansions of their liability.

### 3. Conditions Under Which the Insurer Must Defend

Section 13 of the RLLI sets forth the circumstances in which an insurer issuing a policy that includes a duty to defend must defend its policyholder in any legal action that may implicate coverage under the policy.<sup>165</sup> The section adopts a version of the so-called “complaint-allegation rule” whereby the insurer “must take as true all the facts alleged in the complaint or comparable document that favor coverage” and an accompanying defense.<sup>166</sup> Significantly, the proposed rule does not define a “comparable document,” which creates ambiguity with respect to what other documents would trigger an insurer’s obligation to provide a defense.<sup>167</sup> This rule formulation could, if adopted by courts, result in a

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160. *Id.* § 12 cmt. d.

161. *Id.* § 12 Reporters’ Note d.

162. *Id.*

163. *Id.*

164. *Id.*

165. *Id.* § 13.

166. *Id.* § 13 cmt. a.

167. *Id.* § 13(2)(a).

broader and less clear set of circumstances in which an insurer must provide a defense.<sup>168</sup>

Section 13 also requires an insurer to provide a defense whenever any other allegation, not contained in the complaint or comparable document, is “known to the insurer” and a “reasonable insurer” would regard the allegation as one triggering the duty to defend.<sup>169</sup> Here, similar ambiguity exists as to the potential broad scope of this requirement regarding facts outside of the complaint that an insurer becomes aware of. A number of courts, though, have recognized that an insurer’s knowledge of facts “beyond the complaint” can trigger the duty to defend, so the provision is not novel in spite of questions regarding its uncertain scope and application.<sup>170</sup>

The main controversy in section 13 relates to the situation in which an insurer learns of facts that demonstrate it owes *no duty* to defend its policyholder.<sup>171</sup> These are facts not at issue in the legal action for which coverage is sought that leave “no genuine dispute” that coverage does not exist under a policy, for instance because the defendant seeking a defense is not an insured under the policy at issue or because the property (e.g. car) involved is not the property covered under the policy at issue.<sup>172</sup> Section 13 adopts a “black letter” rule limiting the factual circumstances in which an insurer may properly deny a defense to five specific situations or where the applicable jurisdiction recognizes a “similar, narrowly defined

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168. See Memorandum from RLLI Insurer Liaison Laura Foggan to RLLI Reporters regarding § 13 of Proposed Final Draft (July 19, 2017) (on file with author) (urging revisions to § 13 standard because “case law support is lacking for a standard requiring the insurer to defend based on facts external to the complaint that the insurer ‘should have known’ or that a ‘reasonable insurer’ would take into account”).

169. RESTATEMENT OF THE LAW, LIAB. INS. § 13(2)(b) (AM. LAW INST. 2019); see also Memorandum from Insurer Liaison Laura Foggan to RLLI Reporters regarding § 13(2)(b) of Proposed Final Draft (Apr. 25, 2017) (on file with author) (stating that § 13(2)(b) “suggests a rule that an insurer would be required to defend based on unalleged matters” which “is not the law”).

170. RESTATEMENT OF THE LAW, LIAB. INS., § 13 Reporters’ Note b; but see William T. Barker, *The Draft Restatement Improperly Limits Use of Extrinsic Evidence in Insurer Decision-Making on Duty to Defend*, ALI (Aug. 1, 2016), [https://www.ali.org/media/filer\\_public/26/10/2610e5c9-b133-4dc9-a75c-5a8cc3afd01f/barker-william-extrinsic-eviden ce.pdf](https://www.ali.org/media/filer_public/26/10/2610e5c9-b133-4dc9-a75c-5a8cc3afd01f/barker-william-extrinsic-eviden ce.pdf) [<https://perma.cc/7HLN-H7L2>] (examining version of RLLI § 13).

171. RESTATEMENT OF THE LAW, LIAB. INS. § 13(3) (AM. LAW INST. 2019); see also William T. Barker, *An Insurer Need Not Defend if Undisputed Facts Not at Issue or Potentially at Issue in the Underlying Action Establish as a Matter of Law that the Legal Action Is Not Covered* (motion presented at 2017 ALI Annual Meeting) (proposing amendment to § 13(3) with respect to when an insurer need not provide a defense).

172. RESTATEMENT OF THE LAW, LIAB. INS., § 13(3) (AM. LAW INST. 2019).

exception” to the complaint-allegation rule.<sup>173</sup> This enumerated list of exceptions to the general rule requiring an insurer to provide a defense includes the two situations mentioned previously in which the defendant is not an insured under the policy or where the policy does not cover a “vehicle or other property involved in the accident,” as well as the situations in which the policy has been cancelled or a claim was reported late under a “claims-made-and-reported” policy or is subject to a related-claim or similar policy exclusion.<sup>174</sup> Outside of these narrow circumstances, the insurer is required under the RLLI’s rule to provide a defense even if undisputed facts known to the parties demonstrate that coverage is not available under the policy and the insurer owes no duty to defend.

Each of the five situations permitting the insurer to deny a defense is supported in case law.<sup>175</sup> What is novel about section 13’s approach is that no court has held that these five situations constitute an exhaustive list of the universe of circumstances in which facts not genuinely in dispute permit an insurer to deny a defense.<sup>176</sup> Earlier versions of the RLLI recommended a rule of general applicability in which coverage questions implicating the duty to defend would be determined based on “all of the facts and circumstances reasonably available to the insurer,” but this approach was replaced with an exclusive list of exceptions.<sup>177</sup> Insurers and

173. *Id.* § 13(3)(f).

174. *Id.* A claims-made-and-reported policy refers to an insurance policy in which a claim must be both made against the insured and reported to the insurer during the policy period for coverage to apply. *Infra* Part II.0.

175. See Memorandum from RLLI Insurer Liaison Laura Foggan to RLLI Reporters regarding § 13(3) (Aug. 17, 2017) (on file with author) (stating there is no case law anywhere limiting an insurer’s ability to deny a defense to the enumerated situations in § 13(3)); Letter from RLLI Insurer Liaison Laura Foggan to RLLI Reporters regarding § 13 (July 11, 2016) (on file with author) (recommending “at a minimum for the Restatement to recognize explicitly that the [§ 13(3)] examples are not exhaustive”); Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding “Support for Revising Scope of Insurer Duty to Defend (§ 13) in Council Draft No. 1” (Oct. 1, 2015) (on file with author) (discussing related case law).

176. See Memorandum from RLLI Insurer Liaison Laura Foggan to RLLI Reporters regarding § 13(3) (Aug. 17, 2017) (on file with author) (discussing different approaches in the case law and lack of affirmative limitation to the five situations proposed in the RLLI); see also Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding “Concerns About Scope of Insurer Duty to Defend (§ 13) Based on New Language in Council Draft No. 1” (Sept. 25, 2015), at 1 (on file with author) (stating that proposed approach in § 13(3) would “represent a major departure in insurance law, and one that is not supported by existing case law”).

177. RESTATEMENT OF THE LAW, LIAB. INS. § 13 (AM. LAW INST., Discussion Draft, Apr. 30, 2015).

others challenged the list as overly restrictive and novel in its formulation,<sup>178</sup> but a return to an “all-the-facts-and-circumstances approach” was rejected on the grounds it would “go well beyond” the enumerated exceptions and create too much uncertainty for policyholders.<sup>179</sup>

The RLLI’s final approach of narrowly limiting the conditions in which an insurer may deny a defense based on facts not in dispute has the effect of increasing an insurer’s costs and potential liability. Under the rule, an insurer that clearly owes no duty to defend its policyholder may nevertheless be required to defend the policyholder, at least until a later stage when the insurer is permitted to terminate its defense. The policyholder, meanwhile, obtains a windfall defense. The rule formulation, therefore, is another with novel aspects that disadvantage insurers.

#### 4. Terminating the Duty to Defend a Legal Action

Similar concerns regarding the RLLI’s inclusion of a specific list of circumstances (as opposed to a less rigid general rule) in which an insurer may deny a duty to defend at the onset of a legal action exist with respect to an insurer’s ability to later terminate that defense. Section 18 of the RLLI provides that an insurer may *only* terminate its duty to defend upon the occurrence of one or more of eight enumerated events.<sup>180</sup> These events include: 1) an explicit waiver by the policyholder of the right to a defense; 2) final adjudication of the action; 3) final adjudication or dismissal of the parts of the action that eliminate a basis for coverage and the duty to defend; 4) settlement of the action; 5) partial settlement of the action that eliminates any basis for coverage; 6) exhaustion of the applicable policy limits (if so stated in the policy); 7) a correct determination by the insurer that it does not owe a duty to defend pursuant to the rules in section 13; and 8) final adjudication that the insurer does not have a duty to defend the action.<sup>181</sup>

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178. See sources cited *supra* notes 175-176 (showing instances of parties objecting to the approach proposed in § 13(3)); Letter from Michael F. Aylward to RLLI Reporters regarding Restatement of the Law, Liability Insurance Tentative Draft No. 3: Section 13(3) Duty to Defend (Sept. 29, 2016) (on file with author) (recommending the RLLI “stick with the language” providing a general rule as opposed to enumerated exceptions); Letter from Anastasia Nye to RLLI Reporters regarding § 13 (Sept. 6, 2016) (on file with author) (cautioning that “efforts to categorize or list instances where non-liability facts are properly considered in determining the defense obligation will not capture all instances”).

179. RESTATEMENT OF THE LAW, LIAB. INS. § 13 cmt. d (AM. LAW INST. 2019).

180. RESTATEMENT OF THE LAW, LIAB. INS. § 18 (AM. LAW INST. 2019).

181. *Id.*

The comments supporting this rule explain that it envisions broad “judicial supervision” over insurer withdrawals of a defense.<sup>182</sup> The RLLI states that the approach is justified based on the importance of the insurer’s duty to defend and the harm that can occur if an insurer prematurely withdraws from a defense.<sup>183</sup> By singling out liability insurance contracts for broad judicial supervision, however, the RLLI seeks to impose a new and unique oversight structure that does not exist with respect to any other type of contract between two private parties.<sup>184</sup> Indeed, no court has expressly articulated an exclusive list of circumstances that enable an insurer to lawfully terminate its defense or has expressly indicated that an insurer needs to seek court permission before acting pursuant to terms in a private contract.<sup>185</sup>

Section 18’s clear effect, if adopted by courts, would be to limit insurers’ ability to terminate a defense. This approach would, in turn, increase insurers’ costs associated with providing a defense that may not be warranted in the first place and costs associated with obtaining a partial or final adjudication or settlement, or similar form of judicial approval.<sup>186</sup> It would also increase insurers’ potential liability exposure for breach of the duty to defend if an insurer withdrew a defense in any manner not specifically enumerated in section 18 or otherwise permitted under the narrow circumstances set forth in section 13 where an insurer may deny a defense based on facts not in dispute in the legal action. All of these results operate to the detriment of insurers.

##### 5. Insurer Recoupment of the Costs of Defense

An issue tied to the RLLI’s recommended limitations on an insurer’s ability to either initially deny a defense (section 13) or subsequently

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182. *Id.* § 18 cmt. a.

183. *Id.*

184. See Letter from RLLI Insurer Liaison Laura Foggan to RLLI Reporters regarding §§ 13, 18 (Sept. 16, 2015) (on file with author) (stating that approach in § 18 “fundamentally alters the terms of insurance contracts and contradicts black letter law”).

185. The Reporters’ Notes accompanying § 18 cite cases that discuss in general terms circumstances in which an insurer may terminate a defense, but do not contain citations to any case setting forth an exhaustive list of circumstances, one or more of which must exist, for an insurer to terminate a defense, which is the approach taken in § 18. RESTATEMENT OF THE LAW, LIAB. INS. § 18 Reporters’ Notes a-j (AM. LAW INST. 2019).

186. See Letter from Kim V. Marrkand to RLLI Reporters regarding § 18 (Aug. 4, 2017), at 5 (on file with author) (expressing view that “§18 should be deleted in its entirety because it simply goes way too far, contravenes what a Restatement should do and is contrary to the well-developed jurisprudence on the duty to defend,” and, at a minimum, amended to avoid “unnecessary, time-consuming and costly litigation”).

withdraw a defense (section 18) is whether the insurer can recoup its costs in providing a defense when the insurer had no obligation to do so. Section 21 of the RLLI addresses an insurer's potential recoupment of defense costs and sets forth a "black letter" rule rejecting any common law right of recoupment by an insurer.<sup>187</sup> Accordingly, any defense costs incurred by an insurer must be absorbed by the insurer unless the applicable policy states otherwise.

This "no-recoupment" default rule has case law support, but is a minority approach.<sup>188</sup> One of section 21's comments acknowledges the "majority position" of an insurer's right to recoupment of defense costs, often based on a theory of unjust enrichment, yet proceeds to characterize the section's no-recoupment rule as a "position embraced by . . . recent state-court decisions" as part of an emerging common law trend.<sup>189</sup> The comment then undercuts this characterization, conceding that "a slightly greater number of state courts have espoused contrary views" and that a "majority of federal courts making Erie predictions also have adopted positions contrary to the rule stated in this Section."<sup>190</sup> Regardless of the description used, though, a minority of courts follow a no-recoupment rule and it is clearly appropriate for a Restatement to adopt.

What makes the rule controversial—other than the fact it adds to the growing set of RLLI provisions that favor policyholders and increase insurers' costs—is the fact that it contradicts another ALI Restatement, namely the Restatement Third, Restitution and Unjust Enrichment (R3RUE).<sup>191</sup> This Restatement, which was completed in 2011, includes a lengthy discussion of restitution in the context of insurance.<sup>192</sup> It sets forth several rules and illustrations that recognize an insurer's ability to successfully bring a claim to recover defense costs associated with a legal action in which the insurer owed no duty to defend.<sup>193</sup>

The RLLI devotes significant ink to reconciling this conflict between

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187. RESTATEMENT OF THE LAW, LIAB. INS. § 21 (AM. LAW INST. 2019).

188. *See id.* § 21 Reporters' Note a ("In case law and commentary, the position adopted in this Section typically has been referred to as the minority position.").

189. *Id.* § 21 cmt. a. The version of the RLLI that received final approval at the 2018 ALI Annual Meeting described this minority rule as the "emerging state-court majority rule." RESTATEMENT OF THE LAW, LIAB. INS. § 21 cmt. a (AM. LAW INST., Revised Proposed Final Draft No. 2, Sept. 7, 2018).

190. RESTATEMENT OF THE LAW, LIAB. INS. § 21 cmt. a (AM. LAW INST. 2019).

191. RESTATEMENT (THIRD) OF RESTITUTION AND UNJUST ENRICHMENT § 35 (AM. LAW INST. 2011).

192. *Id.* § 35 cmt. c.

193. *Id.*

section 21's no-recoupment rule and the R3RUE.<sup>194</sup> The RLLI states that the R3RUE “expresses a general view with respect to recoupment that differs from the special case of the default rule” of section 21 because the R3RUE treats liability insurance defense costs purely as “rendering an extra-contractual performance” and fails to take “full account” of “special considerations of insurance law.”<sup>195</sup> These special considerations, the RLLI argues, include benefits an insurer obtains from providing a defense when it “believes in good faith (and in fact correctly) that the underlying action is not covered, in view of the risk of enhanced liability that could attend an adverse decision on coverage.”<sup>196</sup> The RLLI contends that an insurer's ability to exercise control over the cost, quality, and direction of a defense, and participate in settlement discussions for a claim it bears no obligation still constitute benefits that belie a recovery under a theory of unjust enrichment as set forth in the R3RUE.<sup>197</sup>

This argument to try to reconcile these two Restatements might best be described as a “stretch.” The RLLI's adoption of a different rule directly at odds with both the R3RUE and the case law trend allowing recoupment also suggests the approach fails to satisfy the ALI's guideline that a Restatement chooses the rule that “leads to more coherence” in the law.<sup>198</sup> In any event, the soundness of the RLLI's approach is less important than the symbolism of the no-recoupment rule's inclusion. Adopting a minority approach that plainly favors policyholders and proposes to increase insurers' costs, even at the expense of contravening the approach taken in another recent Restatement, appears to feed into the narrative that the project demonstrates a bias against insurers. Although there is certainly no restriction in the ALI's rules governing Restatements against either adopting a minority approach or overriding another recent Restatement, the decision to proceed this way could be perceived as inviting greater controversy in a project already saturated with it.

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194. RESTATEMENT OF THE LAW, LIAB. INS. § 21 cmt. b (AM. LAW INST. 2019). The version of the RLLI that received final approval at the 2018 ALI Annual Meeting conceded only that an “apparent conflict” existed between § 21's no-recoupment rule and the approach taken in the R3RUE. RESTATEMENT OF THE LAW, LIAB. INS. § 21 cmt. a (AM. LAW INST., Revised Proposed Final Draft No. 2, Sept. 7, 2018). It argued that the R3RUE started from a different assumption about insurance law that “disappear[ed] once insurance law is understood to include a no-recoupment default rule,” which offered a puzzling and apparently self-fulfilling explanation. *Id.*

195. RESTATEMENT OF THE LAW, LIAB. INS. § 21 cmt. b (AM. LAW INST. 2019).

196. *Id.*

197. *Id.*

198. ALI STYLE MANUAL, *supra* note 17, at 5.

## 6. Insurer Duty to Make Reasonable Settlement Decisions

One of the most consequential topics of the RLLI involves an insurer's duty to act responsibly in pursuing settlement of a policyholder's claim.<sup>199</sup> Case law often refers shorthand to an insurer's "duty to settle," but the RLLI recognizes that insurers do not have a duty to settle every claim.<sup>200</sup> Rather, an insurer's duty is to "make reasonable settlement decisions" where a potential exists for a judgment in excess of the applicable policy limits, and the policyholder could be responsible for paying that excess amount.<sup>201</sup>

Section 24 of the RLLI states that a reasonable settlement decision would be one made by a reasonable insurer that bears sole responsibility for the full amount of the potential judgement.<sup>202</sup> This decision includes the responsibility for insurers to make a policy's limits available for settlement of a claim that exceeds those limits if a reasonable insurer would do so in the circumstances.<sup>203</sup> The duty set forth in the RLLI also requires an insurer "to accept a settlement offer that a reasonable insurer would accept and to make an offer to settle when a reasonable insurer would do so."<sup>204</sup>

An insurer that breaches this duty is subject to liability for "any foreseeable harm caused by the breach, including the full amount of damages assessed against the insured in the underlying legal action, without regard to the policy limits."<sup>205</sup> Consequently, an insurer that fails to accept a reasonable settlement offer, for instance in a good faith effort to negotiate a lower settlement on behalf of its policyholder, "bears the risk of an excess judgment against the insured at trial."<sup>206</sup> The main controversy with the RLLI's approach is that it expressly recommends subjecting an insurer to broad extra-contractual liability in the absence of any alleged "bad faith" on the insurer's part.<sup>207</sup>

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199. See RESTATEMENT OF THE LAW, LIAB. INS. § 24 (AM. LAW INST. 2019) (explaining the link between an insurer's duty to make reasonable settlement decisions and the application of general contract law duties of good faith and fair dealing within the insurance policy context).

200. *Id.* § 24 cmt. b.

201. *Id.* § 24(1).

202. See *id.* § 24(2); see also *id.* § 24 cmt. c (explaining standard as a "disregard the limits" rule or requiring insurer's "equal consideration" to the interests of its insured).

203. *Id.* § 24(3).

204. *Id.* § 24 cmt. d.

205. *Id.* § 27(1).

206. *Id.* § 24 cmt. d.

207. See, e.g., Letter from Kim V. Marrkand to RLLI Reporters regarding §§ 24 and 27, at 1–2 (Dec. 27, 2017) (on file with author) ("The core of the problem is that Section 24, despite the clear language of the Black Letter Law speaking to the 'duty to make reasonable

As a comment supporting section 24 states, “courts in many jurisdictions refer to the standard for breach of the duty to make reasonable settlement decisions as one of ‘bad faith.’”<sup>208</sup> The RLLI, in comparison, eschews any reference to bad faith to describe the insurer’s breach of the duty to make reasonable settlement decisions. Instead, the RLLI adopts a “commercial-reasonableness standard” that it asserts “most courts actually apply” in practice, “even those that invoke the language of bad faith.”<sup>209</sup> The RLLI’s approach, therefore, merges negligence and bad faith standards and jurisprudence such that in any breach-of-settlement duty case “the ultimate test of liability is whether the insurer’s conduct was reasonable under the circumstances.”<sup>210</sup>

By recommending a negligence standard for an insurer’s breach of the duty to make reasonable settlement decisions, the RLLI proposes to dramatically expand the scope of liability against insurers in the United States.<sup>211</sup> The approach removes any need for evidence showing an insurer’s intentional or reckless misconduct or other impure motive, such as the insurer purposefully placing its interests above its policyholder. All that is required to subject an insurer to liability for an excess judgment is a determination by a jury or trier of fact, with the benefit of hindsight, that a “reasonable insurer” would have accepted a settlement offer.<sup>212</sup> This approach permits liability even where an insurer acted in good faith at all times with respect to the interests of its policyholder.

The RLLI’s approach also proposes to expand liability in situations in which an insurer never receives a settlement demand.<sup>213</sup> It adopts an ambiguous requirement subjecting an insurer to extra-contractual liability where the insurer does not make a settlement offer in the absence of a settlement demand, or opts not to make a counteroffer, where a jury or trier of fact determines—again, with the benefit of hindsight—that a reasonable insurer would have done so.<sup>214</sup> Although a comment to section 24

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settlement decisions,’ would nevertheless impose liability upon an insurer who has in fact acted reasonably in evaluating a settlement offer.”); Schwartz & Appel, *supra* note 30, at 465–71 (discussing concerns with RLLI approach permitting liability where an “insurer acted perfectly reasonably” in negotiating a settlement).

208. RESTATEMENT OF THE LAW, LIAB. INS. § 24 cmt. a (AM. LAW INST. 2019).

209. *Id.*

210. *Id.*

211. *See supra* notes 3, 41, 207 stating concerns with RLLI approach in § 24).

212. RESTATEMENT OF THE LAW, LIAB. INS. § 24 cmt. d (AM. LAW INST. 2019).

213. *See id.* § 24 cmt. f (stating that, absent a reasonable offer by the plaintiff, it may be unreasonable for an insurer to not make a settlement offer before trial).

214. *See id.* (adopting a reasonableness standard regarding the insurer’s obligation to make settlement offers or counteroffers).

recognizes that “it may be strategically useful, from the perspective of a reasonable insurer that bears full risk of judgment, to refrain from making a settlement offer” in various situations, the rule effectively turns every insurer’s good faith decision not to make an offer or counteroffer into a potential jury question.<sup>215</sup>

The RLLI’s allowance of extra-contractual liability where an insurer acts in good faith may be a questionable approach from a public policy perspective,<sup>216</sup> and yet another in the project designed to expand insurers’ liability, but it is not unprecedented.<sup>217</sup> A number of courts adopt a negligence standard in breach-of-settlement duty cases and additionally recognize that an insurer may need to initiate settlement efforts to satisfy its duty.<sup>218</sup> Nevertheless, the RLLI’s discussion of this approach, which endeavors in part to reclassify many bad faith cases as negligence cases, may overstate the actual support for the precise rule among courts. At the very least, the RLLI provides an unclear analysis of where the law stands and which jurisdictions have in their bad faith jurisprudence dispensed with any need to show some form of insurer misconduct that at least demonstrates an absence of good faith before subjecting an insurer to potentially massive extra-contractual liability.

In addition, it is important to recognize that the RLLI’s approach, similar to other provisions discussed, recommends the most permissive standard recognized by courts for bringing a claim against an insurer for breach of its settlement obligations. The clear import of the rule, if adopted by courts, would be to dilute existing standards in bad faith litigation and expand liability against insurers.<sup>219</sup>

#### 7. Damages for Breach of the Duty to Make Reasonable Settlement Decisions

As discussed in the previous section, an insurer that breaches the RLLI’s duty to make reasonable settlement decisions is subject to liability for “any foreseeable harm” caused by the breach, including the full amount

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215. *Id.*

216. *See supra* note 207; *see also* Victor E. Schwartz & Christopher E. Appel, *Common-Sense Construction of Unfair Claims Settlement Statutes: Restoring the Good Faith in Bad Faith*, 58 AM. U. L. REV. 1477, 1495–99 (2009) (expressing view that bad faith claims should include a minimum element of intentional or reckless misconduct).

217. *See* RESTATEMENT OF THE LAW, LIAB. INS. § 24 Reporters’ Note a, f (AM. LAW INST. 2019) (citing cases in which the insurer has an affirmative duty to explore settlement possibilities).

218. *Id.*

219. *See infra* Part II.0.

of any excess judgment assessed against the policyholder.<sup>220</sup> This damages rule, set forth in section 27, proposes to include punitive damages among the types of “foreseeable” damages an insurer must pay where a punitive award has been assessed against the policyholder in the underlying legal action.<sup>221</sup> Therefore, a policyholder who has been punished by a court for his or her reprehensible behavior can, in bringing a successful claim for breach of the duty to make reasonable settlement decisions, shift that entire punishment onto the insurer.

No court has adopted such a rule.<sup>222</sup> In fact, every court that has considered the approach has rejected it. As a section 27 comment and corresponding Reporters’ Note acknowledge, there have been five reported court rulings on this issue and all five concluded that requiring insurers to pay punitive damages levied against a policyholder with respect to a breach of the insurer’s settlement duty would violate state law.<sup>223</sup> In these jurisdictions, insurance coverage for punitive damages is not permitted,<sup>224</sup> which is a public policy judgment based on the recognition that punitive damages are “intended to punish *the defendant* for his wrongful acts and to deter similar conduct in the future.”<sup>225</sup>

220. RESTATEMENT OF THE LAW, LIAB. INS. § 27(1) (AM. LAW INST. 2019).

221. *See id.* § 27 cmt. e (stating a “punitive-damages award is a foreseeable consequence of the insurer’s breach”).

222. *Id.*; Victor E. Schwartz, Proposed Amendment to Restatement of the Law, Liability Insurance Proposed Final Draft No. 2 (motion presented at 2018 ALI Annual Meeting) (proposing to amend § 27 to remove provisions dealing with insurer liability for punitive damages assessed against insured in underlying action); Joanne M. Locke & Phil Goldberg, Proposed Amendment to Restatement of the Law, Liability Insurance Proposed Final Draft (motion presented at 2017 ALI Annual Meeting) (proposing to amend § 27 to remove provisions dealing with insurer liability for punitive damages assessed against insured in underlying action).

223. *See* PPG Indus., Inc. v. Transamerica Ins. Co., 975 P.2d 652, 658 (Cal. 1999); *Lira* v. Shelter Ins. Co., 913 P.2d 514, 517–18 (Colo. 1996); *Soto* v. State Farm Ins. Co., 635 N.E.2d 1222, 1224–25 (N.Y. 1994); *see also* Magnum Foods, Inc. v. Cont’l Cas. Co., 36 F.3d 1491, 1506 (10th Cir. 1994) (stating that policyholder may not shift liability for punitive damages to insurer; the duty of good faith does not include duty to settle or contribute to settlement of a punitive damages claim, which is “uninsurable”). In the most recent case referenced in Reporters’ Note e, *Wolfe* v. *Allstate Prop. & Cas. Ins. Co.*, the Third Circuit held that punitive damages awarded against an insured in the underlying case could not be considered compensable damages in an action against the insurer for bad faith/failure to settle. “To hold otherwise would shift the burden of the punitive damages to the insurer, in clear contradiction of Pennsylvania public policy.” *Wolfe* v. *Allstate Prop. & Cas. Ins. Co.*, 790 F.3d 487, 493 (3d Cir. 2015).

224. *See* RESTATEMENT OF THE LAW, LIAB. INS. § 27 Reporters’ Note e (AM. LAW INST. 2019).

225. *Lira*, 913 P.2d at 517 (citing *Seaward Constr. Co. v. Bradley*, 817 P.2d 971, 974 (Colo. 1991)) (emphasis added).

As the California Supreme Court explained, a rule like the one envisioned in section 27 of the RLLI would allow an insured to “shift to its insurer, and ultimately to the public, the payment of punitive damages awarded in the third party lawsuit against the insured as a result of the insured’s intentional, morally blameworthy behavior against the third party.”<sup>226</sup> “To allow such recovery,” the court continued, “would (1) violate the public policy against permitting liability for intentional wrongdoing to be offset or reduced by the negligence of another; (2) defeat the purposes of punitive damages, which are to punish and deter the wrongdoer; and (3) violate the public policy against indemnification for punitive damages.”<sup>227</sup>

The RLLI’s only proffered support for enabling a policyholder to shift responsibility for a punitive damages award onto his or her insurer comes from two dissenting opinions.<sup>228</sup> The RLLI states that section 27 “follows the approach of the dissenting judges” for public policy reasons such as the encouragement of reasonable settlement decisions by insurers, even though no court has actually adopted this public policy.<sup>229</sup> The rule is a clear innovation in common law doctrine, and another that would plainly provide a windfall to policyholders while increasing the potential liability of insurers if adopted by courts.

#### 8. Consequences of the Breach of the Duty to Cooperate

The RLLI’s fifty sections of “black letter” liability insurance rules restate a single duty on the part of policyholders: the duty to cooperate.<sup>230</sup> This duty includes the obligation for policyholders to reasonably assist in the investigation, defense, and potential settlement of the legal action for which coverage is sought.<sup>231</sup> Section 30 addresses the consequences of a policyholder’s breach of the duty to cooperate. It provides that an insurer may be relieved of its obligations under a policy only if it demonstrates that the policyholder’s breach of the duty to cooperate caused or will cause prejudice to the insurer.<sup>232</sup>

As the comments supporting this rule explain, courts have taken a

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226. *PPG Indus., Inc.*, 975 P.2d at 658.

227. *Id.*

228. *See* RESTATEMENT OF THE LAW, LIAB. INS. § 27 Reporters’ Note e (AM. LAW INST. 2019) (citing *PPG Indus., Inc.*, 975 P.2d at 658–62 (Mosk, J., dissenting) and *Lira*, 913 P.2d at 520–22 (Lohr, J., dissenting)).

229. *Id.* § 27 cmt. e.

230. *See id.* § 29.

231. *Id.*

232. *See id.* § 30(1).

range of approaches with respect to the effect of a policyholder's breach of the duty to cooperate.<sup>233</sup> Courts on one end of the spectrum follow a "strict-condition rule" in which any material breach of the policyholder's duty to cooperate relieves the insurer of its policy obligations.<sup>234</sup> Courts on the other end apply a prejudice requirement in which an insurer is only relieved of its policy obligations if it can demonstrate a "substantial likelihood" that the policyholder's cooperation would have affected the outcome of the legal action, such as by allowing the insurer to win a dismissal.<sup>235</sup> The RLLI's approach adopting a prejudice requirement more closely aligns with the latter approach.<sup>236</sup>

Specifically, the RLLI endorses a "prejudice standard in the duty-to-cooperate context [that] is difficult for insurers to satisfy."<sup>237</sup> The comments supporting the rule expressly reject any "undemanding standard" for prejudice to an insurer, and assert that a policyholder's failure to cooperate should only relieve an insurer of its policy obligations where that failure is shown to "affect the outcome of the action."<sup>238</sup> The RLLI also dismisses the notion that an increase in an insurer's defense costs alone, for instance cost increases brought about by a policyholder's willful failure to cooperate, can satisfy the recommended prejudice standard.<sup>239</sup>

Instead, an insurer harmed by what may be a policyholder's deliberate efforts to undermine the handling of an insurance claim and flout a cooperation policy condition may only obtain relief if the harm raises to a litigation outcome-changing level. The RLLI cites as examples policyholder misconduct that deprives the insurer of a full or partial defense, increases the amount of a judgment in a substantial way, or deprives the insurer of an opportunity to settle the action for a substantially lower amount than the damages ultimately awarded.<sup>240</sup> The consequences of smaller offenses that nonetheless harm an insurer and violate the policy must be absorbed by the insurer; a result that could encourage intentional misconduct by policyholders by excusing misconduct in all except the most

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233. *See id.* § 30 cmt. a (discussing how some jurisdictions handle a breach of the duty to cooperate).

234. *See id.* (stating that a minority of jurisdictions follow a "strict-condition rule").

235. *Id.* § 30 cmt. b.

236. *See id.* (discussing proposed prejudice standard).

237. *Id.* § 30 cmt. a.

238. *Id.* § 30 cmt. b, c.

239. *See id.* § 30 cmt. b (stating that to satisfy the RLLI's prejudice standard "[i]t is not ordinarily enough that the insured's failure to cooperate increased the cost or difficulty of the defense").

240. *See id.* (discussing scenarios where conduct "has affected or will affect the outcome of the action").

egregious circumstances.<sup>241</sup>

Although the approach in section 30 has some case law support,<sup>242</sup> it provides another example of the RLLI adopting a rule on the end of the spectrum that most disadvantages insurers.<sup>243</sup> The rule allows policyholders to violate their one restated duty with relative impunity so long as the misconduct cannot be said to exceed the high bar of affecting the ultimate outcome of the action. An acknowledged result of limiting an insurer's ability to rely on cooperation conditions to address abusive policyholder behavior is the potential for increased insurance costs, which are costs the RLLI expressly contends an insurer should not be able to recover.

### 9. Notice and Reporting Conditions

The final version of the RLLI states that an insurer must demonstrate it suffered prejudice to enforce two types of policy provisions: 1) a provision setting forth the policyholder's duty to cooperate with his or her insurer (addressed in the previous section); and 2) a provision requiring the policyholder to provide timely notice of a claim.<sup>244</sup> As discussed in Part I, earlier versions of the RLLI proposed a novel "universal" prejudice requirement for an insurer to enforce any policy condition under the policyholder's control before landing on this case law-supported approach.<sup>245</sup> Section 35 of the RLLI provides that an insurer need not demonstrate prejudice with respect to a subset of liability insurance policies known as "claims-made-and-reported" policies that expressly condition coverage on the policyholder reporting a claim within a specified period.<sup>246</sup>

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241. See Schwartz & Appel, *supra* note 30, at 471–76 (discussing earlier version of the RLLI's proposed duty to cooperate rule and its potential to encourage rather than deter intentional misconduct by policyholders); see also Letter from Victor E. Schwartz and Christopher E. Appel to RLLI Reporters regarding "Improving the Policyholder Duty to Cooperate in the Restatement of the Law of Liability Insurance" (Apr. 10, 2015) (on file with author) (explaining the consequences of a breach of the duty to cooperate and concerns about the RLLI's proposed approach).

242. See RESTATEMENT OF THE LAW, LIAB. INS. § 30 cmt. a (AM. LAW INST. 2019) (stating that a majority of jurisdictions impose some form of prejudice requirement).

243. See *supra* Part II.0, 0–0 (discussing the RLLI's approach to topics of misrepresentation, duty to defend, recoupment, and duty to make reasonable settlement decisions).

244. See RESTATEMENT OF THE LAW, LIAB. INS. § 34(3) (AM. LAW INST. 2019) (addressing conditions in liability insurance policies).

245. See *supra* Part I.B.0 (discussing the RLLI's proposed prejudice requirement for enforcing any policy condition under the policyholder's control).

246. See RESTATEMENT OF THE LAW, LIAB. INS. § 35(2) (AM. LAW INST. 2019)

As the comments supporting this rule recognize, “[c]ourts generally conclude that putting the reporting requirement in the insuring agreement of a claims-made-and-reported policy makes that condition sufficiently material to the contract that the ordinary notice-prejudice rule does not apply.”<sup>247</sup> Claims-made-and-reported policies also serve important additional purposes beyond the traditional claims-management purpose of a notice-of-claim condition, namely “simplifying insurers’ reserving practices” and “reducing the amount of uncertainty in insurance pricing.”<sup>248</sup> The comments further note that claims-made-and-reported policies typically provide an “extended reporting period” (e.g. 60 days) after the policy period expires for the policyholder to report claims that arose near the end of policy period.<sup>249</sup>

The RLLI, however, goes on to adopt a “black letter” rule stating that if a claims-made-and-reported policy does not include an extended reporting period, courts should take it upon themselves to write a “reasonable” extended reporting period into the policy.<sup>250</sup> A comment supporting this approach states that reported cases “rarely address” this situation, but concedes that these decisions strictly enforce a claims-reporting condition without fashioning some additional “reasonable” reporting period.<sup>251</sup> The RLLI attempts to marginalize this case law on the basis that the reported cases “often describe claims that are reported over a year after the policy period ended,” leaving “few published opinions . . . that involve claims that are reported less than three months after the end of the policy period.”<sup>252</sup> It speculates, without support, that “insurers wisely choose not to press” cases involving shorter delays, suggesting the case law supporting strict enforcement of claims-reporting conditions might be different if insurers did.<sup>253</sup>

In any event, the RLLI proceeds to state that “recent authority” supports the approach taken in section 35.<sup>254</sup> This recent authority, and the sole “source” of this RLLI rule, however, is actually a single cited case

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(discussing notice and reporting conditions).

247. *Id.* § 35 cmt. c.

248. *Id.*; *see also id.* § 35 cmt. d, e (discussing justifications for strict enforcement of claim-reporting condition).

249. *See id.* § 35 cmt. c, f (discussing claim-reporting conditions and proposed extended reporting period).

250. *Id.* § 35 cmt. g.

251. *Id.*

252. *Id.*

253. *Id.*

254. *Id.*

from a California mid-level appellate court in 2005.<sup>255</sup> In that case, the court also did not adopt a rule authorizing a “reasonable” extended reporting period as set forth in section 35. The court held that a policyholder’s reporting of a legal malpractice claim to his insurer a few days after the policy period expired warranted “equitable excuse of the reporting condition” where it was ambiguous as to “whether a ‘claim’ was even made” against the policyholder during the policy period.<sup>256</sup> The court additionally made clear it was not adopting a “bright-line” rule allowing equitable relief where a policy did not contain an extending reporting period, stating “[e]quities vary with the peculiar facts of each case” and that “most of the time—it will not be equitable to excuse the non-occurrence of a condition.”<sup>257</sup>

The RLLI’s reliance on this single case to support a “black letter” (i.e. bright-line) liability insurance rule appears, at best, misplaced. The rule “restated” in section 35 can be more accurately characterized as a novel approach that would allow a policyholder to avoid enforcement of a claim-reporting period in any claims-made-and-reported policy without an extended reporting period so long as the policyholder reported a “last minute claim” within a “reasonable time.”<sup>258</sup> The rule directs courts to assess what a “reasonable time” may be and effectively rewrite the policy language.<sup>259</sup> Regardless of the public policy arguments for or against such an approach, the fact remains that it is not an approach followed by courts. It represents another aspirational RLLI rule that runs counter to case law and would have the practical effect of increasing insurers’ potential liability if adopted by courts.

#### 10. Liability for Insurance Bad Faith

The RLLI addresses an insurer’s liability for bad faith in section 49, but the topic is one that must be read in combination with earlier sections,

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255. *Id.* § 35 cmt. g, Reporters’ Note g (citing *Root v. Am. Equity Specialty Ins. Co.*, 30 Cal. Rptr. 3d 631, 646–47 (Cal. Ct. App. 2005)).

256. *Root*, 30 Cal. Rptr. 3d at 635, 647.

257. *Id.* at 647; *see also* *World Health & Educ. Found. v. Carolina Cas. Ins. Co.*, 612 F. Supp. 2d 1089, 1098 (N.D. Cal. 2009) (declining to follow *Root*).

258. *See* Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi ALI President, and Roberta Cooper Ramo, ALI Council Chair (Jan. 8, 2018) (summarizing concerns with draft RLLI, including § 35); Letter from Laura Foggan, RLLI Insurer Liaison, to David F. Levi, ALI President, and Roberta Cooper Ramo, ALI Council Chair (Apr. 27, 2017) (on file with author) (stating concerns with draft RLLI).

259. *See* sources cited *supra* note 258 (expressing concerns regarding potential final approval of the RLLI based on provisions that include § 35).

most notably section 24 addressing an insurer's duty to make reasonable settlement decisions.<sup>260</sup> As discussed, section 24 attempts to merge existing bad faith jurisprudence with an insurer's duty to make reasonable settlement decisions, and impose broad extra-contractual damages pursuant to an ordinary negligence standard.<sup>261</sup> Indeed, the comments supporting section 49 expressly state that an "action for breach of the duty to make reasonable settlement decisions that is framed as a 'bad faith' action is not a liability insurance bad-faith action under the rules followed in this Restatement."<sup>262</sup> Under section 49, bad faith refers to situations in which an insurer fails to perform its policy obligations without a "reasonable basis for its conduct" and does so with the "knowledge of its obligation to perform or in reckless disregard of whether it had an obligation to perform."<sup>263</sup>

On the surface, section 49's "more demanding two-pronged standard," which incorporates both objective and subjective elements, might appear a robust standard that comports with the approach followed by many courts.<sup>264</sup> But, when viewed in context with section 24, which proposes to appropriate a wide swath of cases traditionally regarded as bad faith cases, insurer bad faith under the RLLI is sapped of meaning.<sup>265</sup> An insurer is subject to a broad array of extra-contractual damages under the RLLI that are comparable to bad faith damages even where the insurer's conduct falls well below the bad faith standard set forth in section 49. Damages for an insurer's unintentional breach of the duty to make reasonable settlement decisions include liability for the full amount of any judgment awarded against the policyholder without regard to the policy's limits, "any foreseeable harm"<sup>266</sup>—a broad category that, as discussed, includes punitive damages awarded against the policyholder in the underlying action,<sup>267</sup> attorney fees where relevant and permitted by statute or court

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260. See RESTATEMENT OF THE LAW, LIAB. INS. §§ 24, 49 (AM. LAW INST. 2019) (discussing duty to make reasonable settlement decisions and insurance bad faith).

261. See *supra* Part II.0 **Error! Reference source not found.** (discussing the RLLI's approach to insurer duty to make reasonable settlement decisions).

262. RESTATEMENT OF THE LAW, LIAB. INS. § 49 cmt. b (AM. LAW INST. 2019).

263. *Id.* § 49.

264. *Id.* § 49 cmt. b.

265. *Id.* § 24 cmt. a (discussing relationship between duty to make reasonable settlement decisions and bad faith); *supra* Part II.6; see also Schwartz & Appel, *supra* note 216, at 1497 (discussing need for bad faith standard to include minimum element of intentional or reckless misconduct and cautioning that "[i]f bad faith comes to mean everything, then it will soon mean nothing").

266. RESTATEMENT OF THE LAW, LIAB. INS. § 27(1) (AM. LAW INST. 2019).

267. See *supra* Part II.7 (analyzing damages for breach of the duty to make reasonable settlement decisions).

rule,<sup>268</sup> and “[a]ny other loss, including incidental or consequential loss” foreseeable by the insurer at the time of contracting.<sup>269</sup>

In comparison, an insurer that engages in intentional or reckless misconduct that harms its policyholder—i.e. the standard set forth in section 49—may obtain nearly the same scope of relief. Section 50 of the RLLI states that the remedies available for insurance bad faith include compensatory damages, including reasonable attorney fees, “any other loss” caused by the bad faith conduct, “[o]ther remedies as justice requires,” and punitive damages if the insurer’s conduct meets the applicable state-law standard.<sup>270</sup> Thus, the difference between the remedies available under the RLLI for an insurer’s *unintentional* breach of the duty to make reasonable settlement decisions and an insurer’s *willful* acts of bad faith boil down to the latter tacking on recovery of attorney fees (as opposed to merely carrying the possibility of recovery of attorney fees), allowing some additional types of compensatory damages such as non-economic damages, and recognizing the possibility of punitive damages where these damages are already supported by state law.<sup>271</sup>

The result is that there is not a major difference in the RLLI in what a policyholder may recover against his or her insurer for what may be a major difference in both degree and kind with respect to the insurer’s conduct. This is no accident. Sections 24 and 49 are designed to reclassify “several categories of insurance-law cases that many courts classify together as insurance bad-faith cases” so that the most permissive judicially recognized standard for policyholders to satisfy (i.e. negligence) may be applied to the broadest group of cases pursuant to section 24.<sup>272</sup> At the same time, the RLLI’s “demanding” bad faith standard in section 49 omits reference to longstanding insurance bad faith standards and concepts that require a showing of an insurer’s malice, ill-will, or evil motive to support a bad faith claim.<sup>273</sup>

To be clear, the RLLI adopts a bad faith standard in section 49 with case law support.<sup>274</sup> Nevertheless, novel aspects exist in the manner in

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268. See RESTATEMENT OF THE LAW, LIAB. INS. § 48 cmt. e (AM. LAW INST. 2019) (discussing awards of attorney fees).

269. *Id.* § 48(4).

270. *Id.* § 50.

271. See *id.* § 50 cmt. a, d (discussing recovery of compensatory and punitive damages for bad faith).

272. *Id.* § 24 cmt. a.

273. See Schwartz & Appel, *supra* note 216, at 1495–99 (discussing development of bad faith standards to address egregious insurer misconduct); *supra* note 125 (discussing punitive damages standards pertaining to bad faith).

274. See RESTATEMENT OF THE LAW, LIAB. INS. § 49 Reporters’ Note cmt. b (AM. LAW

which the RLLI treats the topic of insurance bad faith, its restated insurer duty to make reasonable settlement decisions, and the available remedies. The RLLI proposes to move the law of bad faith away from the intentional, egregious, and reprehensible behaviors that have historically provided the lynchpin of this body of law toward a comparatively “watered down” approach that promotes broader application and increased liability against insurers.

### III. OVERALL ANALYSIS AND IMPLICATIONS OF THE RESTATEMENT

The consistency in which the RLLI recommends liability insurance rules that would increase insurers’ liability and costs is striking. Each of the ten topics discussed in Part II, which implicate more than ten RLLI sections, “restate” rules that disadvantage insurers compared to prevailing state common law, most in a manner that includes some measure of novelty. Several of the RLLI’s proposed rules are also completely novel and do not reflect the law of any jurisdiction in the United States. Against that backdrop, it is fair to conclude that the RLLI is not a “pure” Restatement of existing common law as traditionally defined by the ALI and that the concerns expressed by insurers and others have merit.<sup>275</sup>

But, is it possible that the ten topics examined are somehow not indicative of the entire work product, and that the RLLI’s apparent thumb on the scale against insurers is counterbalanced by provisions that operate to reduce insurers’ liability and costs? Might there even be novel RLLI provisions that benefit insurers?

A review of the RLLI’s fifty sections suggests the answer to both of these questions is “no.” In fact, only two RLLI sections addressing an issue with a clear case law divide stand out as endorsing what might be described as an “insurer-friendly” rule. One is section 19 addressing the consequences of a breach of the duty to defend, an issue discussed in Part I.<sup>276</sup> Here, the RLLI Reporters proposed both an extreme complete forfeiture-of-coverage defenses rule and then a novel limited forfeiture-of-coverage defenses rule before adopting the final “prevailing legal rule” in

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INST. 2019) (discussing liability standard for insurance bad faith).

275. At the very least, the novel RLLI provisions discussed in Part II contravene the ALI’s requirement that Restatement rules be “constrained by the need to find support in sources of law.” ALI STYLE MANUAL, *supra* note 17, at 6; *see also supra* notes 17–22 and accompanying text (discussing the guidelines for developing Restatements).

276. *See supra* Part I.B.3 (analyzing the RLLI’s proposed approach to breach of insurer duty to defend).

which an insurer that breaches the duty to defend loses its right to assert any control over the defense or settlement of the claim.<sup>277</sup>

The other is section 41 addressing “Allocation in Long-Tail Harm Claims Covered by Occurrence-Based Policies.”<sup>278</sup> Long-tail harm refers to “indivisible harm, whether bodily injury or property damage, that is attributable to continuous or repeated exposure over time to the same or similar substances or conditions or that has a long latency period.”<sup>279</sup> Examples include latent injury claims from repeated exposure to asbestos or other toxic substances.<sup>280</sup>

The RLLI recognizes that liability claims for long-tail harm can present “difficult issues” where the alleged indivisible harm implicates multiple insurance policies in effect for different periods over a relatively long period of time, for instance several decades.<sup>281</sup> An issue that emerges is how courts should allocate responsibility for the indivisible harm among insurers under policies that cover only harm that occurs during the policy period (i.e. occurrence-based policies). Courts have developed two general approaches to this issue: the “all sums” approach and the “pro rata” approach.<sup>282</sup>

Under the “all sums” approach, the policyholder may recover the full amount of a policy’s coverage limits from any of the triggered policies.<sup>283</sup> As the RLLI recognizes, the approach is “analogous to joint and several liability in tort” in that it permits a policyholder to selectively recover from an insurer until the limits of the policy are exhausted and then seek recovery under another triggered policy, and so on, until the claim is either paid or the limits of all of the triggered policies are exhausted.<sup>284</sup> Under the “pro rata” approach, courts allocate the amounts paid to claimants *equally* across all triggered years, beginning with the first year in which harm occurred and ending with the last year in which harm triggered an occurrence-based policy (and including any years in which coverage was not procured).<sup>285</sup> Accordingly, the policyholder may recover that proportional amount of the covered losses allocated to the triggered

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277. RESTATEMENT OF THE LAW, LIAB. INS. § 19 cmt. a (AM. LAW INST. 2019).

278. *Id.* § 41.

279. *Id.* § 41 cmt. a.

280. *See id.* § 41 ill. 1–4 (discussing examples of long-tail harms).

281. *Id.* § 41 cmt. a.

282. *See id.* § 41 cmt. c (discussing theories of allocation for long-tail harms).

283. *See id.* (discussing the “all sums” approach to allocation for long-tail harms).

284. *Id.*

285. *See id.* (discussing the “pro rata” approach to allocation for long-tail harms). The approach adopted in the RLLI is also referred to as the “pro rata by years” or “time on the risk” approach. *Id.*

policy's period, up to the policy's coverage limit.<sup>286</sup>

The RLLI adopts the “pro rata” approach as the default rule.<sup>287</sup> It concludes that the approach provides “the most consistent, simplest, and fairest solution” to the allocation problem for long-tail harm claims.<sup>288</sup> The reason this approach may be characterized as “insurer-friendly” is that an insurer is ultimately subject to the lesser of a pro rata share of its triggered policy's coverage limit or that coverage limit, as opposed to full exhaustion of the triggered policy under the all sums approach. Nevertheless, as the RLLI acknowledges, “a clear majority of the jurisdictions that have addressed the question have adopted the pro rata approach.”<sup>289</sup>

Other than recommending these two majority rules, the RLLI does not appear to endorse any other rule—majority or minority—involving a split of case law authority in a manner that favors insurers. Indeed, comments discussing the RLLI's pro rata default rule suggest that certain policy language could be interpreted as all sums, which may undercut the extent to which that rule may be characterized as favorable to insurers.<sup>290</sup> In any event, the juxtaposition of these two “insurer-friendly” majority rules, one of which affects only a narrow set of policies and circumstances (i.e. long-tail harm claims covered by occurrence-based policies), with other RLLI rules discussed in Part II that generally impact all liability insurance policies, and are poised to significantly enhance insurer liability and costs, reveals an unmistakable imbalance. Insurers who comprise half of the liability insurance equation are disadvantaged by the cumulative impact of the RLLI's proposed rules so that the policyholders who comprise the other half may obtain new and greater advantages.

If a court adopted the RLLI lock, stock and barrel, an insurer in any jurisdiction in the United States would be subject to increased liability exposure or defense costs, and most likely both. This is because the RLLI is littered with novel rule formulations, both large and small, that propose to increase insurers' liability and costs at every stage of the insurance procurement and claims handling process. As discussed, an insurer would be more limited under the RLLI in its ability to challenge and void a policy based on a material misrepresentation (sections 7–9), deny a defense at the

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286. *See id.* (describing how payments are calculated under the “pro rata” approach).

287. *Id.*

288. *Id.*

289. *Id.*

290. *See id.* § 41 cmt. d (discussing language in versions of standard commercial general-liability (CGL) insurance policies that “does not provide any justification for limiting an insurer's responsibility to harm that occurs during the policy period,” and, at most, “creates an ambiguity regarding the question of allocation . . . [that] should be construed against the drafter”).

outset of a claim (section 13), or terminate an existing defense (section 18). An insurer would also be unable to recoup any costs it was not obligated to provide under a policy (section 21). In addition, an insurer would be subject to an expanded scope of bad faith liability for any unintentional breach of the duty to make reasonable settlement decisions (section 24), for instance by rejecting any settlement offer deemed “reasonable” with the benefit of hindsight or possibly by failing to make a reasonable settlement offer or counteroffer. This breach would then subject the insurer to liability for extra-contractual damages comparable to bad faith damages (section 27), including the full amount of any excess judgment and any other foreseeable harm. All the while, the specter of new direct liability would loom over the insurer (section 12) for any failure to exercise reasonable care in the selection of defense counsel to represent the policyholder or for any insurer conduct that could be said to override the professional judgment of that selected counsel.

These RLLI rules, and others discussed, combine to propose a liability insurance regime that is truly novel. In doing so, the RLLI implicates the same concerns expressed by Justice Scalia that “modern Restatements . . . must be used with caution” by courts where these work products “have abandoned the mission of describing the law, and have chosen instead to set forth their aspirations for what the law ought to be.”<sup>291</sup> Although the RLLI contains numerous provisions that are not aspirational, the fact it contains a significant number of provisions that are clearly aspirational should present major red flags to any court relying on this work product. The RLLI departs from the ALI’s own instructions that Restatements “restate” clear formulations of common law “as it presently stands,” be “constrained by the need to find support in sources of law,” and avoid proposing “major innovations in matters of public policy.”<sup>292</sup>

Public policy arguments can be made for or against any of the novel rules put forth in the RLLI, but that is not what a Restatement is designed to accomplish nor what courts have come to expect from Restatements over the past century. Restatements are supposed to provide an educational resource for courts on the prevailing or best-reasoned state common law rules, not an academic exercise in which to recommend new liability regimes.<sup>293</sup> In this regard, the RLLI falls short and appears instead to invite major innovations in matters of public policy that increase insurers’ liability and costs.

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291. *Kansas v. Nebraska*, 135 S. Ct. 1042, 1064 (2015) (Scalia, J., concurring and dissenting in part) (citations omitted).

292. ALI STYLE MANUAL, *supra* note 17, at 3, 6.

293. *See supra* Part I.0 (providing an overview of the Restatement development process).

The ALI's stamp of approval on the RLLI puts the organization at a crossroads with respect to modern Restatements.<sup>294</sup> Throughout the RLLI's development, an incredible number of submissions, often painstakingly researched, were made to the RLLI Reporters, ALI Council and leadership, and general membership identifying novel project provisions and ringing alarm bells.<sup>295</sup> The ALI Council and leadership made important course corrections along the way, including the postponement of multiple project votes and the insistence on several major rule changes on the eve of the RLLI's final approval by the ALI membership, but these laudable efforts did not fully address the RLLI's novel features. Rather, piecemeal changes to especially jarring one-sided provisions provided Band-Aids for a project developed with a purpose to innovate in matters of public policy and move the law in a particular direction. It remains to be seen whether in the future the ALI embraces having aspirational Restatements or shuns them to avoid backlash, such as by judges adopting Justice Scalia's view that the work products deserve little weight<sup>296</sup> or by repudiations from state legislatures.<sup>297</sup> The RLLI can either serve as a clear "wake up" call against including novel legal rules in Restatements or as a call to arms for leveraging the Restatement "brand" in future projects to propose novel legal rules intended to revise rather than restate law.

#### IV. CONCLUSION

The ALI's foray into restating the law of liability insurance has been subject to wide-ranging criticisms, particularly among stakeholders in the insurer community, to the point where multiple state legislatures have taken the unprecedented step of enacting laws to repudiate the entire Restatement. This article has provided a comprehensive analysis of the RLLI to assist judges and others debating whether to rely upon the project as an authoritative source of liability insurance rules. As discussed throughout this article, criticisms of the RLLI expressed by insurers, ALI members, and others appear well founded. The project's history is replete with proposed departures in the common law, and the final RLLI

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294. See Schwartz & Appel, *supra* note 14 (discussing the reputation of the ALI).

295. See *supra* note 51 (noting multi-volume appendix with more than 1,200 pages of materials submitted throughout the RLLI's development).

296. See *Kansas v. Nebraska*, 135 S. Ct. 1042, 1064 (2015) (Scalia, J., concurring and dissenting in part) (stating view that courts should be wary of modern Restatements that fail to accurately describe the law).

297. See *supra* notes 5–7 and accompanying text (discussing actions taken by state legislatures to prevent courts from adopting RLLI provisions).

incorporates novel provisions that would, if adopted by courts, systematically change the liability insurance landscape in ways that would increase insurers' liability and costs. Accordingly, judges contemplating proposed RLLI rules should exercise caution and not presume a recommended rule is firmly grounded in existing common law. Judges should proceed with the understanding that the RLLI represents an effort to reshape rather than restate the law.