And You Thought that the American Law Institute Was Done With Insurance? Heads Up—More Is On the Way!

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In May 2018, the members of the American Law Institute convened in Washington, D.C. and voted to give final approval to the first Restatement devoted solely to issues of insurance coverage. The *Restatement of Law, Liability Insurance* ("RLLI"), which took eight years to complete, had proved to be a controversial undertaking and continues to meet with opposition from the insurance industry as well as several state legislatures that have enacted statutes forbidding state judges to rely on its provisions in deciding coverage cases.

While some ACCC Fellows have continued to track how the RLLI is faring in the courts, most have, not unreasonably, assumed that the ALI is done with insurance law. As may be seen, ALI Reporters are, in fact, presently working on three separate projects that will have important implications for how courts decide insurance and bad faith cases.

1. First Party Bad Faith (Restatement (Third) of Torts—Miscellaneous Provisions)

For the last two decades, the ALI has been working on a new Restatement (Third) of Torts. When the project is completed, it will consist of nine volumes separately addressing subject such as Products Liability, Apportionment of Liability, Liability for Physical and Emotional Harm, and Liability for Economic Harm.

In 2019, the project Reporters began work on a catch-all volume, entitled "Concluding Provisions,"[2] which will address miscellaneous topics not covered in another part of the Restatement Third of Torts that either require updating or that have emerged since the publication of the Second Restatement in the 1970s. These topics will include medical monitory, vicarious liability, wrongful death and survival actions, among others.

The project Reporter is Professor Michael Green of the Washington University in St. Louis School of Law. It is Professor Green's view that first party bad faith is a significant tort that has emerged since the Second Torts Restatement and that the ALI would be remiss in

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2 This volume has since been re-named "Miscellaneous Provisions."

creating a Third Torts Restatement that did not address it.[3] As the ALI does not appear to be interested in undertaking a *Restatement of Law, First Party Insurance*, the agreed remedy is to at least address the tort aspects of first party bad faith in this catch-all *Concluding Provisions* volume for the Third Tort Restatement.

In August 2022, Professor Green circulated Preliminary Draft No. 3, which addressed diverse topics, including vicarious liability, negligent misrepresentations, wrongful death and medical monitoring. Chapter Three (Interference with Economic Interests) for the first time now includes a section (Section 20 A). addressing "Bad Faith Performance of First Party Insurance Contracts."

Like all Restatements, Section 20 A begin with a black letter rule :

§ 20 A. Bad-Faith Performance of First-Party Insurance Contract

An insurer is subject to tort liability when the insurer's claims processing of a first party insurance policy:

(a) lacks a reasonable basis;

(b) the insurer knew of the lack of reasonable basis or acted in reckless disregard of the lack of a reasonable basis; and

(c) the insurer's performance is a factual cause of harm to the insured and within the insurer's scope of liability.

This general rule is followed by fifteen separate Comments that flesh out the rule along with Reporter's personal Notes and legal authority for these propositions. The Comments range from the special nature of insurance contracts and why courts have imposed tort liability on insurers, through the standard for imposing liability, the inter-relationship between common law bad faith and state insurance claims handling statutes and the damages available to aggrieved policyholders.

For the most part, Section 20 A tracks the Model Act that the National Association of Insurance Commissioners promulgated in 1990 and which has since been adopted by nearly every state. It also seeks to mirror the RLLI's treatment of bad faith. As may be recalled, Section 49 of the RLLI stated that:

> An insurer is subject to liability to the insured for insurance bad faith when it fails to perform its duties under a liability insurance policy:
>
> (a) Without a reasonable basis for its conduct; and

[3] Sections 49 and 50 of the *Restatement of Law Liability Insurance* did address bad faith remedies and damages but solely in the context of third party liability insurance.

(b) With knowledge of its obligation to perform or in reckless disregard of whether it had an obligation to perform.

Comment a. to Section 4 had identified the "objective" element as the familiar requirement that the insurer's coverage position must be "fairly debatable." In contract to this objective "fairly debatable" element, the subjective element depends on whether the insurer failed to perform when it knew it was obligated to do so or acted with "reckless disregard" for its obligations. Comment a. observes that a "reckless disregard" may be found (1) because of lack of investigation of the relevant facts; (2) a failure to conduct the necessary state-specific legal research to evaluate the coverage position or (3) some other circumstance that placed the insurer on notice that it had not done what it needed to do in order to evaluate whether it had a reasonable basis for its position.

Similarly, Section 20 A adopts a dual objective/subjective standard for first party bad faith. As explained in **Comment d.**

To make out a prima facie case of bad faith, the plaintiff-insured must prove both that there was no reasonable basis for the defendant-insurer's claims processing and that, in its claims processing conduct, the defendant insurer knew or acted in reckless disregard of the lack of reasonable basis. Thus, the first element requires a showing that a reasonable insurer would have performed differently from the defendant insurer. The second element, a subjective one, requires proof that the insurer knew its conduct was unreasonable or acted in reckless disregard of facts or legal authority that reveal the unreasonableness.

Comment e. identifies the following potential bases for first party bad faith:

Bad faith in claims processing may include: (1) denials of claims for which no reasonable basis exists for the denial; (2) offers of settlement in amounts below the minimum that would be reasonable based on the facts of the claim and the scope of coverage; (3) investigations that take an unreasonably long time or that are unreasonably onerous or demanding; (4) imposing conditions on insureds during claims processing that are unreasonable or impossible to fulfill; and/or (5) conditioning payment for an uncontested aspect of a claim on the insured agreeing to a global settlement of the claim.

Comment f. struggles to answer whether first party bad faith is an intentional or negligent tort and observes that:

The conduct aspect of the bad-faith tort is similar to negligence insofar as it adopts an objective standard based on reasonableness. But the subjective knowledge element cannot be squared with negligence, as an actor can act

> negligently without any knowledge of, indeed while remaining oblivious to, the risk and without appreciating that his or her conduct is unreasonable.

Comment g. is one of the few sections that were changed between Tentative Draft No. 3 in August 2022 and Council Draft No. 4. Whereas the draft originally only allowed insurers to defend against bad faith claims by showing that their position was based on facts that were not only known to them at the time but had been communicated to the insured in the coverage denial, this latter requirement has now been deleted.

Comment h. states that an insurer can act unreasonably but not be subject to bad faith liability if its misconduct did not actually harm the insured:

> Thus, an insurer who fails reasonably to investigate a claim and does so because of a cynical policy to reduce administrative costs, is not liable under this Section if the claim is for an uncovered loss; nor is the insurer liable if the claim is one for which a justifiable basis exists for denial. However, an insurer who engages in dilatory claims investigation and processing may be liable for any harm caused by the delay in payment or for other harm that the deficient claims processing caused. Simply, if the insurer harms the insured, the insurer may be subject to liability under this Section; if the insurer causes no harm to the insured, the insurer is not liable under this Section, no matter how egregious its conduct.

Comment i. expands upon Comment f.'s declaration that an insurer may be liable if it fails to investigate a first party loss, explaining that "[a]n insurer must act reasonably in investigating a claim when there are factual or legal matters that must be resolved.

Comment j. states that "[b]esides intentional infliction of emotional distress, an insurer's conduct in investigating and processing a claim may constitute another tort, such as defamation or negligent infliction of emotional distress."

Comment k. avers that insurers are not fiduciaries but affirms that they may not put their own interests ahead of their insured's:

> An insurer does not have a fiduciary duty to its insured in its processing of first-party insurance claims; the insurer is not required to take the insured's interests as primary over the insurer's. But, nor is the insurer in the opposite position; it cannot prioritize its own interests over the interests of the insured. The insurer must, in other words, act in a way that gives equal weight to its and its insured's often divergent interests.

Comment l. explores the respective roles of judge and jury in resolving first party bad faith and concludes that "[b]oth the objective and subjective elements of the bad-faith tort are mixed questions of law and fact that the factfinder must resolve." It appears that this section overstates the general rule and ignores instances in which an insurer may use summary judgment motions to dispose of bad faith claims.

Comment m. addresses the impact of state claims handling statutes on common law bad faith actions. It declares that:

> Virtually all states have enacted statutory provisions prohibiting specified unfair insurer claims practices, although, in most states, the statutes are not enforceable through private rights of action. However, in common-law bad-faith claims, courts may use the insurer's violation of such provisions as the basis for finding a lack of reasonable basis in the insurer's claims processing in a manner analogous to the doctrine of negligence per se.

In short, the Reporters call for courts to use a new "negligence per se" standard for private causes of action for policyholder suits based upon insurer violation of unfair claims practice statutes. The Reporter's Note only cites two decisions for this novel proposition, one of which (*Moody v. Oregon Cmty. Credit Union*, 505 P.3d 1047 (2002), *leave to appeal granted* (Or. 2022) is still under review by the Oregon Supreme Court. The other is the West Virginia Supreme Court's 2003 decision in *Barefield v. DPIC* which says nothing about negligence per se. This is awfully thin legal authority for adding a new legal proposition to a Restatement.

Comment n. declares that "ordinary negligence or insurers' good-faith mistakes are not an adequate basis for bad faith tort liability."

Finally, **Comment o.** sets forth the damages that an insured may recover for first party bad faith. Consistent with Section 51 of the RLLI, it states that consequential damages may be recovered, together with emotional harm, including loss of consortium damages. It also declares that an insured may generally recover attorney's fees for establishing coverage but not for bad faith.

In contrast to the 2018 *Restatement of Law, Liability Insurance*, which devoted most of its analysis to issues of substantive issues of insurance law, this Torts Restatement only addresses first party bad faith. Further, Professor Green has for the most part adopted the bad faith framework that Professors Baker and Logue had earlier set forth in the Liability Restatement.

There is one other important difference between the treatment of bad faith issues in these two Restatements. The Liability Insurance Restatement was developed over a period of eight years through a process of intense debate between the project Reporters and hundreds of lawyers and judges who were experts in insurance law. The RLLI project also benefited from the input of a liaison from the insurance industry and, in its final three years, voluminous input from major U.S. insurers as well as stakeholders in the insurance defense community.

By contrast, these stakeholders have been almost entirely absent from the creation of the Torts Restatement's analysis of first party bad faith. This was due in large part to the fact that it was not apparent to many people that a Torts Restatement would include a discussion of insurance law. As a result, few of the ALI members who were appointed to serve as Advisors on this project have any serious expertise in insurance or bad faith litigation. Nor, despite the

large number of insurance lawyers who are members of the ALI, did many of these individuals sign up for the Members Consultative Group that provides a second layer of input to the Reporters.

Section 20 A and various other sections of the Miscellaneous Provisions volume of the Third Torts Restatement were due to be debated and voted on May 22, 2023 at the ALI's Annual Meeting in Washington, D.C. In the event, the time allotted for these sections was entirely consumed by a fiery debate over medical monitoring, with the result that these sections were put over to the ALI's next meeting, which will occur in San Francisco in May 2024. Meanwhile, Professor Green has agreed to rework Section 20 A in light of comments that he has received in recent months from experienced coverage counsel, including several ACCC Fellows. His revised text will be circulated to project participants in advance of the September 29, 2023 Philadelphia meeting of Advisors and MCG participants for this Restatement.

2. Restatement (Third), Conflicts of Law

Since it was published in 1971, the *Restatement (Second), Conflicts of Law* , has had an enormous impact on choice of law issues in insurance coverage disputes, moving courts away from the traditional place of contracting (*lex loci contractus*) approach and refocusing the analysis on the law of the state with the "most significant relationship" to the insured risk. Five decades later, a new Conflicts Restatement is well underway that will substantially rewrite the basis principles set forth in the Second Restatement. The project, which has been underway since October 2014, is helmed by Professor Kermit Roosevelt of UPenn; the associate Reporter responsible for its insurance sections is Professor Laura Little of the Temple University Beasley School of Law.

Despite the popularity of the Second Restatement, the Reporters for this new project are of the view that it has led to inconsistent and confusing results, particularly with respect to contracts that did not contain an express choice of law designation. The Reporters hope that this new Restatement will set forth choice of law rules that are understandable and that lead to predictable results.

Choice of law issues arising under contracts are addressed in Chapter 8 of this Third Restatement. Chapter 8 encourages businesses to include choice of law designations in their contract and stipulates (Section 8.02) that such clauses will be upheld if the designated state has a substantial relationship to the parties or to the transaction, or there is otherwise a reasonable basis for the parties' choice. A clause will not be enforced if it is contrary to a fundamental policy of the state that would provide the governing law in the absence of the parties' choice or if the parties have chosen the law of a state other than the forum and a local statutory directive requires that forum law be applied.

Sections 5 to 12 of Chapter 8 address particular types of contracts that do not include a choice of law designation. ACCC Fellows will want to focus on Section 8.8, which states:

> Choice-of-law issues relating to a liability- or property-insurance policy are presumed to be determined by the law of the state that, at the time of the application, is the domicile of the juridical or natural person that purchased the policy.

Unlike the Second Restatement, which had focused on the "principal location of an insured risk," Comment f. to Section 8 focuses on the insured's domicile. In the case of a business, domicile is presumed to be the insured's corporate headquarters at the time that the policy was issued. The Reporters emphasize the ease of determining the insured's principal place of business, in contrast to Second Restatement litigation, and the resulting predictability of results.

Finally, Section 13 provides that if a contract lacks a choice of law clause and falls outside the scope of contracts governed by Sections 5-12, the choice of law should reflect factors including where the contract is to be performed, the place of negotiation, where the parties are domicile, the place of the subject matter of the contract and where the contract was made.

Chapter 7 of this Restatement, which addresses choice of law issues in tort cases, was debated and approved at the 2023 ALI Annual Meeting. Further text will be forthcoming from the Reporters in advance of the Advisers/MCG meeting for this project in Philadelphia on October 26, 2023, although it is unclear how much of Chapter 8 will be included or will be ready for consideration by the ALI membership at the San Francisco Annual Meeting in 2024.

3. Restatement of Law, Consumer Contracts

This Restatement was approved by the ALI at its annual meeting in May 2022. It states that it applies to insurance contracts but that, in the event of conflicts between its provisions and the RLLI, the Liability Insurance Restatement's provisions will control.

During the floor debate at the 2022 Annual Meeting, a motion to strike Section 2 was defeated by a very narrow margin, which is relatively unusual for ALI meetings. Section 2 states:

> **§ 2. Interpretation and Construction of Consumer Contracts**
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> (a) Regardless of whether expressly stated, standard contract terms in consumer contracts include the duty of good faith and faith dealing in the performance of the contract.
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> (b) Standard contract terms in consumer contracts are interpreted (1) to effectuate the reasonable expectations of the consumer, and 2. against the drafter of the term.

(c) Ambiguities in the language of a standard contract term or the process by which a consumer assents to its provisions are resolved against the business supplying the term or process

Consumer advocates at the May 2022 meeting also urged the Reporters to amend Section 2 to not only require that contract terms be conspicuously displaced but that the contracting party expressly assent to the inclusion of all contract terms. It was pointed out by the Reporters that this would be unfeasible for insurance contracts, since insureds rarely actually receive and review policies before they go into effect, and the motion was decisively defeated on a voice vote.

Conclusion

Individuals who are strangers to the American Law Institute frequently express frustration at the lack of transparency in its deliberative processes. In its defense, the ALI requests that its members check their client allegiances at the door and engage in candid and difficult discussions that would be impossible if the public had complete access to early drafts and work products of these Restatements.

At the same time, the author cannot emphasize enough the importance of Adviser input and Members Consultative Group participation as a means of guiding project Reporters, particularly with respect to wide-ranging projects such as the *Miscellaneous Provisions* Tort Restatement, where no professor can reasonably be expected to have expertise on all of the topics addressed.

It is concerning, therefore, that in each of the three Restatements discussed in this article, only a handful of the Advisers and Members Consultative Group members are insurance coverage practitioners. Given the significant number of ACCC Fellows who are members of the ALI, it is imperative that our members join the MCGs for these Restatements and make our views heard. Whether you represents policyholders or insurance companies, we all have something to contribute that may ensure that these Restatements reflect the reality of insurance law and provide a useful tool for courts and lawyers to apply.