Anatomy of a Bad Faith Claim

American College of Coverage Counsel
2019 Law School Symposium
Nova Southeastern University, Shepard Broad College of Law

Fort Lauderdale, FL
November 1, 2019

Robert Allen
The Allen Law Group
Dallas, Texas
bob.allen@theallenlaw.com

John C. Bonnie
Weinberg, Wheeler, Hudgins, Gunn & Dial, LLC
Atlanta, Georgia
jbonnie@wwhgd.com

Meghan Magruder
King & Spalding, LLP
Atlanta, Georgia
mmagruder@kslaw.com

Choice of law considerations can have a critical impact on the success or failure of either the prosecution or the defense of a bad faith claim. Where more than one proper venue potentially exists for litigation of bad faith claims; jurisdiction may reside in the state court, the federal court or both; and the choice of law rule varies depending upon the nature of the claim or the source of the alleged bad faith standard, a clear understanding of the potentially applicable conflict of law rules and considerations is imperative.

The choice of law considerations in insurance bad faith cases are many, but several significant issues that can dramatically impact the outcome of the bad faith case are addressed here.

A. Is There A Statute In the Forum Jurisdiction Mandating Application of the Forum State's Law to the Insurance Policy?

At least thirteen states (and one territory) have enacted statutes mandating the proper choice of law outcome in the case of insurance contracts, with the effect of legislatively varying the rule otherwise applicable to non-insurance contracts. Five of these address choice of law in the case of contracts generally and utilize the same model wording.[1] Nine of them address choice of law in the context of certain insurance policies, and include Alabama (Ala. Code § 27-14-22), Arizona (Ariz. Rev. Stat. Ann. § 20-1115), Minnesota (Minn. Stat. Ann. § 60A.08), North Carolina (N.C. Gen. Stat. Ann. § 58-3-1), Oregon (Or. Rev. Stat. Ann. § 465.480)(environmental contamination only), South Carolina (S.C. Code Ann. § 38-61-10), Tennessee (Tenn. Code Ann. § 56-7-102), Texas (Tex. Ins. Code Ann. Art 21.42), Virginia (Va. Code Ann. § 38.2-313).

As addressed below, these statutes do not necessarily prevent or obviate the need for reference to the otherwise prevailing choice of law rules, and do not mean that in these states a choice of law analysis can be dispensed with in favor of the law of the place of the statute. In fact, the statutes are not absolute, are subject to exceptions, and have been judicially limited in some circumstances. It is important to know of their existence, however, because they are the starting point for consideration of the law which may control a policy of insurance deemed to be or arguably issued in any of these jurisdictions.

1. Alabama

Ala. Code § 27-14-22 provides that: "All contracts of insurance, the application for which is taken within this state, shall be deemed to have been made within this state and subject to the laws thereof." By its terms, the focus of the statute is the location of the application, rather than the location of the subject matter of the insurance or the location of the delivery of the policy. As a general matter, however, it might be assumed that if an application for insurance coverage is made in Alabama, the property or insured interest is located there and the policy will then necessarily be delivered there.

---

[1] California (Cal. Civ. Code § 1646), Guam (Guam Code Ann. Tit. 18, § 87112); Montana (Mont. Code Ann. § 28-3-102), Oklahoma (Okla. Stat. Ann. Tit. 15, § 162), and South Dakota (S.D. Codified Laws § 53-1-4).

Alabama has repeatedly followed the rule of *lex loci contractus*, and in a recent case involving a dispute over the application of Tennessee or Alabama law to an uninsured motorist claim, the court applied Tennessee law to a policy issued there, without reference to where the application for the coverage was taken. *Cherokee Ins. Co., Inc. v. Sanches,* 975 So.2d 287 (Ala. 2007). In an older case, the Alabama Supreme Court noted that the application for the involved policy was taken in Alabama, but proceeded to note also that the policies were issued in Alabama, ultimately applying Alabama law to the question of insured motorist coverage under the policy. *American Economy Ins. Co. v. Thompson*, 643 So.2d 1350 (Ala. 1994). It is not entirely clear then how the statute would be deemed to apply if application of the statute resulted in an outcome different from application of the rule of *lex loci contractus*. Notably, an Ohio Court, applying the most significant relationship test of the *Restatement (Second)*, recently applied Alabama law to an insurance policy in part due to the Alabama statute, where the application for insurance occurred in Alabama. *Liberty Mut. Ins. Co. v. Petit,* No. 2:09-cv-111, 2010 WL 2302372 (S.D. Ohio Jun. 7, 2010).

2. Arizona

Ariz. Rev. Stat. Ann. § 20-1115 provides that:

> No policy delivered or issued for delivery in this state and covering a subject of insurance resident, located or to be performed in this state, shall contain any condition, stipulation or agreement:
>
> 1. Requiring the policy to be construed according to the laws of any other state or country, except as necessary to meet the requirements of the motor vehicle financial responsibility laws or compulsory disability benefit laws of such other state or country.
>
> 2. Preventing the bringing of an action against the insurer for more than six months after the cause of action accrues.
>
> 3. Limiting the time within which an action may be brought to a period of less than two years from the time the cause of action accrues in connection with all insurances other than property and marine and transportation insurances. In property and marine and transportation policies such time shall be one year from the date of occurrence of the event resulting in the loss except that an insurer may extend such limitation beyond one year in its policy provisions.
>
> Any such condition, stipulation or agreement shall be void, but such voidance shall not affect the validity of the other provisions of the policy.

With rare exception, the case law addressing this statute has only considered the provisions of the statute regarding the limitations period for bringing an action under an insurance policy. There is no case addressing the manner in which the statute interfaces with Arizona's application

of the *Restatement (Second)* approach to the resolution of conflict of law issues. In *Mission Ins. Co. v. Nethers*, 581 P.2d 250 (Az. App. 1978), however, the court found the statute inapplicable to a policy issued in California.

3. Minnesota

Minn. Stat. Ann. § 60A.08 Subd. 4 provides that "All contracts of insurance on property, lives, or interests in this state shall be deemed to be made in this state."

The application of this statute has been limited, and the place of contracting has instead been given greater weight, resulting in the non-application of the statute to policies issued elsewhere. *U.S. Fid. & Guaranty Co. v. Louis A. Roser Co., Inc.*, 585 F.2d 932 (8th Cir. 1978); *Travelers Ins. Co. v. American Fidelity & Cas. Co.,* 164 F.Supp. 393 (D. Minn. 1958). In both *Louis A. Roser* & *Travelers v. American Fidelity*, the courts applied the law of other states because the policies were negotiated, entered into and performed elsewhere, although Minnesota interests were likely involved. This result was at least in part based upon the decision of the United States Supreme Court in *Hartford Accident & Indemn. Co. v. Delta & Pine Land Co.*, 292 U.S. 143, 54 S.Ct. 634, 78 L.Ed. 1178 (1934), in which the Court voided on constitutional grounds application of a similar Mississippi statute. See *Louis A. Roser Co., supra*, at 941, n.2; *Travelers v. American Fidelity, supra*, at 398-399. The statute was not cited or addressed in a recent case applying Minnesota law to a class action coverage case in which Minnesota law was found to apply to claims by those both within and outside the state. *Mooney v. Allianz Ins. Co.*, 244 F.R.D. 531 (D. Minn. 2007). This statute was cited, however, and Minnesota law applied in *Onstad v. State Mut. Life Assur. Co.*, 32 N.W.2d 185 (Minn. App. 1948).

4. North Carolina

N.C. Gen. Stat. Ann. § 58-3-1 provides that: "All contracts of insurance on property, lives, or interests in this State shall be deemed to be made therein, and all contracts of insurance the applications for which are taken within the State shall be deemed to have been made within this State and are subject to the laws thereof."

The North Carolina statute has been similarly limited, again on the authority of *Hartford Accident & Ind. Co. v. Delta & Pine Land Co.,* 292 US. 143, 54 S.Ct. 634, 78 L.Ed. 1178 (1934). *See Turner v. Liberty Mut. Ins. Co.*, 105 F. Supp. 723 (E.D.N.C. 1952)(applying New Jersey law, despite location of insured tractor in North Carolina). But *Delta & Pine Land* has also been distinguished by other North Carolina courts and the statute more often than not applied to policies issued in other states where the interests of a North Carolina insured and property located in North Carolina are at issue. *Collins & Aikman Corp. v. Hartford Acc. & Indemn. Co.,* 436 S.E.2d 243, 245 (N.C. 1993)(finding that North Carolina had much more "than a casual connection with the substance of the insurance policy", justifying application of North Carolina law); *Martin v. Continental Ins. Co.,* 474 S.E.2d 146 (N.C. App. 1996)(same). *See also, Continental Cas. Co. v. Physicans Weight Loss Centers of America, Inc.*, 61 Fed.Appx. 841 (4th Cir. 2003)(but noting the *Delta & Pine Land* issue was not raised in the lower court). In a recent case, the North Carolina federal court noted that the statute is applicable giving due consideration to constitutional concerns "where there is

a 'close connection' between North Carolina and the interests insured by the policy." *Hartford Fire Ins. Co. v. St. Paul Fire & Marine Ins. Co.,* 606 F. Supp.2d 602 (E.D.N.C. 2009), *citing Continental Cas. Co. v. Physicians Weight Loss Centers of America, Inc., supra.*

5. Oregon

Or. Rev. Stat. Ann. § 465.480(2) provides in relevant part that:

> (2) Except as provided in subsection (8) of this section, in any action between an insured and an insurer to determine the existence of coverage for the costs of investigating and remediating environmental contamination, whether in response to governmental demand or pursuant to a written voluntary agreement, consent decree or consent order, including the existence of coverage for the costs of defending a suit against the insured for such costs, the following rules of construction shall apply in the interpretation of general liability insurance policies involving environmental claims:
>
> (a) Oregon law shall be applied in all cases where the contaminated property to which the action relates is located within the State of Oregon. Nothing in this section shall be interpreted to modify common law rules governing choice of law determinations for sites located outside the State of Oregon
>
> ***
>
> (8) The rules of construction set forth in this section and sections 2 and 7 of this 2013 Act do not apply if the application of the rule results in an interpretation contrary to the intent of the parties to the general liability insurance policy.

Or. Rev. Stat. Ann. § 465.480(2).

It appears from the scant case law available that the conflict of law provisions of this statute will be applied as written, *Continental Ins. Co. v. Fost Maritime Co.*, No. 302CV03936 (N.D. Cal. 2002), but there is little case law on the provisions.

6. South Carolina

S.C. Code Ann. § 38-61-10 provides that: "All contracts of insurance on property, lives, or interests in this State are considered to be made in the State and all contracts of insurance the applications for which are taken within the State are considered to have been made within this State and are subject to the laws of this State."

This statute has been determined to modify the rule of *lex loci contractus* otherwise applicable to other contracts, under circumstances where a contract of insurance is involved. *Sangamo Weston, Inc. v. National Sur. Corp.,* 414 S.E.2d 127 (S.C. 1992). South Carolina courts have also consistently maintained that application of the statute does not violate constitutional protections

because of the state's significant interest in determining who bears responsibility for injury to South Carolina property and citizens. *Id.* The statute is applicable regardless of whether the insurance contract was entered into in another state, *Johnston v. Comm'l Travelers Mut. Acc. Assoc. of America*, 131 S.E.2d 91 (S.C. 1963), and the policyholder need not be a citizen of South Carolina for the statute to apply. *Sangamo Weston, supra.* The inquiry is whether the subject of the insurance contract is located in South Carolina. *Heslin-Kim v. CIGNA Group Ins.*, 377 F. Supp.2d 527 (D.S.C. 2005). Other cases applying the law of other states have been distinguished on the basis that they involve merely transient contacts with South Carolina. *Id.* at 532.

7. Tennessee

Tenn. Code Ann. § 56-7-102 (West) provides that:

> Every policy of insurance, issued to or for the benefit of any citizen or resident of this state on or after July 1, 1907, by any insurance company or association doing business in this state, except fraternal beneficiary associations and mutual insurance companies or associations operating on the assessment plan, or policies of industrial insurance, shall contain the entire contract of insurance between the parties to the contract, and every contract so issued shall be held as made in this state and construed solely according to the laws of this state.

In an early case, the Tennessee Court of Appeals found the statute inapplicable to a policy of insurance applied for and covering an insured located in Michigan, although he ultimately moved to North Carolina. *Page v. Detroit Life Ins. Co.,* 11 Tenn. App. 417 (Tenn. App. 1929). The statute was held applicable to a policy issued and delivered to Tennessee residents in another case, however, with the court rejecting the insurer's contention that the policy was a Connecticut contract because it was issued by a company located in that state. *Gray v. Aetna Life Ins. Co.,* 156 S.W.2d 391 (Tenn. 1941). In *Burns v. Aetna Cas. & Sur. Co.*, the Tennessee Supreme Court found the statute inapplicable to the uninsured motorist claim of an employee of a company (and the employee's spouse) issued a vehicle fleet insurance policy by an insurer in Connecticut to the corporate insured in Rhode Island via a Massachusetts broker. This despite the fact that the employee and his spouse were Tennessee residents and that the vehicle involved in the accident was principally garaged in Tennessee. Notably, the Tennessee federal court refused to apply the statute at the request of an insurer, stating that since the statute's enactment it had never been applied in a manner which was contrary to the state's adoption of the *lex loci contractus* rule. *NGK Metals Corp. v. National Union Fire Ins. Co.*, No. 1:04-cv-56, 2005 WL 1115925 (E.D. Tenn. Apr 29, 2005). The court noted in any event that the statute was enacted to protect Tennessee insureds, not to harm them, and that the carrier sought to invoke the statute so as to avoid the application of another state's law which was more favorable to the insured.

8. Texas

Tex. Ins. Code Ann. Art. 21.42 (West) provides that:

> Any contract of insurance payable to any citizen or inhabitant of this State by any insurance company or corporation doing business within this State shall be held to be a contract made and entered into under and by virtue of the laws of this State relating to insurance, and governed thereby, notwithstanding such policy or contract of insurance may provide that the contract was executed and the premiums and policy (in case it becomes a demand) should be payable without this State, or at the home office of the company or corporation issuing the same.

In an early case, the Supreme Court of Texas found this statute inapplicable to the claim of a Texas resident claiming insured status under a policy covering property located in Kansas and destroyed by a fire in Kansas. The court determined that the rule of *lex loci contractus* controlled, and that the statute should not be given extraterritorial effect. *Austin Bldg. Co. v. National Union Fire Ins Co.*, 432 S.W.2d 697 (Tex. 1968). Citing *Austin Bldg. Co.,* the Fifth Circuit concluded that the statute was "designed only to assure that Texas law will apply to contracts made between Texas citizens and insurance companies doing business in Texas, *when and only when* those contracts are made in the course of the company's Texas business." *Howell v. American Live Stock Ins. Co.,* 483 F.2d 1354 (5th Cir. 1973). Consequently, New Mexico law was deemed to apply to an insurance policy issued to a Texas resident operating a farm in New Mexico which covered the death of a thoroughbred horse which was stabled in New Mexico. *Hefner v. Republic Indemn. Co. of America*, 773 F. Supp. 11 (S.D. Tex. 1991). The statute was found inapplicable although the insurance claim was by a Texas resident injured on property in Texas. The policy had been issued by a California insurer to the limited partner of a Texas limited partnership who was a California resident. The court held that the contract did not arise in the course of in-state business; that California had the more significant relationship (applying the *Restatement (Second)*); and that it had a greater interest in having its law applied. The Texas Court of Appeals reached a similar result in a recent case in which a Texas physician seeking coverage under a policy issued to an entity in California sought to invoke the statute. *Scottsdale Ins. Co. v. National Emergency Services, Inc.*, 175 S.W.3d 284 (Tex. App. 2004). The court noted that for the statute to apply, the contract of insurance must satisfy three requirements:

> (1) The insurance proceeds must be payable to a citizen or inhabitant of Texas;
>
> (2) The policy issued pursuant to the contract must be issued by a company doing business in Texas; and
>
> (3) The policy must be issued in the course of the insurance company's Texas business.

Id. at 292, *citing Hefner, supra*. The court found that "[i]t is not enough for the application of [the statute] that . . . certain of [the named insured's] physicians are Texas residents so that insurance proceeds would be payable in some instances to a citizen or inhabitant of Texas. *Id.* In a recent case finding Texas law controlling in part based upon the statute, the Fifth Circuit also analyzed the choice of law issue in the context of the *Restatement (Second)*, suggesting that the statute is not the only relevant conflict of law consideration. *Mid-Continent Cas. Co. v. Eland Energy, Inc.*, 709 F.3d 515 (5th Cir. 2013).

9. Virginia

VA Code Ann. § 38.2-313 provides that: "All insurance contracts on or with respect to the ownership, maintenance or use of property in this Commonwealth shall be deemed to have been made in and shall be construed in accordance with the laws of this Commonwealth."

Until a 2019 decision of the Virginia Supreme Court, the decisions addressing the statute were entirely from the Virginia federal courts. In a 1989 decision, the Virginia federal court noted that there were no Virginia decisions interpreting the statute, but that "it appears that the Virginia General Assembly intended to alter the general rule regarding interpretation of insurance contracts." *City Insurance v. Lynchburg Foundry Co.*, No. 88-0178, 1989 WL 1102787, *2 (W.D. Va. Apr. 25, 1989). Noting the general application of the *lex loci contractus* rule, the court said the question of application of the statute was academic, since there was no evidence that the law of the place where the policy was issued (Georgia) conflicted with Virginia law. *Id.* at *1. In a more recent case, the Virginia federal court cited the statute without discussion as the basis for applying Virginia law to a dispute involving the value of items comprising a burglary claim against a property insurer. *Sewarz v. First Liberty Ins. Corp.*, No. 3:10CV120, 2012 WL 12438 (E.D. Va. Jan. 3, 2012). In an earlier case, the Virginia federal court cited both the rule of *lex loci contractus* and the statute as the basis for applying Virginia law, without addressing the way in which they would be harmonized if application of the rule and the statute led to different results. *Factory Mut. Ins. Co. v. Liberty Mut. Ins. Co.*, 518 F. Supp.2d 803 (W.D. Va. 2007). *See also City of Lynchburg v. Ins. Co. of Ireland,* No. 87-0181, 1990 WL 1232911 (W.D. Va. Aug 24, 1990). Finally, a Virginia federal court considered the argument that a policy was a Maryland policy because it said it was despite being issued to a Maryland resident, but summarily rejected it and noted the language of the statue.

Earlier this year, the Virginia Supreme Court touched on the statute in *Erie Ins. Exch. v. EPC MD 15, LLC*, 297 Va. 21, 24, 822 S.E.2d 351, 353 (2019). There, EPC was a named insured on a commercial property policy issued by Erie, which sued Erie in connection with fire damage to a building owned by an EPC subsidiary. The subsidiary was not an insured on the policy, but the trial court concluded that EPC's ability to control the subsidiary meant that EPC acquired all of the subsidiary's property for insurance coverage purposes. Since this was tantamount to finding coverage for the loss, judgment was entered for EPC. Erie appealed, and the determination was reversed. In the course of doing so, the court noted § 38.2-313

Specifically, in footnote 5, the Court noted that Erie issued and delivered the policy to a Maryland company to at least initially cover property in Maryland, and that under Virginia choice-of-law principles, the court would ordinarily look to the law of the place where the insurance contract was made/written/delivered. *Id*. at 28 n. 5; 822 S.E.2d at 355. The Court went on to cite § 38.2-313, but noted out that "[n]either party on appeal mentions this statute or questions whether it applies solely to third-party liability insurance on property located in this Commonwealth or also to first-party property insurance on such property." *Id*. Accordingly, the court declined to address the potential applicability of the statute. Additionally, because the parties failed to address Maryland law, the court declined to predict the impact, if any, of Maryland law and

instead stated that "[i]n the absence of a showing to the contrary, we presume that foreign law—whether applicable because of a choice-of-law clause or because of nonconsensual choice-of-law principles—is the same as the law of the forum. Virginia law, therefore, will guide our decision in this case." *Id*.

It therefore remains unclear what the outcome would be if a party advocated the rule of *lex loci contractus* to invoke the law of another state where the insurance policy involved the ownership, maintenance or use of property in Virginia, and thereby implicating VA Code Ann. § 38.2-313.

B. Is Bad Faith a Cause of Action Sounding in Contract or in Tort?

The choice of law rule for tort actions in a particular state is often vastly different than the rule for contract actions. Where the accident occurred is generally paramount in tort cases, while contractual negotiations are significant in contract cases. Even with respect to the majority of states employing some version of the *Restatement (Second) of Conflicts of Laws* most significant relationship test, the factors determinative of the most significant relationship differ in tort cases as compared to contract cases. *Compare* §145 with §188.

Most insurance coverage disputes present threshold issues of contract – the meaning and interpretation of the applicable policy of insurance. But where an insured asserts claims both for breach of the insurance contract and for bad faith, it is not a foregone conclusion that the same law will apply to the two claims from a choice of law standpoint.

In some states, claims of bad faith are considered so intertwined with the duties of the insurer under the insurance contract that the same law which controls the interpretation and application of the policy also controls the question of bad faith. *See, e.g. Colonial Life & Acc. Ins. Co. v. Hartford Fire Ins. Co*., 358 F.3d 1306 (11th Cir. (Ala.) 2004)(applying Alabama's choice of law rules and holding that the bad faith claim sounded in contract and therefore, the doctrine of *lex loci contractus* was applicable); *AT&T Wireless Services, Inc. v. Federal Ins. Co*., No. 03C-12-232, 2007 WL 1849056, (Del. Super. June 25, 2007)(holding that the most significant relationship test of § 188 (contracts) and not §145 (torts) applied to the bad faith claim, finding that the "breach of contract claim and the bad faith claim are too intertwined and interdependent to be separated"); *Fogarty v. Allstate Ins. Co.,* No. CCB–04–414, 2011 WL 1230350, *7 (D. Md. March 30, 2011)("judges of this court have repeatedly held that under Maryland's choice of law rules, the law that governs a bad faith claim is the same law that governs the insurance contract from which the claim of bad faith arises"); *Lafarge Corp. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, Pa., 935 F.Supp. 675, 692 (D.Md. 1996) (holding that the law governing contract interpretation also governed the bad faith claim, since the claims are "inextricably intertwined" and the court would not subject the insurer to "potentially conflicting standards of conduct"); *Commerce and Indus. Ins. Co. v. U.S. Bank Nat. Ass'n,* No. 07 Civ. 5731, 2008 WL 4178474, *4-6 (S.D.N.Y. Sept. 3, 2008)(finding that because "the bad faith claim is 'inextricably intertwined' with the contract claim. . . the same law should govern both the contractual claim as well as the bad faith claims").

Other jurisdictions, however, consider bad faith to arise in tort rather than contract. In these jurisdictions, the law applicable to the bad faith claim upon application of the forum state's

choice of law rule can be different than the law applicable to the contract claim. The rationale of these jurisdictions is often that alleged bad faith handling of a claim is extra-contractual, subject to the law of the place where the bad faith conduct occurred (e.g., where the duty to defend was improperly denied, where the case was improperly settled, etc.), and should therefore not necessarily be determined under the same law applicable contractual claims. *See World Plan Executive Council-U.S. v. Zurich Ins. Co.,* 810 F.Supp. 1042 (S.D. Iowa 1992)(holding that pursuant to policy's choice of law provision, Swiss law controlled claims for breach of the insurance policy, but that policy's choice of law provision was inapplicable to tort claims, which pursuant to §145 of the *Restatement* were controlled by Iowa law); *Schuller v. Great-West Life & Annuity Ins. Co*., No. C-04-62, 2005 WL 2259993 (N.D. Iowa Sept. 15, 2005)(holding that policy's choice of law provision rendered Illinois law applicable to the breach of contract claims, but that bad faith claims were in tort, which pursuant to §145 of the *Restatement* were controlled by Iowa law); W*est American Ins. Co. v. RLI Ins. Co.*, No. 07-0566, 2008 WL 1820839 (W.D. Mo. April 21, 2008)(in dispute between primary and excess carriers regarding alleged bad faith failure to settle, since the bad faith claim sounded in tort, Missouri law required application of §145 of the *Restatement*, as a result of which the bad faith claim was subject to the law of Kansas where the insured was domiciled, and not the law of Missouri where the underlying case was filed and the excess judgment entered); *General American Life Ins. Co. v. Ofner*, 972 F.2d 1339 (Table) (9th Cir. 1992)(affirming district court's determination that the law of Montana and §145 of the *Restatement* controlled the insured's tort claims for bad faith since the insured relocated to Montana after issuance of the policy and resided there at the time of the coverage denial, and that the law of Texas – where the policy was originally issued – did not apply); *Butterfly-Biles v. State Farm Life Ins. Co.,* No. 09–CV–0086*,* 2010 WL 346839 (N.D. Okla. Jan. 21, 2010)(holding that breach of contract claims were controlled by Colorado law, but that bad faith claims were governed by Oklahoma law applying §145 of the *Restatement*); *Martin v. Gray,* 385 P.3d 64 (Okla. 2016)(reversing trial court's determination that Kansas law applied to both the insured's breach of contract claim and claim for bad faith because claim for bad faith sounded in tort, and holding pursuant to Oklahoma's most significant relationship test that Oklahoma law applied to the bad faith cause of action); *Rupp v. Transcontinental Ins. Co*., 627 F.Supp.2d 1304 (D. Utah 2008)(holding that all claims against the carriers sounded in tort not conflict, and that pursuant to §145 of the *Restatement*, Utah law controlled those tort claims, not the law of California where the policies may have been delivered).

The analysis is not necessarily so simple as placing a jurisdiction into one of just two categories, however. While there are outcomes in which the finding of bad faith as a contract claim resulted in application of the same law as the claim for breach of contract (further case examples identified in Item **1.**below) and where the finding of bad faith as a tort claim resulted in application of different laws to the breach of contract and tort claims (further case examples identified in Item **2.**below), other scenarios also arise. These include outcomes in which bad faith is held to be a tort claim but is nonetheless governed by the law applicable to the breach of contract claim (case examples identified in Item **3.**below); in which bad faith is held to be a tort claim and governed by the law applicable to tort claims, but reaching a choice of law outcome the same for both claims (case examples identified in Item **4.**below); and in which bad faith claims

are determined to be "hybrid" in nature, implicating both principles of contract and tort law (case example identified in Item **5.**below).

1. Bad Faith is a contract claim and governed by the same law as the breach of contract claim.

Royal Indem. Co. V. Salomon Smith Barney, Inc., 308 A.D.2d 349, 764 N.Y.S.3d 187 (1st Dept. 2003)(holding that bad faith denial of coverage is redundant of cause of action for breach of contract based on denial of coverage).

Continental Information Systems Corp. v. Fed. Ins. Co., 2003 WL 145561 (S.D.N.Y. Jan 17, 2003)(holding that New York does not recognize a claim for bad faith denial of coverage regardless of whether characterized as sounding in tort or contract).

Payless Shoesource, Inc. v. The Travelers Companies, Inc., 569 F.Supp.2d 1189 (D. Kan. 2008)(holding that allegations of bad faith in handling insurance claims arise under contract law, *citing Mirville v. Allstate Indem. Co.*, 71 F.Supp.2d 1103 (D. Kan. 1999).

Yeager v. Maryland Cas.. Co., 868 F.Supp. 141 (D.S.C. 1994)(holding that a bad faith claim "is basically one in contract", and applying Georgia law pursuant to the rule of *lex loci contractus*).

Certain Interested Underwriters Subscribing to Policy No. B1262P20017013 v. American Realty Advisors, No. 5:16-CV-940-FL, No. 5:17-CV-74-FL, 2017 WL 5195864 (E.D.N.C. Nov. 9, 2017) (recognizing that under North Carolina law, "for choice of law purposes, breach of the covenant of good faith and fair dealing is not an independent tort, but, rather, constitutes part of the underlying breach of contract" and concluding pursuant to a California choice of law provision in the policy, that California law controlled).

Moon v. N. Am. Ins. Co., No. 06-13102, 2007 WL 1599743, at *1 (E.D. Mich. June 1, 2007) (concluding that where beneficiary of life insurance policy executed in Michigan brought claims for breach of contract and bad faith against carrier, law of Michigan and not Arizona law applied, and that under Michigan law, no independent cause of action for bad faith existed).

Comer-Beckett v. State Farm Mut. Auto. Ins. Co., No. CIV. 11-5017-JLV, 2013 WL 12412010, at *1 (D.S.D. June 19, 2013) (holding that Minnesota law and not South Dakota law applied to Plaintiffs' third-party bad faith claims against automobile insurer, and concluding that notwithstanding South Dakota's recognition bad faith action arising in tort, Plaintiffs' bad faith claim had to be treated as one for breach of contract consistent with Michigan law, such that extra-contractual damages were unavailable).

Cecilia Schwaber Tr. Two v. Hartford Acc. & Indem. Co., 437 F. Supp. 2d 485 (D. Md. 2006) (applying Maryland choice of law rules and Maryland law rejecting tort cause of action for insurer bad faith in first party cases, rather than the tort law of Pennsylvania and Indiana, the states in which claim handling operations took place).

Aetna Cas. & Sur. Co. v. Dow Chem. Co., 883 F. Supp. 1101 (E.D. Mich. 1995) (applying Michigan law and finding that although "an insurer has [an implied contractual] duty to act in good faith in negotiating a settlement within the policy limits, and the duty to act in good faith in investigating and paying claims" Michigan law "does not recognize an independent tort based upon a bad faith breach of contract").

In re Payroll Exp. Corp., 921 F. Supp. 1121 (S.D.N.Y. 1996) (holding that under both New Jersey and New York law, bad faith claim sounds in breach of contract and does not otherwise give rise to an independent tort action).

2. Bad faith is a tort claim and governed by the law applicable to tort claims, with the choice of law outcome different for the tort and contract claims.

ROC ASAP, L.L.C. V. Starnet Ins. Co., 2014 WL 667833 (W.D. Okla. Feb 20, 2014)(holding that bad faith is an independent tort subject to Oklahoma's "most significant relationship" test).

Martinez v. Nat'l Union Fire Ins. Co., 911 F.Sup.2d 331 (E.D.N.C. 2012)(holding that bad faith refusal to settle is a claim in tort subject to North Carolina's "law of the situs test", determined by the state of the injury).

Hillman v. Nationwide Mut. Fire Ins. Co., 855 P.2d 1321 (Alaska 1993)(characterizing bad faith as a tort claim).

TPLC, Inc. v. United Nat. Ins. Co., 44 F.3d 1484 (10th Cir. 1995) (applying conflict of laws rules of Colorado and determining that (1) Pennsylvania, the insurer's state of incorporation, had "the most significant relationship to the policy at issue" and thus applying Pennsylvania law to coverage dispute based upon untimely notice while (2) applying Colorado law—which the Court observed recognized the tort of bad faith and which had the most significant relationship to insured's claim—to Plaintiff's bad faith claims)

Newmont U.S.A., Ltd. v. American Home Ass. Co., Newmont USA Ltd. v. American Home Assur. Co., 676 F. Supp. 2d 1146 (E.D. Wash. 2009)(holding in action against primary and excess insurers arising out of environmental liability from operation of a Washington uranium mine that bad faith sounds in tort, implicating §145 rather than §188 of the *Restatement* which then pointed to Washington law; further noting that contract claims would likely be determined by New York law; and concluding that "[a]s messy and unpredictable as it may be, certainly is not an anomaly to have various states laws applied to different issues in an insurance dispute involving a policy without a choice of law provision." *Id.*

3. Bad faith is a tort claim but still governed by the law applicable to the breach of contract claim.

Pogue v. Principal Life Ins. Co., 2015 WL 5680464 (W.D. Ky. 2015)(acknowledging that the insured's claims were founded on both contract and tort; that the "most significant relationship test" of §188 of the *Restatement* applies to contract disputes and that the "any significant

contacts" test applies to tort actions; but that all tort claims arose out of the breach of contract claim and that the parties agreed the more stringent "most significant relationship test" applied to both claims).

4. Bad faith is a tort claim and governed by the law applicable to tort claims, but the outcome is the same for both claims.

Protective Ins. Co. v. Plasse, 2014 WL 3898084 (S.D. Ala. 2014)(holding that breach of contract claims are determined by the rule of *lex loci contractus*, whereas bad faith claims are determined by the rule of *lex loci delicti,* with the latter determined by the state of injury, and then applying Alabama to both claims without explanation).

Engineered Structures, Inc. v. Travelers Prop. Cas. Co. of Am., 328 F. Supp. 3d 1092 (D. Idaho 2018) (applying Idaho law—which recognizes independent cause of action for bad faith—while declining to apply Oregon law (which does not) to builder's bad faith tort claim and breach of contract claim against insurer and recognizing that because "both the breach of contract claim and the bad faith claim depend upon the provisions of the Policy . . . an unnecessarily confusing situation would result if the law of one state is used to interpret the insurance agreement regarding the breach of contract claim and the law of a second state is applied to interpret the same agreement with regard to the bad faith claim") (citing *Allis–Chalmers Corp.*, 471 U.S. 202, 217, 105 S. Ct. 1904, 85 L. Ed. 2d 206 (1985)).

Phan v. Great-W. Life & Annuity Ins. Co., No. CV 13-1318 GAF (ANX), 2013 WL 12133645, at *1 (C.D. Cal. Apr. 30, 2013) (applying California law to Plaintiff's bad faith claim (as opposed to Illinois law given that Illinois law conflicts with fundamental policy of California) and concluding that bad faith claim could proceed since, pursuant to California law, "breach of the implied covenant [of good faith and fair dealing] will provide the basis for an action in tort" but failing to address law applicable to Plaintiff's breach of contract claim since that issue was not before the Court on Defendant's motion to dismiss).

Sentry Ins. v. Novelty, Inc., No. 09-CV-355-SLC, 2009 WL 5087688, at *1 (W.D. Wis. Dec. 17, 2009) (applying Wisconsin law to contract claims based upon policy choice of law provision and as between Indiana and Wisconsin law, and applying Wisconsin law to Plaintiff's bad faith claim, which Wisconsin recognizes as "an intentional tort claim separate from a breach of contract claim").

5. Bad Faith Claims Are "Hybrid" In Nature, Implicating Both Contract and Tort Law.

Larson v. Auto Owners Ins. Co., No. CIV. 12-4020-KES, 2012 WL 4005614, at *1 (D.S.D. Sept. 12, 2012) (observing that although South Dakota permits a cause of action in tort for bad faith in the insurance context, the law of Minnesota applied to Plaintiff's breach of contract and bad faith claims "regardless of whether [the bad faith claim] is seen as a 'contract' or a 'tort'")

Ryder Truck Rental, Inc. v. UTF Carriers, Inc., 790 F. Supp. 637, 638 (W.D. Va. 1992) (observing that Virginia law characterizes a "bad faith claim [a]s a pure contract claim" but declining, at the

motion to amend stage, to "make a determination as to whether Connecticut or New York law governs the insurance contract" since the "record [wa]s not sufficiently developed").

2002 Lawrence R. Buchalter Alaska Tr. v. Philadelphia Fin. Life Assur. Co., 96 F. Supp. 3d 182 (S.D.N.Y. 2015) (applying Alaska law to Plaintiff's bad faith claim (as opposed to New York law)—which generally treats a bad faith claim as sounding in contract but noting a limited exception in cases of insurance contracts where a tort claim is permitted—to Plaintiff's bad faith claim, determining that bad faith claim could not survive since the insurance portion of the contract was collateral to the main investment portion of the contract and likewise dismissing Plaintiff's breach of contract claim pursuant to both Alaska and New York law in light of any lack of conflict between each state's substantive contract law)

Harmon v. State Farm Mut. Ins. Co., 162 Idaho 94, 394 P.2d 796 (2017)(citing both Idaho and Alaska bad faith law under policy held to be governed by Alaska law for breach of contract claims).

C. Do the State's Unfair Claims Settlement Practices Provisions Create a Private Right of Action on the Part of the Insured?

In 1990, the National Association of Insurance Commissioners ("NAIC") adopted a Model Act entitled the Unfair Claims Settlement Practices Act, setting forth uniform standards for the investigation and disposition of insurance claims. The Model Act excepts from its provisions claims involving workers' compensation, fidelity, suretyship or boiler and machinery insurance, and as drafted and issued by the NAIC, is expressly not intended to create or imply a private right of action for violation of its provisions.

Instead, the provisions created a set of standards by which state insurance commissioners could consider and punish the actions of insurance carriers in the handling and payment of insurance claims.

Most states have adopted some form of the model act, but not all states preserved the provision respecting the existence of a private right of action (as opposed implementing the provisions purely as a basis for enforcing administrative penalties). Pursuant to the current version of the Model Act, it is an improper claims practice for a domestic, foreign or alien insurer transacting business in a state to commit enumerated acts if committed flagrantly and in conscious disregard of the Model Act or related rules, or if it has been committed with such frequency to indicate a general business practice to engage in that type of conduct. The Model Act defines "Unfair Claims Practices" as follows:

> A. Knowingly misrepresenting to claimants and insureds relevant facts or policy provisions relating to coverages at issue;
>
> B. Failing to acknowledge with reasonable promptness pertinent communications with respect to claims arising under its policies;

C. Failing to adopt and implement reasonable standards for the prompt investigation and settlement of claims arising under its policies;

D. Not attempting in good faith to effectuate prompt, fair and equitable settlement of claims submitted in which liability has become reasonably clear;

E. Compelling insureds or beneficiaries to institute suits to recover amounts due under its policies by offering substantially less than the amounts ultimately recovered in suits brought by them;

F. Refusing to pay claims without conducting a reasonable investigation;

G. Failing to affirm or deny coverage of claims within a reasonable time after having completed its investigation related to such claim or claims;

H. Attempting to settle or settling claims for less than the amount that a reasonable person would believe the insured or beneficiary was entitled by reference to written or printed advertising material accompanying or made part of an application;

I. Attempting to settle or settling claims on the basis of an application that was materially altered without notice to, or knowledge or consent of, the insured;

J. Making claims payments to an insured or beneficiary without indicating the coverage under which each payment is being made;

K. Unreasonably delaying the investigation or payment of claims by requiring both a formal proof of loss form and subsequent verification that would result in duplication of information and verification appearing in the formal proof of loss form;

L. Failing in the case of claims denials or offers of compromise settlement to promptly provide a reasonable and accurate explanation of the basis for such actions;

M. Failing to provide forms necessary to present claims within fifteen (15) calendar days of a request with reasonable explanations regarding their use;

N. Failing to adopt and implement reasonable standards to assure that the repairs of a repairer owned by or required to be used by the insurer are performed in a workmanlike manner.

Notwithstanding the provision of the Model Act as promulgated by the NAIC, the following states recognize a private right of action for purposes the states' respective versions/enactments of the Model Act:

Alabama (possibly)
Arkansas (possibly)
Connecticut (possibly)
District of Columbia (possibly)
Florida
Kentucky
Maine
Maryland
Massachusetts
Montana
Nebraska (possibly)
Nevada
New Mexico
North Carolina
North Dakota (possibly)
Rhode Island
Texas
Washington (first party)
West Virginia

D. Has the State Adopted or Rejected the ALI's Restatement of the Law of Liability Insurance?

When the American Law Institute issued its Restatement of the Law of Liability Insurance in 2018, it contained various provisions addressing the standard for determining and the damages recoverable for insurer bad faith. These provisions include Section 24, The Insurer's Duty to Make Reasonable Settlement Decisions; Section 27, Damages for Breach of the Duty to Make Reasonable Settlement Decisions; Section 36, Assignment of Rights Under a Liability Insurance Policy; Section 49, Liability for Insurance Bad Faith; and Section 50, Remedies for Liability Insurance Bad faith.

How the Restatement will be received or applied by the courts of the fifty states remains to be seen. Late last year, the Nevada Supreme Court favorably cited the Restatement in answering a certified question from the Ninth Circuit as to the measure of damage for a breach of the duty to defend in the absence of bad faith. *Century Sur. Co. v. Andrew*, 432 P.3d 180 (Nev. 2018).

More neutrally, a Delaware court cited provisions of the Restatement in stating the applicable burden for determining application of an exclusionary provision in an insurance policy, *Akorn, Inc. v. Fresenius Kabi AG*, 2018 WL 4719347, *59, n. 619 (Del. Ch. Ct. 2018), and a Kentucky federal court cited the Restatement in addressing the question of how many claims were presented by an event which was the subject of an alleged liability. *National Cas. Co. v. Western Express*, 356 F. Supp. 3d 1288, 1200 (Okla. 2018).

Other courts have been less charitable, or refused application of various principles of the Restatement: *Catlin Specialty Ins. Co. v. J.J. White, Inc.*, 309 F. Supp. 3d 345, 362 (E.D. Pa. 2018)(declining to apply the Restatement as contrary to the controlling New York law); *Catlin Specialty Ins. Co. v. CBL & Associates Property, Inc.*, 2018 WL 3805868 (Sup. Del. 2018)(same); *Progressive Northwestern Ins. Co. v. Gant*, 2018 WL 4600716 (D. Kan. 2018)(same); *Outdoor Venture Corp. v. Philadelphia Indemn. Ins. Co.*, 2018 WL 4656400 (E.D. Ky. 2018)(same).

Perhaps more importantly, the legislatures of eight states have passed statutes or resolutions questioning, limiting, or outright condemning application of the Restatement in those states, including:

Arkansas (Ark. Code § 23-60-112)
Indiana (House Concurrent Resolution 62)
Kentucky (House Resolution 222)
Michigan (Mich. Comp. Laws § 500.3032)
North Dakota (N.D. Cent. Code § 26.1-02)
Ohio (Ohio Rev. Code § 3901.82)
Tennessee (Tenn. Code § 56-7-1-2)
Texas (Concurrent Resolution 58).