WHY INSURANCE NEEDS A RESTATEMENT: THE CASE OF SETTLEMENT DECISION LAW

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ABSTRACT

Even before its publication, the Restatement of the Law, Liability Insurance had been subjected to withering wholesale criticism that it creates aspirational and pro-policyholder insurance law. This view continues to be forcefully promoted by insurers and their advocates in the legal literature and by governors and state legislatures in the political areas.

This Article finds these wholesale criticisms unwarranted. Liability insurance law is not a field where law is simply found and restated. In fact, settlement law offers the most vivid examples of why the Restatement of the Law, Liability Insurance is possible, useful, and justified. It is possible because there is sufficient agreement on core doctrines to be organized into a common framework. It is useful because, though courts have been handling these cases for more than a century, the basic analytical foundations of the rules associated with this specialized insurance law remain poorly understood and often unarticulated. It is justified, because the project locates insurance settlement law within the broader framework of modern contract, tort, and fiduciary law. Notwithstanding localized quibbles, because Restatements are charged with determining the legal rules that best fit within the broader body of law, the Restatement of the Law, Liability Insurance stands as a considerable achievement.

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INTRODUCTION: THE RESTATEMENT OF THE LAW, LIABILITY INSURANCE AND ITS CRITICS

The *Restatement of the Law, Liability Insurance*[1] ("*RLLI*") was published by the American Law Institute ("ALI") in 2019.[2] Nearly ten years earlier, the project began in relative obscurity under the name *Principles of the Law of Liability Insurance* ("*Principles*").[3] Midway through, the ALI made the unprecedented move of converting *Principles* into the *RLLI*.[4] Interest in the project thereafter surged, especially in the form of critical responses from the insurance industry and its representatives.[5]

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[1] RESTATEMENT OF THE L., LIAB. INS. (AM. L. INST. 2019).

[2] Jeffrey W. Stempel, *From Quiet to Confrontational to (Potentially) Quiescent: The Path of the ALI Liability Insurance Restatement*, 50 BRIEF 11, 14 (2020).

[3] *See* Tom Baker & Kyle D. Logue, *In Defense of the Restatement of Liability Insurance Law*, 24 GEO. MASON L. REV. 767, 771 (2017).

[4] Victor E. Schwartz & Christopher E. Appel, *Restating or Reshaping the Law?: A Critical Analysis of the Restatement of the Law, Liability Insurance*, 22 U. PA. J. BUS. L. 718, 724–25 (2020) ("This decision to convert a pending Principles project into a Restatement was unprecedented in the ALI's history.").

[5] *See, e.g.*, Stempel, *supra* note 2, at 12 (citing sources); A. Hugh Scott, *Why Criticism of ALI's Insurance Restatement is Valid*, LAW360 (May 10, 2017, 11:13 AM), https://www.namic.org/pdf/insbriefs/170524_why-criticism-of-alis-insurance-restatement-is-valid.pdf; William T. Barker, *The Draft Restatement Improperly Limits Use of Extrinsic Evidence in Insurer Decision-Making on Duty to Defend*, 38 INS. LITIG. REP. 1 (2016); John K. DiMungo, *From Principles to Restatement: The Impact of the American Law Institute's Restatement, Law of Liability Insurance on*

In line with wider social trends, the ALI's most recent Restatements have become increasingly polarized and politicized.[6] A process once known for genteel academic debates that centered on the finer points of consideration law[7] or the niceties of the rule against perpetuities,[8] now increasingly mimics the harsher tactics known to the legislative and political arenas. Lines have been sharply drawn,[9] parties and interest groups are mobilized, the stakes are framed as existential, and lobbying and external pressure campaigns have become the norm.[10]

American Insurance Law, 37 INS. LITIG. REP. 569 (2015); Jeff Sistrunk, *ALI's Proposed Penalty for Spurning Defense Irks Insurers*, LAW360 (Oct. 26, 2015), https://www.law360.com/articles/716850/ali-s-proposed-penalty-for-spurning-defense-irks-insurers; Randy Maniloff, *ALI Principles of Insurance Should Concern Industry*, LAW360 (Apr. 16, 2014), https://www.law360.com/articles/528384/ali-principles-of-insurance-should-concern-industry.

[6] *See* Jay M. Feinman, *The Restatement of the Law of Liability Insurance as a Restatement: An Introduction to the Issue*, 68 RUTGERS U. L. REV. 1, 9 (2015) (discussing "the extent to which Restatements represent sound distillations of existing judicial authority, or are shaped by interest groups and politics, or whether it even makes sense to attempt an authoritative Restatement."). *See also* Jeffrey W. Stempel, *Hard Battles Over Soft Law: The Troubling Implications of Insurance Industry Attacks on the American Law Institute Restatement of the Law of Liability Insurance*, 69 CLEV. ST. L. REV. 605, 623–27 (2021) (assessing the controversial process for *Principles of Corporate Governance*, *Restatement of the Law Governing Lawyers*, and *Restatement (Third) of Torts: Liability for Physical and Emotional Harm*).

[7] *See, e.g.*, Feinman, *supra* note 6, at 9 (reviewing the "quaint" discussion between Professors Samuel Williston and Arthur Corbin regarding the definition of consideration in the *Restatement (First) of Contracts*).

[8] *See, e.g.*, *id.* at 24 ("At the 1991 annual meeting, ALI president Roswell Perkins noted that . . . [until the 1980's] 'perhaps the most emotional debate was in 1978, . . . over the Rule Against Perpetuities.' [This changed] when, in Perkins's words, the ALI began 'to bite on more economically divisive meat . . . [that] carries the disease of polarization.'" (citation omitted)).

[9] For examples of detractors see Kim V. Marrkand, *How a Broken Process, Broken Promises, and Reimagined Rules Justify the Bench and Bar's Skepticism Regarding the Reliability of the Restatement of the Law, Liability Insurance*, 50 BRIEF 20, 22–23 (2020); Schwartz & Appel, *supra* note 4. For supporters see Stempel, *supra* note 2; Stempel, *supra* note 6; Lorelie S. Masters & Geoffrey B. Fehling, *The American Law Institute's Restatement of the Law, Liability Insurance: Scholarship and Controversy*, 27 CONN. INS. L.J. 116 (2020); Jay M. Feinman, *A User's Guide to the Restatement of the Law, Liability Insurance*, 26 CONN. INS. L.J. 93 (2019).

[10] *See, e.g.*, Stempel, *supra* note 6, at 615–19 (noting increasingly controversial nature and partisan efforts of ALI projects in recent years).

Critical assessments of the *RLLI* typically piggyback on Justice Scalia's view, found in a 2015 concurrence, directed at the *Restatement (Third) of Restitution and Unjust Enrichment*. There he warned:

> [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. . . . [Innovative] Restatement sections . . . should be given no weight whatever as to the current state of the law, and no more weight regarding what the law ought to be than the recommendations of any respected lawyer or scholar. And it cannot safely be assumed, without further inquiry, that a Restatement provision describes rather than revises current law.[11]

Following Justice Scalia, the *RLLI*'s critics describe it as a work of policyholder advocacy masquerading as a product of ALI neutrality. Hundreds of blogs and articles in legal trade press assert the *RLLI* (sometimes derisively called the "NEWstatement" of insurance law)[12] does not present the law as it is, but reflects an unbalanced and pro-policyholder version of aspirational insurance law that fails a Restatement's goal of describing the positive law as applied by American courts.[13] Critics claim the *RLLI* has adopted the policyholder side in nearly every issue.[14] And

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[11] Kansas v. Nebraska, 574 U.S. 445, 475–76 (2015) (Scalia, J., concurring and dissenting in part) (citations omitted).

[12] *See* Press Release, Nat'l Council of Ins. Legislators, Successful 2017 NCOIL Annual Meeting in Phoenix Concludes (Nov. 20, 2017), https://ncoil.org/2017/12/12/4675/ ("Other highlights of the NCOIL Annual Meeting included . . . General Session titled 'A Restatement or NEWstatement? – Examining the ALI's Proposed Restatement of the Law on Liability Insurance' . . . ."); Press Release, Thomas B. Considine, CEO, Nat'l Council of Ins. Legislators, NCOIL CEO Statement on ALI 'Restatement' of Liability Insurance Law (May 25, 2018), https://ncoil.org/2018/05/25/ncoil-statement-on-ali-restatement-of-liability-insurance-law/.

[13] *See, e.g.*, Schwartz & Appel, *supra* note 4, at 719.

[14] *See, e.g.*, Marrkand, *supra* note 9, at 23 ("[T]he RLLI should be viewed with caution and with the understanding that it is not a fair, balanced, or reliable statement of insurance liability law.").

though some of the more extreme formulations were revised during the drafting process, insurers maintain that the die had been cast before the change from a *Principles* to a *Restatement* was initiated and before the insurance industry became heavily involved in the process.[15] Since insurance carriers began at such a disadvantage, the final document, they argue, remains thoroughly infected with policyholder bias.[16]

As the project neared completion, anti-*RLLI* activism moved from the inner sanctum of the ALI and legal press to the political arena. Governors of six states jointly wrote an unprecedented letter to the ALI's leadership articulating their disapproval of the forthcoming *RLLI*.[17] In addition to citing Justice Scalia's lines and critiquing what they viewed as the aspirational nature of the *RLLI*, the governors included a more unusual contention: their fear that *RLLI* would usurp state lawmaking authority which "[is] properly within the prerogative of our state legislatures . . . ."[18] This is curious, because neither the *RLLI* nor any other Restatements can become the law of a state unless it is adopted by its courts or legislature. Nor was this a one-time slip of a keystroke. This argument was expanded upon by the National Council of Insurance Legislators ("NCOIL")[19] who accused the *RLLI* of encroaching on the states' legislative prerogative.[20]

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[15] *See, e.g.*, *id.* at 21 (suggesting the *Principles* project began on a good note, but was quickly thwarted when "the reporters chose to operate in 'stealth mode' for the first two years of the PLLI project's existence . . . .").

[16] *See generally id.*

[17] Letter from Henry McMaster, Governor of South Carolina, Kim Reynolds, Governor of Iowa, Paul R. LePage, Governor of Maine, Pete Ricketts, Governor of Nebraska, Greg Abbott, Governor of Texas, and Gary R. Herbert, Governor of Utah, to David F. Levi, President, Am. L. Inst. (Apr. 6, 2018), https://ncoil.org/wp-content/uploads/2018/04/2018-04-062520Governors2520to2520ALI2520re2520 Draft2520Restatement-2-1.pdf.

[18] *Id.* at 1. *See also id.* ("Therefore, if the ALI does not significantly revise or rescind the Draft *Restatement*, this implicit usurpation of state authority may require legislative or executive action.").

[19] NCOIL is a national organization comprised of state legislators interested in insurance and financial institution regulation. *See generally* Press Release, NCOIL Voices Concerns with the American Law Institute's Proposed Liability Insurance Restatement; Violates "Legislative Prerogative" (May 8, 2017), http://ncoil.org/wp-content/uploads/2017/05/ALI-final-Press-Release-1.pdf.

[20] *See id.* at 2. NCOIL's CEO, Tom Considine, also sent a letter to the ALI that stated:

> I note that should the ALI refuse our invitation for a dialogue and proceed towards seeking approval of the proposed

These dire warnings did not come to pass. A March 2021 analysis by Randy Maniloff, a prominent lawyer and commentator who represents insurance companies, shows that *RLLI* is generally cited by courts for "benign reasons."[21] As Maniloff explains, though during the drafting process the "*RLLI* was predicted by some to lead to cataclysmic consequences for liability insurers. After nearly three years, and several dozen decisions citing the *RLLI*, that had not come to pass. The sky was still in the sky."[22] Instead, he notes that courts mainly use the *RLLI* to fill "voids and crevices in their own state's law" and predicts this trend will continue.[23] To the extent Maniloff sees a danger for insurers, it is only where there is national divergence on an issue or a lack of clarity within the state law.[24] Here a court "looking for a place to land, may be inclined to adopt the *RLLI*'s position [giving] insurers . . . more to fear than policyholders."[25]

> Restatement from ALI membership at its annual meeting, NCOIL will be forced to consider passing a Resolution that opposes the proposed Restatement as a misrepresentation of the law of liability insurance, and as a usurpation of lawmaking authority from State insurance legislators.

Letter from Tom Considine, CEO, Nat'l Council of Ins. Legislatures, to Richard Revesz, Dir., Am. L. Instit., and Stephanie Middleton, Deputy Dir., Am. L. Instit. 3 (May 5, 2017), https://ncoil.org/wp-content/uploads/2018/04/ALI-Restatement-Letter-5-4-17-1-7.pdf.

[21] Randy Maniloff, *Insurer Wins Biggest ALI Liability Insurance Restatement Case to Date*, ALI ADVISER (Mar. 25, 2021), https://www.thealiadviser.org/liability-insurance/insurer-wins-biggest-ali-liability-insurance-restatement-case-to-date [hereinafter Maniloff, *Insurer Wins*].

[22] *Id.* (italics added). *See also* Randy Maniloff, *3 Courts, in 3 Days, Seek Guidance from the ALI Restatement of Liability Insurance*, 10 COVERAGE OPS., Mar. 2021, https://coverageopinions.info/Vol10Issue2/3Courts.html [hereinafter Maniloff, *3 Courts*] ("I do not believe that courts will eschew their own precedent in favor of adopting a contrary rule contained in the RLLI. Rather, as I see it, the RLLI's impact will be felt by courts using it to fill voids and crevices in their own state's law. Faced with an issue on which there is no home-state law (or the law is not clear), and there is a divergence of positions nationally, the court, looking for a place to land, may be inclined to adopt the RLLI's position.").

[23] Maniloff, *3 Courts, supra* note 22.

[24] *Id.*

[25] *Id.* (italics added).

A second unprecedented response came from state legislatures who launched wholesale denunciations of the *RLLI*.[26] As of early 2021, about ten states passed legislation or resolutions singling out the *RLLI* with the purpose of downgrading it as a source of persuasive authority.[27] An Ohio statute notes that the *RLLI* "does not constitute the public policy of this state and is not an appropriate subject of notice."[28] Utah's statute explains that the *RLLI* "is not the law or public policy of the state if the statement of law is inconsistent or in conflict with . . . state statutes, state case law; or state-adopted common law."[29] Michigan upped the ante even further by legislating that the *RLLI* cannot be consulted unless the rule found therein is "clearly expressed in a statute of this state, the common law, or case law precedent of this state."[30]

This Article finds these wholesale critiques overblown and unwarranted. The primary error lies with the assumption that liability insurance law—especially the portion dealing with settlement—is a field

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[26] *See, e.g.*, Nicholas Malfitano, *Ohio Lawmakers Send First-of-its-Kind Rejection to Powerful Legal Group*, PA. REC. (Aug. 3, 2018), https://pennrecord.com/stories/511510412-ohio-lawmakers-send-first-of-its-kind-rejection-to-powerful-legal-group ("ALI's Deputy Director Stephanie Middleton confirmed no state had ever passed legislation against a Restatement in its entirety before.").

[27] *See* Masters & Fehling, *supra* note 9, at 142–44 (summarizing the legislative efforts undertaken against the *RLLI* in Ohio, Michigan, Arkansas, North Dakota, Texas, Utah, Kentucky, Indiana, Louisiana, and Oklahoma).

[28] OHIO REV. CODE ANN. § 3901.82 (LexisNexis, LEXIS through 2021-2022 Gen. Assemb.).

[29] UTAH CODE ANN. § 31A-22-205 (LexisNexis 2022). These legislative approaches are particularly ill-suited for smaller states that routinely look to sister states and secondary authority to fill the lacuna in their precedents. For example, North Dakota's statute which maintains that the *RLLI* should not be used "as an authoritative reference regarding interpretation of North Dakota laws, rules, and principles of insurance law." N.D. CENT. CODE § 26.1-02-34 (LEXIS through 2021 Sess.). These statues will most likely impact federal courts tasked with making *Erie* predictions on matters that are not addressed by the relevant states' precedents. Per the leading civil procedure treatise, this is exactly the situation in which courts look to Restatements. *See* 19 CHARLES A. WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE (WRIGHT & MILLER) § 4507 (Westlaw, database updated Apr. 2022).

[30] MICH. COMP. LAWS § 500.3032 (2020). As Masters and Fehling point out, one wonders about Michigan's distinction between "the common law" and "case law precedent of the state." Masters & Fehling, *supra* note 9, at 148–49.

Notably, these legislative efforts have inspired their own countermeasures including a letter by three former Arizona Supreme Court chief justices urging the legislature to oppose an anti-*RLLI* bill. *See id.* at 119 n.7. *See also id.* at 152–53 (discussing the letter).

where the law can simply be found and where "majority rules" are easily identified and restated. Because settlement law reflects an undertheorized amalgamation of contract, tort, agency, and fiduciary principles, it offers a vivid demonstration of the qualities that make the *RLLI* possible, useful, and justified.[31] It is possible because there is sufficient agreement on core doctrines that can be organized into a common framework. It is useful because, though courts have been handling these cases for more than a century, the basic analytical foundations of specialized insurance law rules remain poorly understood and often unarticulated. It is justified because the project locates insurance settlement law within the broader framework of modern contract, tort, and fiduciary law. As Restatements are charged with "determin[ing] what specific rule fits best with the broader body of law and therefore leads to more coherence in the law,"[32] the *RLLI* stands as a considerable achievement.

This Article proceed as follows. Part I shows how despite attempts to characterize the *RLLI* as uniquely ultra vires of the ALI's mandate, the substantive critiques lodged against it are hardly novel and were presaged almost a century earlier in response to the *Restatement (First) of Contracts.* Part II makes a structural argument as to why the common law nature of insurance regulation calls out for the type of doctrinal re-organization enabled by the *RLLI*.

The next Parts turn to the specifics of settlement and bad faith law. Part III traces the evolution of bad faith from its origins in contract law to the present construction that does not easily fit into contract, tort, or agency law. Lastly, Parts IV and V examine the *RLLI*'s efforts to structure the insurer's settlement obligations as substantive insurance law that bears its own conceptual and doctrinal grounding. Though broadly supportive of this approach, I nevertheless offer local critiques of the *RLLI* in places where it has either overstepped its boundary or oversimplified the law where more nuance is warranted. These criticisms, however, are grounded in how courts

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[31] According to the ALI Handbook, restatements are to be "analytical, critical and constructive." AM. L. INST., CAPTURING THE VOICE OF THE AMERICAN LAW INSTITUTE: A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 4 (rev. ed. 2015) [hereinafter ALI HANDBOOK]. The ALI recognizes this, framing establishes a tension between the "impulse to recapitulate the law as it presently exists and the impulse to reformulate it, thereby rendering it clearer and more coherent . . . [even as such moves likely] subtly transform[] it in the process." *Id.*

[32] *Id.* at 5.

actually use Restatements,[33] remain alert to the inherent challenges of restating this area of law, and recognize that the process is more art than science.[34] As such it is qualitatively different from the blunderbuss rejections emerging from governors' mansions, statehouses, and found in some of the legal trade press.

I. THE *RLLI* AND THE RESTATEMENT (FIRST) OF CONTRACTS

Critics of the *RLLI* have long sought to position the project as uniquely violative of the grand tradition of Restatements and ultra vires of the ALI's mandate. Since the inception of the ALI in 1923 however, it has characterized Restatements as being "at once analytical, critical and constructive."[35] Per the ALI, "constructive" means:

> [Restatements] should not be confined to examining and setting forth the law applicable to those situations which have been the subject of court action or statutory regulation, but should also take account of situations not yet discussed by courts or dealt with by legislatures but which are likely to cause litigation in the future.[36]

When faced with uncertainty, Restatements "should make clear what is believed to be the proper rule of law."[37]

Against this background, it is worth recalling how even the *Restatement (First) of Contracts*[38]—the initial Restatement published in

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[33] *See, e.g.*, Williamson v. Guentzel, 584 N.W.2d 20, 24 (Minn. Ct. App. 1998) ("Restatements of the law are persuasive authority only and are not binding unless specifically adopted in Minnesota by statute or case law."). *See also* Maniloff, *Insurers Win, supra* note 21; Maniloff*, 3 Courts, supra* note 22.

[34] *See* ALI HANDBOOK, *supra* note 31, at 6 ("A Restatement consists of an appropriate mix of these four elements, with the relative weighing of these considerations being art and not science."). *See infra* text accompanying note 58 (listing the four main tasks).

[35] WILLIAM D. LEWIS & SAMUEL W. WILLISTON, REPORT OF THE COMMITTEE ON THE ESTABLISHMENT OF PERMANENT ORGANIZATION FOR THE IMPROVEMENT OF THE LAW PROPOSING THE ESTABLISHMENT OF AN AMERICAN LAW INSTITUTE 14 (1923), https://www.ali.org/media/filer_public/c1/9d/c19dd2b2-55fa-4ee7-8664-de8f26cb0a1a/1923-rpt-establishment-of-ali.pdf.

[36] *Id.* at 14–15.

[37] *Id.* at 15.

[38] *See* RESTATEMENT (FIRST) OF CONTS. (AM. L. INST. 1932).

1932 and the oldest of the 'good ole' Restatements Scalia so admired—endured many of the same objections now lodged against the *RLLI*.[39] As far back as the early 1930s, the ALI's detractors maintained that academics centered around the ALI were "inject[ing] their own theories or opinions into a statement of 'the law.'"[40]

Writing in the 1933 volume of the *Columbia Law Review*, Professor Edwin Patterson's review of the *Restatement (First) of Contracts* demonstrates how determining the weight of authority involves far more of a judgment call than simple counting.[41] Patterson further noted how rules that appeared well-settled were, upon investigation, "supported by surprisingly few clear-cut decisions,"[42] and criticized the document for treating the underlying cases "as scaffolding to be torn down as soon as the building is finished."[43]

Though ultimately supportive of the *Restatement (First) of Contracts*, Patterson did not shy away from noting its innovative method of conceptualizing the underlying cases.[44] The approach to remedies could be easily criticized as it was "calculated to obliterate distinctions between law and equity," and thereby extend doctrines known only to equity into actions at law.[45] It likewise treated the question of mutual assent uniformly across all contract types even as many precedents tended to assume different rules

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[39] Justice Scalia had little trouble citing to the RESTATEMENT (FIRST) OF CONTS. and RESTATEMENT (SECOND) OF CONTS. *See, e.g.*, Omnicare, Inc. v. Laborers Dist. Council Constr. Indus. Pension Fund, 575 U.S. 175, 198 (2015) (Scalia, J., concurring) (citing RESTATEMENT OF CONTS. §474(b), cmt. b (1932)); Papago Tribal Util. Auth. v. Fed. Energy Regulatory Comm'n., 723 F.2d 950, 954 (D.C. Cir. 1983) (citing RESTATEMENT OF CONTS. § 554 (1932)); Langley v. Fed. Deposit Ins. Corp., 484 U.S. 86, 91 (1987) (citing RESTATEMENT (SECOND) OF CONTS. § 3 cmt. a (1981)).

[40] Edwin W. Patterson, *The Restatement of the Law of Contracts*, 33 COLUM. L. REV. 397, 401 (1933).

[41] *Id.* at 400 ("Yet [determining the weight of authority] is no mere matter of counting cases; respect for the reasoning of an opinion or for the reputation of the court will be thrown into the scale.").

[42] *Id.* at 401.

[43] *Id.* at 402.

[44] *Id.* at 414–15. *See also id.* at 415 ("The innovations of the Restatement, considered in relation to established precedents, have been arrived at by three methods . . . .").

[45] *Id.* at 412–13.

for different sub-species of contract.[46] Finally, Patterson, like many others, thought the *Restatement (First) of Contracts'* approach to promissory estoppel was novel and based on a decidedly minoritarian view in the then-existing caselaw.[47]

Perhaps of greatest interest to insurance lawyers, however, is the *Restatement (First) of Contracts'* innovation regarding disproportionate forfeiture. This doctrine excuses *A*'s non-performance of a condition where failure of the condition produces dire consequences for *A*, yet has minimal impact on *B*.[48] In the insurance realm, this doctrine most famously undergirds the "notice prejudice rule," which often requires an insurer to cover a claim notwithstanding the insured's failure to meet the notice conditions set forth in the policy, unless the insurer can show it was actually prejudiced by the late notice.[49] According to Patterson, this innovation was based on a constructive reading of cases decided on narrower grounds.[50]

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[46] *Id.* at 406, 409. Duncan Kennedy has noted that one of the primary innovations made by contract theorists in the generation prior to the first Restatement was to shift contract law from an area dominated by different transaction types to generalizable rules of offer and acceptance, interpretation, and remedies that prevail across different contractual settings. *See* DUNCAN KENNEDY, *Preclassical Private Law: The Transformation of Contract*, *in* THE RISE & FALL OF CLASSICAL LEGAL THOUGHT 157, 157–241 (Beard Books 2006).

[47] Patterson, *supra* note 40, at 416. *See generally* H. Mark Stichel, *The Restatements – First, Second, Third . . .*, BALT. BAR LIBR. NEWSL., Summer 2019, at 8, 10, http://www.barlib.org/NewsletterSummer2019.pdf ("Section 90 of the Restatement of Contracts, promissory estoppel, was something that Samuel Willison the Reporter for the project had advocated in his treatise but was not accepted generally by the Courts at that time."). *See also* George J. Thompson, *Some Current Economic and Political Impacts in the Law of Contract*, 26 CORNELL L. Q. 4, 9 (1940) (commentary and critique of § 90); George W. Goble, *Trends in the Theory of Contracts in the United States*, 11 TUL. L. REV. 412, 416 (1937) (same).

[48] *See* RESTATEMENT (FIRST) OF CONTS. § 302 (AM. L. INST. 1932). *See also* Jacob & Youngs, Inc. v. Kent, 129 N.E. 889, 890 (N.Y. 1921) ("[A]n omission, both trivial and innocent, will sometimes be atoned for by allowance of the resulting damage, and will not always be the breach of a condition to be followed by a forfeiture.").

[49] *See* Alcazar v. Hayes, 982 S.W.2d 845, 850 (Tenn. 1998) (quoting Brakeman v. Potomac Ins. Co., 371 A.2d 193 (Pa. 1977)). *See also* RESTATEMENT OF THE L., LIAB. INS. § 35(1) (AM. L. INST. 2019) ("[T]he failure of the insured to satisfy a notice-of-claim condition excuses an insurer from performance of its obligations under a liability insurance policy only if the insurer demonstrates that it was prejudiced by the failure.").

[50] Patterson, *supra* note 40, at 417–18.

Nevertheless, he held that the Reporter's approach offered "a franker rationalization of what some courts are doing *sub rosa*."[51] Once reformatted in *Restatement (First) of Contract*, the doctrine is no longer limited to specific contexts but became a general principle applied across the law of contracts.[52]

Patterson's review reminds that, *pace* Justice Scalia, few *substantive* critiques raised against the *RLLI*'s approach were not already presaged in debates surrounding the very first ALI Restatements. Patterson held that the innovations in the *Restatement (First) of Contracts* relied on: (i) "deliberately choosing to canonize a minority view which the framers deemed more just;" (ii) "abstracting the net result of a line of decisions and discarding their incongruent rationalizations;" and (iii) extending existing rules to new situations by deduction or analysis.[53] While the *RLLI*'s critics use considerably darker and harsher tones than Patterson, his remarks are remarkably similar to the list of substantive criticisms lodged against the *RLLI*.[54]

While the ALI has revised its restating principles over the years, the central triad of "analytical critical and constructive" carries forward into the 2015 edition.[55] The current *ALI Handbook* explains that the Restatement process lives on the inevitable tension between the "impulse to recapitulate the law as it presently exists and the impulse to reformulate it, thereby rendering it clearer and more coherent," notwithstanding that such moves are likely to "subtly transform[] it in the process."[56] When judicial results pull in different directions, Restatements are "not compelled to adhere to . . . 'a preponderating balance of authority' but is instead expected to propose the

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[51] *Id.* at 418.

[52] *See* RESTATEMENT (FIRST) OF CONTS. § 302 (AM. L. INST. 1932). *See also* RESTATEMENT (SECOND) OF CONTS. § 229 (AM. L. INST. 1981).

[53] Patterson, *supra* note 40, at 415.

[54] *See, e.g.*, Schwartz & Appel, *supra* note 44, at 738 ("[T]he 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' . . . ."); *id.* at 752 (arguing the *RLLI* does not represent the full rationale of exceptions to the duty to defend in the cited cases). *See also* Michael Menapace, *Going Beyond the Four Corners to Deny a Defense: A Critique of Section 13(3) of the Restatement of Liability Insurance*, 53 TORT TRIAL & INS. PRAC. L.J. 795, 804 (2018) (arguing the *RLLI* Reporters have underrepresented the full extent of exceptions to the duty to defend).

[55] ALI HANDBOOK, *supra* note 31, at 5.

[56] *Id.* at 4.

better rule and provide the rationale for choosing it."[57] Restatements are therefore understood to take on four main tasks: (i) "ascertain the nature of the majority rule;" (ii) "ascertain trends in the law;" (iii) "determine what specific rule fits best with the broader body of law and therefore leads to more coherence in the law;" and (iv) "ascertain the relative desirability of competing rules."[58] As the ALI emphasizes, balancing this process is an "art and not science."[59]

A more level understanding of both the Restatement process and the structure of American insurance law establishes a more sober framework to assess the *RLLI*. It is fair game to criticize the *RLLI* for adopting a clear minority rule,[60] or for amalgamating several rules to craft a new approach that has little support in the case law.[61] It is also fair to highlight when the *RLLI* favors insureds over insurers, proposes asymmetries in how the law applies to insurers and insureds, fails to take account of how a given rule will impact the day-to-day application of insurance law, or stands on shaky conceptual and analytical footing.[62] By the same token, when imbalances are well-sourced in the underlying caselaw, this criticism is correspondingly less justified.[63]

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[57] *Id.* at 5. This formulation carries forward from the 2005 edition of the ALI handbook. *See* AM. L. INST., CAPTURING THE VOICE OF THE AMERICAN LAW INSTITUTE: A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 5 (2005).

[58] ALI HANDBOOK, *supra* note 31, at 5–6.

[59] *Id.* at 6.

[60] Examples can be found in earlier versions of *RLLI* §§ 9–11 dealing with misrepresentation, and the novel remedial approach to breaches of the duty to defend set forth in preliminary versions of § 19. While previous versions of § 19 would have brought more coherence and symmetry between remedies available for breach of the duty to defend and settlement obligations, the proposal could not be sufficiently anchored in caselaw and was abandoned. *See* Schwartz & Appel, *supra* note 4, at 732–36; Masters & Fehling, *supra* note 9, at 168–80.

[61] To say that such critiques are *fair* does not mean that the *RLLI* is necessarily wrong for going in this direction. Indeed, the ALI Handbook expressly notes that "an Institute Reporter is not compelled to adhere to . . . 'a preponderating balance of authority' but is instead expected to propose the better rule and provide the rationale for choosing it." ALI HANDBOOK, *supra* note 31, at 5. Nevertheless, this move puts the relevant *RLLI* rule in play where it should be subject to the normal set of arguments and debates undertaken by scholars, advocates, and commentators.

[62] *See infra* Part IV.C & Part V.A.

[63] For example, the doctrines of contra proferentem*,* the notice prejudice rule, and attorney fee-shifting in the context of bad faith actions reflects generally settled

More broadly, complaints that the *RLLI* is "creating" or "innovating" insurance law are markedly less compelling when the underlying law remains disparate and undertheorized; when the "majority rule" remains elusive; when central rationales are submerged rather than articulated; when significant issues have not been addressed by the states; when new market practices emerge; or when recent trends point in a different direction than older decisions.[64] As explained in Parts III–V below, these features inhere to the multi-jurisdictional common law system of insurance and are precisely what makes Restatement projects useful.

II. THE STRUCTURE OF AMERICAN INSURANCE LAW AND THE NEED FOR A RESTATEMENT

Before proceeding to the specifics of settlement law in the *RLLI*, we should consider the unusual space that insurance law generally occupies in the American legal landscape. The McCarran-Ferguson Act of 1945 established what has come to be known as "reverse pre-emption," through which federal law directs that insurance is generally left to state law and

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doctrines of insurance law that aid insureds over insurers. While jurisdictions differ regarding the scope and application of these doctrines, they are well sourced in insurance law. *See* Jeffrey E. Thomas, *Contra Proferentem and Ambiguity, in* 1 NEW APPLEMAN ON INSURANCE LAW § 5.02 (Jeffrey E. Thomas & Francis J. Mootz eds., Library ed., LEXIS, database updated through May 2022) ("By 1923, the Court, in *Mutual Life Insurance v. Hurni Packing Co.*, was prepared to say that "[t]he rule is settled that in case of ambiguity that construction of the policy will be adopted which is most favorable to the insured." (citation omitted)). For the notice prejudice rule, see RANDY MANILOFF, JEFFREY STEMPEL & MARGO META, 1 GENERAL LIABILITY INSURANCE COVERAGE § 3.01 (5th ed., LEXIS, database updated through Sept. 2021) ("During the past sixty years, however, the legal landscape has completely shifted, with most states now holding that late notice defeats coverage only if the insurer has been materially prejudiced by untimely notice . . . ."). For attorney's fees, see Robert Kelly, *Costs and Attorney's Fees, in* 12 NEW APPLEMAN ON INSURANCE LAW § 156.07 (Jeffrey E. Thomas & Francis J. Mootz eds., Library ed., LEXIS, database updated through May 2022) ("Most states recognize a 'bad faith' exception to the American Rule, recognizing that the courts have inherent power to impose sanctions in the form of attorney's fees for abusive litigation practices, as where the losing party has acted in bad faith, vexatiously, wantonly, or for oppressive reasons.").

[64] *See, e.g.*, Feinman, *supra* note 6, at 14–18 (noting the complexity in establishing a majority rule and citing scholarly debate about whether given provisions of the *RLLI* adhere to the majority rule).

regulation.[65] The arrangement stands in contrast to otherwise parallel financial service industries such as banking, securities, commodities, and investment management, that are all subject to various forms of federal regulation.[66] Moreover, most practice areas that comprise the expertise of large commercial law firms such as capital markets, bankruptcy, intellectual property, and anti-trust, are regulated under federal authority, and even those matters of commercial and corporate law governed by state law are subject to both formal and informal modes of inter-state coordination and centralization.[67] Insurance, (excluding health insurance), is one of the largest

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[65] 15 U.S.C. §§ 1011–1015.

[66] Major federal banking regulations include: Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended in scattered sections of 12, 15, and 39 U.S.C.). Major securities statutes include: Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15.U.S.C. § 77a et seq.); Securities Exchange Act of 1934, ch. 404, 48 Stat. 881 (codified as amended at 15.U.S.C. § 78a et seq.); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15, 18, 28 and 29 U.S.C.); Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), Pub. L. No. 111-203, 123 Stat. 1376-2223 (codified as amended in scattered sections of 15 U.S.C.). *See generally* 1 LORRAINE MASSARO & ROBERT ZINN, SECURITIES PRACTICE GUIDE § 1.01 (LEXIS, database updated through July 2022). The major statutes on commodity futures include: Commodity Exchange Act, 7 U.S.C. § 1 et seq. (2006); Commodity Futures Trading Commission Act of 1974, Pub. L. No. 96-463, 88 Stat. 1389 (codified in 7 U.S.C. § 4a, and re-codified as 7 U.S.C. § 2). *See generally* 2 ROBERT N. RAPP, BLUE SKY REGULATION § 19.01 (LEXIS, database updated through May 2022). Major federal investment management statutes include: The Investment Company Act of 1940, 15 U.S.C.S. § 80a-1 et seq.; 15.U.S.C. § 77a et seq. (regulating certain sales of investment company securities). S*ee generally* 1 JAMES E. ANDERSON, ROBERT G. BAGNALL & MARIANNE K. SMYTHE, INVESTMENT ADVISORS: LAW AND COMPLIANCE § 1.01 (LEXIS, database updated through May 2022).

[67] The *Uniform Commercial Code* performs this function for commercial law. In corporate law, the influence Delaware state law performs some centralizing functions. *See, e.g.*, Lawrence A. Hamermesh, *The Policy Foundations of Delaware Corporate Law*, 106 COLUM. L. REV. 1749, 1749 (2006) ("It is well known that among the fifty states, Delaware occupies an outsized place in the formation of business entities, particularly publicly held corporations."); *id.* at n.1 (noting more than fifty percent of all U.S. publicly traded companies have their legal home in Delaware); *See* Ronald J. Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329, 350 (2001) ("The aggregated choices of a majority of publicly traded U.S. corporations have resulted in a convergence on the Delaware General Corporation Law as a de facto national corporate law."). By contrast, though large states such as New York, Texas, and California undeniably

industry regulated primarily under state law where states have considerable latitude to craft their own versions of insurance law.

Insurance also stands apart from the foundational common law subjects that are the mainstay of the first-year law student curriculum. Every law student in America is exposed to a body of contract, tort, and property law that has been canonized by successive waves of Restatements, alongside a common scholarly culture amongst academics and between leading treatise writers. Even in areas of intense disagreement, lawyers have a clear sense of where the battle lines are drawn. This is less true of insurance law. Few law students enroll in an insurance course, and in the absence of an accepted canon of cases and concepts, there is less consensus on what "insurance law" is and how its underlying principles ground relevant doctrines.[68]

Finally, in an era of regulation by statute and rulemaking, the ad-hoc, case-driven, common-law process through which insurance law is created is an outlier. The doctrines addressed by the *RLLI* generally obtain their shape from court decisions. Though every state has a reticulated statutory framework of insurance laws and regulations—enforced by an insurance commissioner and compliance department—the law of *insurance coverage litigation* typically is created and managed by courts, and where relevant statutes are read in dialogue with judicially developed doctrines.[69]

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govern more premium dollars, there is less of a sense that these states exert a strong gravitational pull over insurance law generally.

[68] *See, e.g.*, Kenneth S. Abraham, *Four Conceptions of Insurance*, 161 U. PA L. REV. 653, 653 (2013) (insurance may be thought of as a contact, a public utility, a product, and a form of governance); Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WM. & MARY L. REV. 1389 (2007); Feinman, *supra* note 6, at 18 ("[C]oherence of Restatement provisions with the broader body of law is a lofty goal, but the range of potential descriptions of the broader body of law and of insurance law itself render it difficult to achieve.").

[69] *See, e.g.*, CAL. CIV. CODE § 2860 (West, Westlaw through Ch. 16 of 2022 Reg. Sess.) (codifying and clarifying the duties first articulated in San Diego Navy Fed. Credit Union v. Cumis Ins. Soc'y, Inc., 208 Cal. Rptr. 494 (Cal. Ct. App. 1984). *See also* Rancosky v. Wash. Nat'l Ins. Co., 170 A.3d 364, 372–74 (Pa. 2017) (interpreting Pennsylvania's "bad faith statute" in light of surrounding common law principles and judicial developments). Further, while most states maintain a version of the Unfair Claims Settlement Act regulating insurer's settlement duties, only a minority of jurisdictions allow a private right of action for breach of these statutory duties. *See* Victor Schwartz & Christopher Appel, *Common-Sense Construction of Unfair Claims Settlement Statutes: Restoring Good Faith in Bad Faith*, 58 AM. U. L. REV. 1477, 1489–90 (2009). In addition, the statute's core substantive terms

Insurance coverage law is not created through a top-down and rationalized process that emphasizes what issues should be addressed, but through the vagaries of what issues are litigated and appealed. Especially at the state supreme court level, the presence of clear authority on a given issue is not necessarily a function of its significance within the conceptual scheme of insurance law or the legal community's need for guidance but may depend on whether insurance companies "want" a precedent from a given court on a given matter at a particular point in time. There may be considerable gaps in state positive law and these uncertainties are multiplied by the complexities of so-called "*Erie* predictions"[70] whereby federal courts must make non-binding predictions of how state courts would rule.[71] In other domains, Restatements offer a useful corrective to these features. Yet, prior to the *RLLI*, insurance stood as one of the most significant common law fields that had yet to be synthesized and rationalized by a Restatement.

Taken together, four characteristics make the *RLLI* a particularly worthwhile endeavor: (i) the diffuse nature of state-based regulation; (ii) the doctrinal unevenness that inheres to a body of judicially-developed law; (iii) the relative absence of developed academic and scholarly culture to create a unified set of principles; and (iv) the constellation of unique insurance doctrines that are only vaguely understood by those who do not specialize in insurance.

III. THE DOCTRINAL HISTORY OF INSURANCE BAD FAITH[72]

Of all the liability insurance issues covered by the *RLLI*, none is as doctrinally and conceptually difficult as the insurer's settlement obligations. Fair evaluation of the *RLLI* requires both a firm grasp on why this body of law is so difficult to categorize and how it diverges from the general principles of contract law from which it emerged.

This complexity is reflected in the difficulty courts and learned writers have in settling on a name for this area of law. It is referred to, alternatively, as bad faith law, extra-contractual liability, insurer's settlement obligations, insurer's wrongful refusal to settle, the duty to settle, the duty to

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usually obtain their meaning from common law caselaw, such that the specific text of the statute plays a limited role in most coverage litigation. *See id.* at 1489.

[70] Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938).

[71] *See, e.g.*, RESTATEMENT OF THE L., LIAB. INS. § 25 cmt. c (AM. L. INST. 2019). *See also id.* § 21 cmt. a.

[72] I adopt the common nomenclature of "bad faith" when discussing the area generally. When analyzing the *RLLI*'s approach, I distinguish between "settlement law/duties" and "true bad faith." *See infra* Section IV.A.

make reasonable settlement decisions, a failure to settle claim, the excess, and the excess judgment problem.[73]

A. CONTRACT LAW ORIGINS

In the early decades of the twentieth century, general liability insurance policies transitioned from contracts that provided indemnity to insureds who paid damages to third-party claimants, to the modern commercial general liability ("CGL") policies that typically grant insurers both the right and a duty to defend and settle the underlying claim.[74] Bad faith law grows out of the insurance contract granting the insurer exclusive rights to control the defense and settlement, while leaving the insured potentially responsible for at least a portion of the liability arising out of the claim.[75]

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[73] *See* Hilker v. W. Auto. Ins. Co. of Fort Scott, 235 N.W. 413, 414 (Wis. 1931) ("[W]here an injury occurs for which a recovery may be had in a sum exceeding the amount of the insurance, the interest of the insured becomes one of concern to him. At this point a duty on the part of the insurer to the insured arises."); Sukup v. New York, 227 N.E.2d 842, 844 (N.Y. 1967) (referring to "extra-contractual liability" at issue in a bad faith insurance claim); RESTATEMENT OF THE L., LIAB. INS. § 24(2) (AM. L. INST. 2019) ("A reasonable settlement decision is one that would be made by a reasonable insurer that bears the sole financial responsibility for the full amount of the potential judgment."); A.C. Epps & R. Harvey Chappell, Jr., *Insurer's Liability in Excess of Policy Limits: Some Aspects of the Problem*, 44 VA. L. REV. 267, 271 (1958); Leslie L. Roos, *A Note on the Excess Problem*, 350 INS. L. J. 192 (1952); James R. Sutterfield, *Relationships Between Excess and Primary Insurers: The Excess Judgment Problem*, 52 INS. COUNS. J. 638, 640 (1985); Seth M. Hemming, *Insurer's Wrongful Refusal to Settle: A Note on Excess*, 15 LOY. U. L.J. 513 (1984). *See also* Roger C. Henderson, *The Tort of Bad Faith in First-Party Insurance Transactions: Refining the Standard of Culpability and Reformulating the Remedies by Statute*, 26 U. MICH. J.L. REFORM 1, 19–20 (1992) (discussing the origins of bad-faith law and referring to situations of excess verdict). *See generally* William T. Barker & Ronald D. Kent, *Liability Insurance, Policy Limits, and the Development of the Duty to Settle, in* 3 NEW APPLEMAN ON INSURANCE LAW § 23.01 (Jeffrey E. Thomas & Francis J. Mootz eds., Library ed., LEXIS, database updated through May 2022).

[74] *See* Henderson, *supra* note 73, at 19–22. *See also Hilker*, 235 N.W. at 414; G.A. Stowers Furniture Co. v. Am. Indem. Co., 15 S.W.2d 544, 547 (Tex. Comm'n App. 1929, holding approved).

[75] *See Hilker,* 235 N.W. at 414; *G.A. Stowers Furniture Co.,* 15 S.W.2d at 547; Brassil v. Md. Cas. Co., 104 N.E. 622, 624 (N.Y. 1914); Douglas v. U.S. Fid. &

The scenario described in the early caselaw is schematized as follows:

> Driver, who maintains $5,000 of insurance, injures Pedestrian. Liability is quite likely certain, and a reasonable assessment of the damages exceeds $5,000. Driver tenders the claim to Insurer who maintains sole authority to defend and settle the claim. Pedestrian offers to settle all claims against Driver for $4,800, but Insurer refuses and replies with a $1,000 counter-offer. The insured Driver (and perhaps its insurer-funded lawyer) considers $4,800 fair in light of damages and liability and urge Insurer to accept the offer. Insurer refuses and the case proceeds to trial where Pedestrian is awarded $12,000. Insurer presents its $5,000 policy limits, leaving its insured Driver with a $7,000 out of pocket liability.[76]

Courts in the nineteen-teens began allowing insureds to sue their insurers under some circumstances for judgment amounts in excess of policy limits, which came to be known as "excess verdict" claims.[77] Early caselaw grounded this type of claim in the implied covenant of good faith and fair dealing that applies to all contractual relationships. Just as a contract granting the buyer sole discretion to decide whether the goods are conforming requires discretion to be employed in good faith,[78] an insurance contract granting the insurer discretion to settle the claim also imposes an obligation to do so in good faith. Insurers that unreasonably—or in bad faith—refuse a settlement that would have alleviated the insured from personal liability, breach this duty and may be liable for amounts in excess of policy limits.[79]

Guar. Co., 127 A. 708 (N.H. 1924). *See also* Kent D. Syverud, *The Duty to Settle*, 76 VA. L. REV. 1113, 1116–17 (1990).

[76] 74For similar factual situations, see *Hilker*, 235 N.W. at 414; *G.A. Stowers Furniture Co.*, 15 S.W.2d at 544.

[77] *See, e.g.*, *Brassil*, 104 N.E. at 624; *Douglas*, 127 A. at 712.

[78] *See generally* Balt. & Ohio R.R. Co. v. Brydon, 9 A. 126 (Md. 1886).

[79] *See generally* William T. Barker & Ronald D. Kent, *Insurer Has Duty to Make Reasonable Settlements, in* 3 NEW APPLEMAN ON INSURANCE § 23.02 (Jeffrey E. Thomas & Francis J. Mootz eds., Library ed., LEXIS, database updated through May 2022) (summarizing the history and general principles of excess verdict claims).

Though central to modern insurance coverage law, the absence of any policy language detailing this obligation[80] has long generated confusion as to the nature and scope of the duty.[81] Since the duty is sourced in the parties' requirements of good faith, its breach is often framed as "bad faith," which is sometimes interpreted as requiring dishonesty or even subjective ill-will towards the insured.[82] Other courts look to tort law and require insurers to display reasonably prudent behavior in making settlement decisions, while others frame the matter in fiduciary terms and obligate insurers to give due regard to the interest of their insureds.[83]

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[80] *See* Leo P. Martinez, *The Restatement of the Law of Liability Insurance and the Duty to Settle*, 68 RUTGERS U. L. REV. 155, 160 n.26 (2015) (citing sources).

[81] *See Hilker,* 235 N.W. at 414 (motion for rehearing granted due to "confusion with reference to the character of the duty which an indemnity insurance company owed to its insured in the matter of making a settlement," and noting there are "two lines of authority, one of which holds that the indemnity company is liable for negligent conduct, while the other holds that it is liable only when its conduct or lack of conduct amounts to bad faith."). *See also* Farmers Ins. Exch. v. Henderson, 313 P.2d 404, 406 (Ariz. 1957) (noting that "[t]he principal difficulty experienced by the courts has been in fixing a test for the degree of consideration the insurer must give the insured's interests . . . ." While some courts allow the insurer to give "paramount consideration to its interests," others demand that "paramount consideration must be given to protect the insured," while a "third position is that the insurer must give equal thought to the end that both the insured and the insurer shall be protected." The court concluded that while "enunciation of the rule is not difficult but its application is troublesome.").

[82] *See, e.g.*, *Bad faith*, BLACK'S LAW DICTIONARY 139 (6th ed. 1990):

> *Insurance.* 'Bad faith' on part of insurer is any frivolous or unfounded refusal to pay proceeds of a policy; it is not necessary that such refusal be fraudulent. For purposes of an action against an insurer for failure to pay a claim, such conduct imports a dishonest purpose and means a breach of a known duty (*i.e.,* good faith and fair dealing), through *some motive of self-interest or ill will*; mere negligence or bad judgment is not bad faith (emphasis added).

See also infra note 120 and accompanying text.

[83] *See, e.g.*, *Hilker*, 235 N.W. at 414–15. *See also* Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1138–41 (1954) (collecting cases from 1930s, 40s, and 50s); Douglas R. Richmond, *Bad Insurance Bad Faith Law,* 39 TORT TRIAL & INS. PRAC. L.J. 1, 22 n.129 (2003) (citing numerous sources characterizing the relationship of insurer and insured as "fiduciary").

Writing in a 1954 *Harvard Law Review* article, *Liability Insurance and Responsibility for Settlement*, still foundational to the field, Professor (later Judge) Robert Keeton framed the duty in terms of the potential conflicts that inhere to the settlement context.[84] When the settlement offer is at or near policy limits, the insurer has a strong incentive to reject the settlement and try its luck in court.[85] To the insurer, settlement requires payment at or near limits immediately, while trial affords the possibility of a defense verdict or at least considerable delay in paying the claim. The insurer may thus be tempted to gamble with the insured's money because "heads" (defense verdict) results in a win for the insurer, while "tails" (above limits recovery) is a loss that redounds to the insured alone.[86] Keeton drew on agency and fiduciary concepts to correct these misaligned incentives, arguing that insurer must give "equal consideration" to its interests and the insured's.[87] This became operationalized as the "disregard the limits rule," which requires an insurer to assess the claim against its insured as if the insurance carrier maintained sole financial responsibility for the entirety of the claim—notwithstanding the reality of policy limits.[88]

Keeton's article was soon cited by courts across the country,[89] including a series of California decisions credited with catapulting these

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[84] Keeton, *supra* note 83, at 1136–37.

[85] *Id.* at 1136 ("This simple fact situation and variants upon it present problems of great difficulty because of the conflicting interests which one party or another must represent.").

[86] *See id.* at 1138 (discussing the insurer's incentives). *See also, e.g.*, Clearwater v. State Farm Mut. Auto. Ins. Co., 792 P.2d 719, 723 (Ariz. 1990) (reviewing the unique nature of a third-party claim and the risks to the policyholder that arise under such circumstances).

[87] *See* Keeton, *supra* note 83, at 1146 ("The equality referred to is not equal weight in determination of the choice, but equality in consideration—that is, consideration of each portion of the total risk without regard to who is bearing that portion of the risk."). Though the standard draws on fiduciary principles, it does not generally transform the insurer into a full-fledged fiduciary of its insured. *See* Richmond, *supra* note 83, at 25.

[88] Keeton, *supra* note 83, at 1146–48. *See also* Jeffrey E. Thomas, *The Standard for Breach of a Liability Insurer's Duty to Make Reasonable Settlement Decisions: Exploring the Alternatives*, 68 RUTGERS U. L. REV. 229, 235–57 (2015) [hereinafter Thomas, *Exploring the Alternatives*] (critiquing the *RLLI* for conflating the two standards and offering an account of the potential difference between the equal consideration doctrine and the disregard the limits rule).

[89] In the twenty years following its publication, the article was cited in by the Supreme Courts of California, Hawaii, Iowa, Kansas, Maryland, Minnesota,

claims to the mainstream. Reaching back to language first articulated by a New York court in 1914, the California Supreme Court of the mid-century explained that "the rights of the insured 'go deeper than the mere surface of the [written] contract . . .' and that implied obligations are imposed 'based upon those principles of fair dealing which enter into every contract.'"[90] The court remained cagey however, regarding the source of this duty. Pressed whether it sounded in contract or tort law, the California Supreme Court demurred, holding it could be either. [91]

Missouri, New Hampshire, New Jersey, Pennsylvania, Rhode Island, South Dakota, Tennessee, Utah, and Washington, and in the Second, Third, Fifth, Eighth, Ninth, Tenth, and D.C. Circuits, alongside numerous lower state and federal courts. *See, e.g.*, Tomerlin v. Canadian Indem. Co., 394 P.2d 571, 577 (Cal. 1964); Olokele Sugar Co. v. McCabe, Hamilton & Renny Co., 487 P.2d 769, 770 (Haw. 1971); Kooyman v. Farm Bureau Mut. Ins. Co., 315 N.W.2d 30, 33, 35 (Iowa 1982); Associated Wholesale Grocers, Inc. v. Americold Corp., 934 P.2d 65, 90 (Kan. 1997); Bean v. Allstate Ins. Co., 403 A.2d 793, 795 (Md. 1979); Bratnober v. Rowell, Inc., 123 N.W.2d 916, 921 (Minn. 1963); Linder v. Hawkeye-Sec. Ins. Co., 472 S.W.2d 412, 414 (Mo. 1971); Dumas v. State Farm Mut. Auto. Ins. Co., 274 A.2d 781, 783 (N.H. 1971); Lieberman v. Emps. Ins. of Wausau, 419 A.2d 417, 423 (N.J. 1980); Cowden v. Aetna Cas. Sur. Co., 134 A.2d 223, 227 (Pa. 1957); Emp.'s Fire Ins. Co. v. Beals, 240 A.2d 397, 404 (R.I. 1968); Helmbolt v. LeMars Mut. Ins. Co., 404 N.W.2d 55, 57 (S.D. 1987); Dillingham v. Tri-State Ins. Co., 381 S.W.2d 914, 916–17 (Tenn. 1964); Ammerman v. Farmers Ins. Exch., 450 P.2d 460, 462 (Utah 1969); Murray v. Mossman, 355 P.2d 985, 988 (Wash. 1960); Bourget v. Gov't Emps. Ins. Co., 456 F.2d 282, 284 (2nd Cir. 1972); Keystone Shipping Co. v. Home Ins. Co., 840 F.2d 181, 186 (3rd Cir. 1988); Seguros Tepeyac, S.A., Compania Mexicana de Seguros Generales v. Jernigan, 410 F.2d 718, 725 (5th Cir. 1969); Riske v. Truck Ins. Exch., 490 F.2d 1079, 1082 (8th Cir. 1974); State Farm Mut. Auto. Ins. Co. v. Brewer, 406 F.2d 610, 612 (9th Cir. 1968); Magnum Foods, Inc. v. Cont'l Cas. Co., 36 F.3d 1491, 1504 (10th Cir. 1994); Lesmark, Inc. v. Pryce, 334 F.2d 942, 945 (D.C. Cir. 1964); Tyler v. Grange Ins. Ass'n, 473 P.2d 193, 199 (Wash. Ct. App. 1970); Emps. Ins. of Wausau v. Albert D. Seeno Const. Co., 692 F. Supp. 1150, 1159 (N.D. Cal. 1988).

[90] Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 200–01 (Cal. 1958) (quoting Hilker v. W. Auto. Ins. Co. of Fort Scott, 231 N.W. 257, 258 (Wis. 1931) (quoting Brassil v. Md. Cas. Co., 104 N.E. 622, 642 (N.Y. 1914))).

[91]*Comunale*, 328 P.2d at 203 ("Although a wrongful refusal to settle has generally been treated as a tort, it is the rule that where a case sounds both in contract and tort the plaintiff will ordinarily have freedom of election between an action of tort and one of contract." (citations omitted)).

B. BAD FAITH IN GENERAL CONTRACT LAW

Keeton's mid-century championing of bad faith liability coincided with broader trends in general contract law. Though it has earlier antecedents,[92] the doctrine of good faith entered mainstream American contract law in the same era as it was incorporated into the *Uniform Commercial Code* ("*UCC*") and *Restatement (Second) of Contracts*.[93] This period was also the heyday of the non (or anti-) textualist approaches to contract law. Doctrines such as unconscionability were on the rise and the more formalist concepts of parol evidence and plain meaning gave way to contextualist ideas such as usage of trade and course of dealing that were canonized in the *UCC*.

Since the 1980s, good faith doctrine has come under extensive critique by neo-formalist judges and theorists, and the fate of good faith in insurance and general contract law have diverged.[94] Per the neo-formalist view, legal obligations can only be created through express contractual language[95] and do not arise from amorphous principles or implied covenants of good faith.[96]

The assault on good faith was led by the most respected voices in the legal establishment. Sitting on the D.C. Circuit, then-Judge Antonin Scalia explained how a rigorous textualist would "virtually . . . read the doctrine of good faith . . . out of existence."[97] Judge Frank Easterbrook

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[92] *See*, *e.g.*, Kirke La Shelle Co. v. Paul Armstrong Co., 188 N.E. 163, 168 (N.Y. 1933). *See also* Robert H. Jerry, II, *The Wrong Side of the Mountain: A Comment on Bad Faith's Unnatural History*, 72 TEX. L. REV. 1317, 1319 (1994) (detailing the "ancestral heritage" of good faith law).

[93] *See, e.g.*, Dennis M. Patterson, *Good Faith, Lender Liability, and Discretionary Acceleration: Of Llewellyn, Wittgenstein, and the Uniform Commercial Code*, 68 TEX. L. REV. 169 (1989); Zipporah B. Wiseman, *The Limits of Vision: Karl Llewellyn and the Merchant Rules*, 100 HARV. L. REV. 465 (1987).

[94] *See, e.g.*, Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541 (2003); Alan Schwartz & Robert E. Scott, *The Common Law of Contract and the Default Rule Project,* 102 VA. L. REV. 1523 (2016).

[95] *See, e.g.*, David Charny, *The New Formalism in Contract*, 66 U. CHI. L. REV. 842, 849 (1999); John E. Murray, Jr., *Contract Theories and the Rise of Neoformalism,* 71 FORDHAM L. REV. 869, 889 (2002); Ralph J. Mooney, *The New Conceptualism in Contract Law*, 74 OR. L. REV. 1131 (1995).

[96] *See generally* 11 CORBIN ON CONTRACTS § 59.2 (John E. Murray, Jr. ed. Rev. ed., LEXIS, database updated through Nov. 2021) (noting damages for breach of the duty of good faith are rare).

[97] Tymshare, Inc. v. Covell, 727 F.2d 1145, 1153–54 (D.C. Cir. 1984).

similarly held that parties are entitled to enforce the written agreement "to the letter, even to the great discomfort of their trading partners, without being mulcted for lack of 'good faith.'"[98] Easterbrook explained how the implied covenant "is not an invitation to the court to decide whether one party ought to have exercised privileges expressly reserved in the document."[99] This is because contract law does not require the parties to act as each other's fiduciaries. A gap between party expectation and the outcome under the contract "does not imply a general duty of 'kindness' in performance" or assessment of "whether a party had 'good cause' to act as it did."[100] Easterbrook's judicial and law-faculty colleague, Judge Richard Posner, sounded similar notes, explaining that "[t]here is no blanket duty of good faith" since "[c]ontract law does not require parties to behave altruistically toward each other . . . ."[101] More recently, a unanimous United States Supreme Court joined in on maligning the doctrine of good faith, affirmatively quoting a scholarly assessment which found "it does not appear that there is any uniform understanding of the [good faith] doctrine's precise meaning," and that "[t]he concept of good faith in the performance of contracts is a phrase without general meaning (or meanings) of its own."[102]

These views have often prevailed. For example, Montana courts in the 1970s awarded enhanced damages for bad faith breaches in diverse settings beyond insurance, such as employment, lending, legal services, franchise agreements, and other ostensibly arms-length commercial settings.[103] In the 1990s, Montana reversed course and now limits such damages to a narrow set of exceptional circumstances.[104] California law tells a similar story. Along with their expansion of insurance bad faith, mid-century California courts recognized extra-contractual damages for bad faith

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[98] Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1357 (7th Cir. 1990).

[99] *Id.*

[100] *Id.* at 1357.

[101] Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 280 (7th Cir. 1992).

[102] Nw., Inc. v. Ginsburg, 572 U.S. 273, 285 (2014) (internal quotation marks omitted) (quoting *Tymshare, Inc.*, 727 F.2d at 1152 (quoting Robert S. Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 201 (1968))).

[103] *See, e.g.*, Story v. City of Bozeman, 791 P.2d 767, 773–75 (Mont. 1990) (detailing Montana's history of the doctrine of good faith).

[104] *Id.* at 776–77 (adopting the *UCC* approach to bad faith, insisting the tort should only be applied in situations where the parties have a special relationship).

breach of employment and in other commercial contracts.[105] Since the 1990s, California courts' decisions have expressly limited such damages to insurance.[106] Contemporary treatises are at pains to emphasize the limited scope of the principle noting that good faith obligations have been curtailed from earlier high water marks.[107] This shift is alternately celebrated, noted with detached neutrality,[108] or bemoaned,[109] but few doubt the shrinking or "underenforced"[110] nature of the doctrine.

This narrow conception of good faith has even worked its way into the *UCC*, the source most responsible for mainstreaming the concept into American law.[111] Amendments from the 1990s explain how the *UCC* "does not support an independent cause of action for failure to perform . . . in good

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[105] Cleary v. Am. Airlines, Inc., 168 Cal. Rptr. 722, 727–30 (Cal. Ct. App. 1980) (noting plaintiff may have a cause of action in both contract and tort for wrongful discharge), *overruled in part by* Guz v. Bechtel Nat'l Inc., 8 P.3d 1089 (Cal. 2000); Tameny v. Atl. Richfield Co., 610 P.2d 1330, 1334–35 (Cal. 1980) (under particular circumstances, employee has a cause of action in tort against the employer).

[106] *See* Freeman & Mills, Inc. v. Belcher Oil Co., 900 P.2d 669, 674–75 (Cal. 1995) (limiting damages under a breach of contract claim). *See generally* 6 CORBIN ON CONTRACTS § 26.10 (John E. Murray, Jr. ed. Rev. ed., LEXIS, database updated through Nov. 2021); E. ALLEN FARNSWORTH, ET AL., CONTRACTS: CASES AND MATERIALS 34 (9th ed. 2019).

[107] *See, e.g.*, 6 CORBIN ON CONTRACTS § 26.11 (John E. Murray, Jr. ed. Rev. ed., LEXIS, database updated through Nov. 2021) ("Like bad faith breach of contract, the related area of lender liability has a spectacular beginning, but seems to have lost its steam."); *id.* § 26.10 ("While many states allow a tort action for bad faith breach against insurance companies, few allow it generally." (citation omitted)); *id.* §26.5. *See also* Paul MacMahon, *Good Faith and Fair Dealing as an Underenforced Legal Norm*, 99 MINN. L. REV. 2051, 2052–53 (2015) ("The caselaw [on good faith] is replete with judges expressing the need for caution . . . ."); *id. at* n.11. *See generally* 2 E. ALLEN FARNSWORTH, FARNSWORTH ON CONTRACTS §7.17b, at 394 (3d. ed. 2004).

[108] *See* Harold Dubroff, *The Implied Covenant of Good Faith in Contract Interpretation and Gap-Filling: Reviling a Revered Relic*, 80 ST. JOHN'S L. REV. 559, 562 (2006); Edward J. Imwinkelried, *The Implied Obligation of Good Faith in Contract Law: Is it Time to Write its Obituary?*, 42 TEX. TECH. L. REV. 1, 10–12, 21 (2009).

[109] *See* Emily M.S. Houh, *Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1029 (2003); Jay M. Feinman, *Good Faith and Reasonable Expectations*, 67 ARK. L. REV. 525, 525–26 (2014).

[110] MacMahon, *supra* note 107, at 2051–52.

[111]93 *See generally* Patterson, *supra* note 94; Wiseman, *supra* note 94.

faith."[112] The commentary explains these revisions were designed to clarify that good faith "does not create a separate duty of fairness and reasonableness which can be independently breached."[113]

The doctrinal implications of neo-formalist good faith law are neatly captured in the four limiting principles articulated by the Supreme Court of Utah:

- First, this covenant [of good faith] cannot be read to establish new, independent rights or duties to which the parties did not agree ex ante.
- Second, this covenant cannot create rights and duties inconsistent with express contractual terms.
- Third, this covenant cannot compel a contractual party to exercise a contractual right "to its own detriment for the purpose of benefitting another party to the contract."
- Finally, we will not use this covenant to achieve an outcome in harmony with the court's sense of justice but inconsistent with the express terms of the applicable contract.[114]

Read even against the most pro-insurer expressions of blackletter insurance law, these standards reveal a vast gulf in the fortunes of good faith in the different settings. Standard liability policies not only fail to contain express language detailing the insurer's settlement obligations, but the provisions that do exist generally undercut them. The insuring clause of the standard CGL coverage form assigns all discretion to the insurer, who "may, at [insurer's] discretion, investigate any 'occurrence' and settle any claim or 'suit' that may result."[115] The insurer's sole discretion is reinforced through the "no action" and "voluntary payment" clauses that expressly prevent insureds from settling a claim without the insurer's consent.[116]

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[112] U.C.C. § 1-103 cmt. 1 (AM. L. INST. & UNIF. L. COMM'N, Approval Draft for the Revision of Uniform Commercial Code Article 1- General Provisions, 2001). *See also id.* § 1-201(19) (documenting changes in definition of good faith).

[113] *Id.* § 1-103 cmt. 1.

[114] Oakwood Vill. LLC v. Albertsons, Inc., 104 P.3d 1226, 1240 (Utah 2004) (citations omitted) (presented in bullet form for emphasis and ease of reference).

[115] INS. SERVS. OFFICE INC., COMMERCIAL GENERAL LIABILITY FORM (CG 00 01 04 13) 1 (2012), https://www.techriskreport.com/wp-content/uploads/sites/26/2019/05/2012-CGL.pdf.

[116] *Id.* at 11.

Notwithstanding decades of caselaw imposing heightened duties on insurers that extend beyond the express terms of the policy, insurance policies remain unchanged. The net result is almost every aspect of insurance settlement law contrasts with the oft-cited proposition that an action for beach of the implied duty of good faith "cannot be maintained (a) in derogation of the express terms of the underlying contract or (b) in the absence of breach of an express term of the underlying contract."[117]

The divergence between insurance and contract law conceptions goes even deeper. This is because from a neo-formalist perspective, insurance settlement offers a particularly *weak* case for implying rigorous good faith obligations. To the extent theorists such as Posner and Easterbrook see *any* justification for implying obligations by law, it is when the issue was "not resolved explicitly by the parties" because it "*could not have been contemplated at the time of drafting*."[118] By contrast, the conflicts surrounding settlement frequently recur and are well-known to all sophisticated players in the insurance arena. Under the dominant contract law paradigm, unless an insured expressly contracts for the insurer's settlement duties, it should be estopped from seeking those rights via implied covenants.[119] Since the insurance policies remain unchanged, however, courts in the insurance setting have wrought expansive obligations out of the implied covenant of good faith.[120]

[117] Burger King Corp. v. Weaver, 169 F.3d 1310, 1317–18 (11th Cir. 1999) (applying Florida law). The case is cited more than 130 times under the relevant Westlaw headnote.

[118] Indus. Representatives, Inc. v. CP Clare Corp., 74 F.3d 128, 130 (7th Cir. 1996) (Easterbrook, J.) (citing Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting, 908 F.2d 1351, 1357 (7th Cir. 1990) (Easterbrook, J.)) (internal quotation marks omitted) (emphasis added).

[119] Indeed, some policies either assign the settlement rights to the insured or give the insured a veto over the insurer's settlement. *See* Dan A. Bailey & Timothy W. Burns, *The Insuring Clauses, in* 4 NEW APPLEMAN ON INSURANCE LAW § 26.05[4] (Jeffrey E. Thomas & Francis J. Mootz eds., Library ed., LEXIS, database updated through May 2022) (describing defense cost reimbursement policies). *See generally* Tom Baker & Sean J. Griffith, *The Missing Monitor in Corporate Governance: The Directors' & Officers' Liability Insurer*, 95 GEO. L.J. 1795 (2007) (reporting empirical evidence on the settlement tendencies of D&O insurers).

[120] Notably, while Judges Posner and Easterbrook have led the charge against expansive good faith duties in general contact law; few of these sensibilities are imported into their insurance law holdings. Whether theorized or not, these judges seem to understand that insurance bad faith is simply a different species from general contract law. *See* Lockwood Int'l, B.V. v. Volm Bag Co., 273 F.3d 741 (7th Cir.

C. EXPANSION OF INSURANCE BAD FAITH

While the general contract law concept of bad faith was shrinking, the trend in insurance law moved in the opposite direction. Initially limited to the settlement context, courts expanded it to other insurance paradigms. A 1967 California case known as *Crisci* not only found the insurer liable for failing to reasonably settle the underlying claim,[121] but allowed the policyholder to claim damages for the resulting *mental anguish* caused by liquidating its assets to satisfy the excess verdict.[122] This was justified by holding that insurance is not simply a contract to "obtain commercial advantage" but designed for "the peace of mind and security" upon loss which warranted recovery when the insurer harmed the "comfort, happiness or personal esteem" of its policyholder.[123]

This holding paved the way for subsequent cases to migrate bad faith from third to first-party settings. As a 1973 holding by California court explained:

> In [third-party] cases, we considered the duty of the insurer to act in good faith and fairly in handling the claims of third persons against the insured, described as a "duty to accept reasonable settlements"; in the case before us we consider the duty of an insurer to act in good faith and fairly in handling the claim of an insured, namely a duty not to withhold unreasonably payments due under a policy. *These are merely two different aspects of the same duty.*[124]

2001) (Posner, J.) (holding that insurer breached duty of good faith owed to its insured by paying plaintiff to replead covered claims as uncovered claims); R.C. Wegman Const. Co. v. Admiral Ins. Co., 629 F.3d 724 (7th Cir. 2011) (Posner, J.) (holding that insurer breached duty of good faith by not advising the potential of excess judgement); Transp. Ins. Co. v. Post Exp. Co., 138 F.3d 1189, 1192–93 (7th Cir. 1998) (Easterbrook, J.); Pistas v. New Eng. Mut. Life Ins. Co., 843 F.2d 1038 (7th Cir. 1988) (Easterbrook, J.).

121 Crisci v. Sec. Ins. Co. of New Haven, 426 P.2d 173 (Cal. 1967).

122 *Id.* at 178 (analyzing the plaintiff's claim for mental distress damages).

123 *Id.* at 179. Similar approaches are found in Noble v. Nat'l Am. Life Ins. Co., 624 P.2d 866, 867–68 (Ariz. 1981) (en banc) and State Farm Fire & Cas. Co. v. Nicholson, 777. P.2d 1152, 1155 (Alaska 1989).

124 Gruenberg v. Aetna Ins. Co., 510 P.2d 1032, 1037 (Cal. 1973) (emphasis added).

This shift necessitated a change in the underlying theory. No longer centered on Keeton's conflicts of interest paradigm, insurance bad faith came to include more generic forms of insurer misconduct defined by the insurer's failure to employ reasonable diligence in determining the nature and extent of its liability. Other jurisdictions followed California's lead.[125]

This doctrinal background helps contextualize the confusion surrounding bad faith law. For nearly a century, courts have noted the muddled avalanche of standards articulated under the broad heading of "insurance bad faith."[126] As far back as 1931, the Wisconsin Supreme Court expressly set out to clarify the "confusion with reference to the character of the duty which an indemnity insurance company owed to its insured in the matter of making a settlement."[127] The court found "two lines of authority, one of which holds that the indemnity company is liable for negligent conduct, while the other holds that it is liable only when its conduct or lack of conduct amounts to bad faith."[128] Despite this apparently clear distinction, the court found that "consideration of the authorities leads us to believe that

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[125] *See* Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 375 (Wis. 1978) (citing *Gruenberg* and stating: "It is manifest that a common legal principle underlies all of the foregoing decisions; namely, that in every insurance contract there is an implied covenant of good faith and fair dealing. The duty to so act is imminent in the contract whether the company is attending to the claims of third persons against the insured or the claims of the insured itself. Accordingly, when the insurer unreasonably and in bad faith withholds payment of the claim of its insured, it is subject to liability in tort."). *See also* Rancosky v. Wash. Nat'l Ins. Co., 170 A.3d 364, 372 (Pa. 2017) ("Of particular importance in the development of the law in this area, the Supreme Court of Wisconsin, after expressly adopting the *Gruenberg* right of action for bad faith . . . .").

[126] *See, e.g.,* Keeton, *supra* note 83, at 1139–40 (noting inconsistency in what is required to show bad faith breach by insurer); *id.* at 1139 n.6 ("There has been a variety of opinions as to the weight of authority regarding the choice between the 'negligence rule' and some form of the 'bad faith rule.' A conclusive answer as to a classification of the jurisdictions or as to a trend toward one or the other rule is impossible because so many of the opinions . . . do not conclusively select between the rules." (citations omitted)); Martinez, *supra* note 80, at 160 ("The boundaries of the duty to settle can be best described as inexact. Despite the well-settled nature of the duty, the duty is neither articulated in policy language nor addressed in any state statute."); Syverud, *supra* note 75, at 1122 ("[T]he insurance company is liable only if its behavior in failing to settle departs from some norm by a margin a jury can fairly label 'negligent,' 'bad faith' . . . or some combination of the two. Both the norm and the margin for error have been the subject of disagreement among the courts." (footnotes omitted)).

[127] Hilker v. W. Auto. Ins. Co. of Fort Scott, 235 N.W. 414, 414 (Wis. 1931).

[128] *Id.*

what confusion there is on the part of courts is purely tautological, and springs from a none too critical use of terms."[129]

In the ensuing years, bad faith has come to cover a wide range of allegations of insurance companies' malice or obduracy that extend far beyond the initial settlement conflict of interest paradigm.[130] These include defects in claims processing and mismanagement, poor lawyering by defense counsel, poor selection of defense counsel by the insurer, inadequate investigation, inadequate communication with the insured, improper focus on coverage defenses at the expense of defending the underlying claim, and more general failures to understand the law, the facts, or both.[131]

The introduction of first-party claims only compounded the underlying uncertainty, since at least some courts demand more significant showings of malice or ill-will for the first-party action to lie.[132] In addition, scholars note that courts often claim to apply one standard while actually applying another, or show little regard for what standard is, in fact, being

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[129] *Id.*

[130] ROBERT H. JERRY, II. & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW §112[b][1] (6th ed. 2018).

[131] *See* Thomas, *Exploring the Alternatives*, *supra* note 88, at 257–82; Kenneth S. Abraham, *The Natural History of Insurers Liability for Bad Faith*, 72 TEX. L. REV. 1295 (1994); Richmond, *supra* note 83, at 5; Martinez, *supra* note 80, at 166–70; JERRY & RICHMOND, *supra* note 130, §112[a]–[c]. *See also* RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. a (AM. L. INST. 2019); *id.* § 24 reporters' note to cmt. a.

[132] *See* RANDY J. MANILOFF & JEFFREY W. STEMPEL, GENERAL LIABILITY INSURANCE COVERAGE: KEY ISSUES IN EVERY STATE, 690–92 (4th. ed. 2018). *See also* Rancosky v. W. Nat'l Ins. Co., 170 A.3d 364, 373–76 (Pa. 2017) (analyzing whether subjective ill-will is a necessary component to make out a bad faith claim). *See generally* Martinez, *supra* note 80, at 160–70; Thomas, *Exploring the Alternatives*, *supra* note 88, at 257–82 (conducting a multi-state survey and noting the difficulties in identifying the standard courts actually apply). *See also id.* at 297–319 (analyzing the complexities in determining the correct standard based on analysis of leading cases from many states); Jeffrey E. Thomas, *Extra-Contractual Liability in the Restatement of the Law, Liability Insurance: Breach of the Duty to Settle or Bad Faith?*, 12–15 (May 17, 2017) (manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2970232 [hereinafter Thomas, *Extra-Contractual Liability*].

applied.[133] Learned writers even disagree about how many standards are found in the caselaw.[134]

The rules that surround insurance settlement thus occupy a space where restating its principles is both possible and desirable. On the one hand, nearly all jurisdictions recognize that insurers owe some duty to insureds when making settlement decisions.[135] Yet, the further one digs underneath this basic premise, the less certain the law becomes. One can easily generate an impressive string cite of cases holding that only reckless disregard, ill-will, and other indicia of classic bad faith sustain findings of extra-

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[133] *See* Thomas, *Exploring the Alternatives*, *supra* note 88, at 257–82, 280–81 (surveying duty to settle standards across numerous jurisdictions and noting that "[c]ourts often make statements in dicta or for rhetorical purposes without those statements having much bearing on the outcome of the case. Sometimes those statements are picked up by later cases and become the law, but sometimes those statements are ignored and have no precedential impact."). For more on the multiplicity of standards and tests for the duty to settle, see those set forth in 1 WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION §2.03[2] (2d ed., LEXIS, database update through Nov. 2021) [hereinafter NEW APPLEMAN INSURANCE BAD FAITH LITIGATION]. *See also* 14A STEVEN PLITT, DANIEL MALDONADO, JOSHUA D. ROGERS & JORDAN R. PLITT, COUCH ON INSURANCE §203:25 (3d ed., Westlaw, database updated through Dec. 2021) [hereinafter COUCH ON INSURANCE] (noting that whether framed as bad faith or negligence, courts tend to ask, "whether a prudent insurer without policy limits would have accepted the settlement offer."). Again, this issue stems back many decades. *See* Keeton, *supra* note 83, at 140, 1139–45 ("The distinction between the 'bad faith rule' and the 'negligence rule' is less marked than these terms would suggest.").

[134] For example, while the *RLLI* assumes the 'disregard the limits' rule is a subset of the equal consideration doctrine, Professor Thomas argues that equal consideration is more solicitous to the insured than a "pure" disregard the limits rule. Thomas, *Exploring the Alternatives*, *supra* note 88, at 257–82, 287. Thomas considers the latter approach the majority or near majority rule. *Id.* at 289–90.

[135] *See* Besel v. Viking Ins. Co. of Wis., 49 P.3d 887, 890 (Wash. 2002) (en banc) (deciding extra contractual liability for settlement breaches is the "majority rule in the United States."). *See also* Ellen S. Pryor & Charles Silver, *Defense Lawyers' Professional Responsibilities: Part I—Excess Exposure Cases*, 78 TEX. L. REV. 599, 656–57 (2000) ("[A]ll jurisdictions require carriers to make reasonable settlement decisions . . . ."); 16 RICHARD A. LORD, WILLISTON ON CONTRACTS §49:107 (4th ed., Westlaw, database updated through Nov. 2021) ("Most courts require that an insurer act reasonably when deciding whether to settle a claim . . . .").

contractual liability.[136] But one can also construct an equally impressive string cite showing that lack of reasonableness—operationalized as a failure to give equal consideration or a failure to disregard the limits in making settlement decisions—generates liability.[137] Some writers maintain the ground has shifted to a degree that older precedents no longer reliably predict how modern courts might rule,[138] and nearly every scholar and treatise-writer studying the issue has concluded that courts employ a plethora of standards where similar words and concepts take on different and inconsistent meanings.[139] Rather than support a claim that the *RLLI* deviates from settled rules to create aspirational insurance law,[140] this cacophony demonstrates precisely why the *RLLI*'s re-conceptualization is needed.

IV. *RLLI'S* APPROACH TO SETTLEMENT LAW

A. SETTLEMENT LAW AS SUBSTANTIVE INSURANCE LAW

The doctrinal and conceptual uncertainties of bad faith law coupled with the gap between how good faith operates in contract law versus insurance law sets the stage for the most "constructive" act in the *RLLI*:[141] decoupling settlement law from its origins in contractual bad faith. By establishing settlement law as a self-standing aspect of substantive insurance

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[136] *See, e.g.*, Richmond, *supra* note 83, at 4 ("We have defined 'bad faith' as dishonest, malicious, or oppressive conduct carried out with a state of mind characterized by hatred, ill will, or a spirit of revenge.") (quoting Colum. Nat'l Ins. Co. v. Freeman, 64 S.W.3d 720, 723 (Ark. 2002)).

[137] *See, e.g.*, 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 2.03; Thomas, *Exploring the Alternatives*, *supra* note 88, at 261 n.175 (collecting authority from Professors Ken Abraham and Kent Syverud, as well as noted insurance writers, Steven Ashley, William Barker and Ronald Kent, stating that the disregard the limits rule as stated in California's *Crisci* holding is the majority rule).

[138] *See, e.g.*, 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 2.03[2][a][C][iii] ("States requiring subjective culpability are now a small and dwindling minority. The better rule is the 'disregard the limits' rule . . . .").

[139] *See supra* notes 130–34 and accompanying text.

[140] *See, e.g.*, Kim V. Marrkand, *Duty to Settle: Why Proposed Sections 24 and 27 Have No Place in a Restatement of the Law of Liability Insurance,* 68 RUTGERS U. L. REV. 201 (2015).

[141] *See generally* ALI HANDBOOK, *supra* note 31, at 4–5.

law, the *RLLI* both conceptualizes insurance law and reconciles it with the dominant contract and fiduciary principles.[142]

RLLI § 24, captioned *The Insurer's Duty to Make Reasonable Settlement Decisions*, deliberately abjures the morally-laden terms of good/bad faith.[143] Shorn of any intent-based language, § 24 advocates for the insurer's settlement decisions to be evaluated under a reasonableness/negligence standard, which does not require showings of malice or recklessness sometimes associated with "insurance bad faith."[144] The section also avoids the "duty to settle" shorthand that prevails amongst many courts and commentators,[145] which may give the (incorrect) impression that the insurer has a duty to settle every case.[146]

The *RLLI* justifies this somewhat novel construction through its second significant move: grounding an insurer's settlement duty in the distinctive features of the insurer-insured relationship in the third-party liability realm, which is absent from other applications of good faith law. The *RLLI*, therefore, distinguishes between claims predicated on: (i) potential conflicts of interest generated by above-limits verdicts unique to

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[142] *See* RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. a (AM. L. INST. 2019).

[143] *Id.*

[144] *Id.*

[145] *Id.* For commentators, see, e.g., Syverud, *supra* note 75; Seth J. Chandler, *Reconsidering the Duty to Settle*, 42 DRAKE L. REV. 741 (1993); Robert Heidt, *The Unappreciated Importance, for Small Business Defendants, of the Duty to Settle*, 62 ME. L. REV. 75 (2010). For state supreme courts, see, e.g., Murphy v. Allstate Ins. Co., 553 P.2d 584 (Cal. 1976); Mowry v. Badger State Mut. Cas. Co., 385 N.W.2d 171 (Wis. 1986); Haddick *ex rel.* Griffith v. Valor Ins., 763 N.E.2d 299 (Ill. 2001); Whitney v. State Farm Mut. Auto Ins. Co., 258 P.3d 113 (Alaska 2011).

Kim Marrkand critiques the *RLLI* for creating a new name rather than using the more common, "duty to settle" heading, which in her view is more descriptive of the higher true-bad faith standard. *See* Marrkand, *supra* note 140, at 202, 206–10140. In my own experience teaching insurance law, students generally assume that a "duty to settle" requires insurer to settle every case or face liability—in essence, a strict liability standard that put more burdens on insurers than § 24, and certainly more than the standard Marrkand advocates for. *See id.* at 209 n.42.

[146] *See* Bruce L. Hay, *A No-Fault Approach to the Duty to Settle*, 68 RUTGERS U. L. REV. 321, 322 (2015) ("The main hypothesis of the Article is that adoption of the no-fault liability [for insurer settlement claims] would produce lower joint costs for insurer and insured."). *See also* Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 776 (W. Va. 1990) (holding that "it will be the insurer's burden to prove by clear and convincing evidence that it attempted in good faith to negotiate a settlement, that any failure to enter into a settlement where the opportunity to do so existed was based on reasonable and substantial grounds, and that it accorded the interests and rights of the insured at least as great a respect as its own.").

the third-party liability context; and (ii) suits based on improper or self-interested claims management that have closer analogues outside the liability insurance setting.[147]

Thus, in addition to the duty to make reasonable settlement decisions, the *RLLI* recognizes a separate cause of action known as "insurance bad faith" (identified herein as "true bad faith" to distinguish it from the generic use of bad faith terminology throughout the case law and commentariat). This rule, along with its corresponding remedial provision, appear in §§ 49–50.[148] True bad faith applies when the insurer engages in "improper conduct in the settlement context [that] goes beyond unreasonableness," and/or "improper conduct outside of the settlement context" that is akin to first-party claims handling and misconduct claims.[149] For these more significant infractions, claimants must show an insurer failed to perform its obligations: "(a) [w]ithout a reasonable basis for its conduct; and (b) [w]ith knowledge of its obligation to perform or in reckless disregard of whether it had an obligation to perform."[150] Unlike § 24, true bad faith actions focus less on the potential of the insurer gambling with the insured's money, and more on the insurer's behavior in adjusting the claim and interfacing with the insured and third-party claimants.

The result is to divide what is generically referred to as "bad faith" into two main branches. The first focuses on conflicts of interests represented by the excess verdict and judged under a reasonableness standard. The second centers on claims handling and management conduct in the third-party context—along with all first-party claims—which are held to the more demanding standard of "true bad faith." Though the *RLLI* is limited to liability insurance and does not cover first-party insurance or first-party bad faith claims, the *RLLI* notes the standards are analogous and that "[m]uch of

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[147] For a relevant example outside of insurance, see Dalton v. Educ. Testing. Serv., 663 N.E.2d 289, 289 (N.Y. 1995) (finding relevance of good faith to a case between a student and administrators of the SAT who failed to follow their internal procedures).

[148] *See* RESTATEMENT OF THE L., LIAB. INS. § 49 (AM. L. INST. 2019) ("An insurer is subject to liability to the insured for insurance bad faith when it fails to perform under a liability policy . . . ."); *id.* § 50 (listing "remedies for liability insurance bad faith").

[149] *Id.*§ 24 cmt. a.

[150] *Id.* § 49. Note, however, that at least one commentator understands that the *RLLI* sets the bar for bad faith too high. *See* Thomas, *Extra-Contractual Liability*, *supra* note 132, at 5–7 (arguing *RLLI*'s requirement of subjective intent for bad faith is more commonly found in first-party cases but is not well supported in the liability insurance context).

the relevant law governing insurance bad faith has been developed in the first-party insurance context," since true liability insurance bad-faith actions are uncommon.[151] The *RLLI*'s distinction thus runs *within* the third-party context and offers a more conceptually refined approach than conventional views, which distinguish between somewhat lower standards for "third-party bad faith" claims against liability insurers and more demanding standards of "first-party bad faith" claims against property or disability insurers.[152]

B. "PROCEDURAL FACTORS" AND CONFLICTS OF INTEREST

While the *RLLI*'s conceptual division may be theoretically sound, it is frequently blurred in practice.[153] Many classic third-party bad faith actions reveal that the reason an entity in the business of pricing and litigating risk makes *un*reasonable settlement decisions is entwined with what the *RLLI* calls "procedural factors."[154] These include failures to: conduct a reasonable factual investigation and analysis of the claims; negotiate in a reasonable manner; follow recommendations of the adjuster or selected defense lawyer; apprehend the state of the facts or the law; or adhere to internal claims-handling procedures.[155] These defects may be exacerbated and even encouraged by plaintiffs who hope to set up the insurer for a bad faith claim.[156]

These procedural factors inevitably muddy the waters between what the *RLLI* understands as bad faith under § 49 and the conflicts-of-interest rationale underwriting § 24's reasonableness standard. The most difficult cases for the *RLLI* are when negligent (yet, less than bad faith) claims practices serve as the primary reason why the insurer unreasonably failed to settle the claim within limits.

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[151] RESTATEMENT OF THE L., LIAB. INS. § 49 cmt. b (AM. L. INST. 2019).

[152] See, for example, the framing adopted in MANILOFF & STEMPEL, *supra* note 132, at 407. *See also* Richmond, *supra* note 83.

[153] *See, e.g.*, Wade v. Emcasco Ins. Co., 483 F.3d 657, 667 (10th Cir. 2007) (listing eight factors used to determine whether insurer breached its settlement duties, which include failure to investigate, to follow advise of its own counsel, and to inform the insured of a settlement offer). Additionally, see the eleven factors cited in JERRY & RICHMOND, supra note 130, at 841. *See also* Thomas, *Extra-Contractual Liability*, *supra* note 132, at 14 ("Because third-party bad faith evolved from the duty to settle, cases addressing non-settlement bad faith commonly include failure to settle claims.").

[154] RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. e (AM. L. INST. 2019)

[155] *Id.*

[156] *See* TOM BAKER, KYLE D. LOGUE & CHAIM SAIMAN, INSURANCE LAW AND POLICY: CASES AND MATERIALS 614–28 (5th ed. 2021).

A close reading of § 24, however, suggests a subtle distinction between the two settings. Illustration 1 presents the insurer's unreasonable behavior in "mathematical" or actuarial terms that deliberately absents allegations of malice, recklessness, or claims-handling deficiencies.[157] Illustration 1 states:

> A claimant files a personal-injury lawsuit against the insured seeking damages. . . . The policy contains a policy limit of $75,000 and no deductible. The claimant offers to settle for $45,000. The insurer rejects the offer. The case proceeds to trial and a judgment of $175,000 is entered against the insured. In a subsequent action for breach of the duty to make reasonable settlement decisions, the insured introduces evidence supporting the conclusion that, at the time of the settlement negotiations, $45,000 was a reasonable settlement value of the case, based on the judgment that it was reasonable to conclude that the plaintiff had a 30 percent chance of success and likely damages of $150,000. *Based on this evidence, a trier of fact could conclude that a reasonable insurer would have accepted the offer and, thus, the insurer breached its duty.*[158]

The italicized language emphasizes that when the claimant can show the insurer's decision was substantively unreasonable on mathematical/actuarial grounds, the insurer's failure to accept a reasonable settlement is ordinarily assumed to be the cause of the excess verdict.

This formulation is contrasted with Illustration 3, which outlines a claim premised on "procedural factors:"

> A claimant files a tort suit against the insured seeking compensatory damages of $500,000. The insured has a duty-to-defend liability insurance policy that assigns settlement discretion to the insurer, with a policy limit of $100,000. Early in the litigation the claimant makes a time-limited

[157] The *RLLI* follows Keeton, *supra* note 83, at 1136, 1142, 1144 n.21, 1155 n.47. *See also* Transp. Ins. Co. v. Post Express Co., 138 F.3d 1189, 1192 (7th Cir. 1998) (using a mathematical illustration to demonstrate the values at which insurer and insured each have on a hypothetical claim).

[158] RESTATEMENT OF THE L., LIAB. INS. § 24, cmt. d, illus. 1 (AM. L. INST. 2019) (emphasis added).

> settlement offer for the policy limits directly to the insurance-claims manager, giving the insurer 60 days to investigate and either accept or reject the offer. The insurer immediately rejects the offer without conducting a reasonable investigation. The claim goes to trial and results in a jury verdict against the insured of $500,000. In the subsequent breach-of-settlement-duty lawsuit brought by the insured against the insurer, *the trier of fact may, but need not, properly* conclude from the insurer's failure to investigate that the insurer's settlement decisions were unreasonable. *If the trier of fact concludes that the $100,000 offer was unreasonably high at the time it was made and that the claimant was unwilling to accept any reasonable settlement offer, the insurer will not be held liable for the excess judgment.*[159]

The italicized language emphasizes that the insurer's negligent—though shy of bad faith—failure to live up to its procedural obligations permits—though does not require—a finding of liability. Beyond pointing out the insurer's claims management shortcomings, here the claimant must prove how these shortcomings caused the settlement negotiations to fail.[160] The corresponding comment explains that if a reasonable insurer would not have accepted the settlement offer because it was too high, then even the invocation of the insurer's many deficient claims practices is unlikely to avail.[161] Instead, the claimant will have to make recourse to *RLLI* § 49 and satisfy the higher demands of true bad faith under that section.

C. CRITIQUES OF THE *RLLI*'S APPROACH

The decision to isolate unreasonable settlement decisions from other claims processing defects has been critiqued from opposing directions. In a pair of articles (one directed to the 2015 draft of the *RLLI* and the other, written with co-authors, towards the final product), Kim Marrkand maintains

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[159] *Id.* § 24, cmt. e, illus. 3 (emphasis added).

[160] *Id.* § 24, cmt. e ("[F]ailure to employ reasonable procedures does not necessarily mean that the insurer's decision was substantively unreasonable," but a jury may nevertheless "decide based on these other procedural factors that the settlement decision was unreasonable.").

[161] *Id.*

the *RLLI*'s view of liability is too expansive.[162] She argues that the case law does not support liability predicated solely on the actuarial mismatch between the settlement offer and the underlying claim.[163] Marrkand explains that courts undertake an objective analysis of the totality of procedural and actuarial circumstances, which include not only the strength of the underlying claims, but also evaluates the actions of the insured, its defense counsel, the plaintiff(s), and their counsel.[164]

Marrkand's analysis is most on target to the 2015 *RLLI* draft the initial article commented on. This draft focused heavily on expected values and came close to creating per se liability whenever an insurer rejected an actuarially reasonable offer—notwithstanding mitigating factors that may be in play in the case.[165] Insurers could have been liable for turning down almost any settlement that could be characterized as actuarially reasonable, even if a reasonable counteroffer was presented.[166]

The *RLLI*, however, was revised in response to this line of critique.[167] The finalized blackletter law defines a reasonable settlement

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[162] Marrkand, *supra* note 140; Kim V. Marrkand, Martha J. Koster & Joel S. Nolette, Commentary, *Unsettling the Law of Insurance Settlements: Sections 24 and 27 of the Restatement of the Law Liability Insurance*, 2020 RUTGERS U. L. REV. 96 (2020).

[163] Marrkand, *supra* note 140, at 208–14; Marrkand, Koster & Nolette, *supra* note 162, at 109–10.

[164] Marrkand, *supra* note 140, at 209–10; Marrkand, Koster & Nolette, *supra* note 162, at 109–10.

[165] Marrkand, *supra* note 140, at 208 ("The focus in section 24, however, is '*only* on whether the insurer declined a reasonable settlement offer.' The settlement decision itself, stripped of consideration of reasons or factors, viewed without any context beyond numbers, is the primary concern of section 24." (footnotes omitted)).

Prior versions of § 24 Illustration 1 explained that when the insurer rejects a reasonable settlement offer, "[t]he insurer is subject to liability for the full amount of the verdict." RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. d, illus. 1 (AM. L. INST., Discussion Draft 2015).

[166] *See, e.g.*, PRINCIPLES OF THE L., LIAB. INS. § 27 cmt. d (AM. L. INST., Tentative Draft No. 2, 2014) ("[O]nce a claimant has made a settlement demand in the underlying litigation that is within the range of reasonableness, a liability insurer that rejects that demand thereafter bears the risk of any excess judgment against the claimant at trial.").

[167] Notwithstanding changes to the finalized *RLLI*, insurer reactions have remained just as strongly opposed. *See, e.g.*, Marrkand, *supra* note 9, at 22–23 (calling the duty to make reasonable settlement decisions a "newly denominated

decision as "one that would be made by *a reasonable insurer*"[168]—a formulation designed to include the range of factors deemed relevant to insurers.[169] The comments stress "it will not be sufficient for the policyholder to simply demonstrate that the amount of the offer was reasonable; [because] the policyholder must also demonstrate that a reasonable insurer would have accepted the offer."[170] This concept is reinforced even by the actuarially-oriented Illustration 1, which explains that upon showing a numerical mismatch, "a trier of fact *could conclude* that a reasonable insurer would have accepted the offer . . . ."[171]

Moreover, responding to the line of critique exemplified by Marrkand, the finalized *RLLI* version expressly allows courts to consider whether the *underlying claimant* bears responsibility for failing to settle the claim.[172] This is significant because when policyholders are vastly

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duty"); Schwartz & Appel, *supra* note 4, at 756 ("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."); Marrkand, Koster & Nolette, *supra* note 162, at 97–98 163(*RLLI*'s treatment of settlement law "departs from established principles, sometimes radically."). *See also* ERIC J. DINALLO & KEITH J. SLATTERY, ALI'S RESTATEMENT OF THE LAW LIABILITY INSURANCE: REGULATORY CONSIDERATIONS 3 (2017), https://wlflegalpulse.files.wordpress.com/2017/05/dinallo-white-paper-regulatory-considerations-ali-restatement-liability-insurance-jan-17-2017.pdf ("Section 24 of the Draft subjects the insurer to excess damages beyond policy limits for failure to 'make reasonable settlement decisions.'").

[168] RESTATEMENT OF THE L., LIAB. INS. § 24(2) (AM. L. INST. 2019) (emphasis added).

[169] By contrast, the *RLLI* Discussion Draft defines reasonableness in terms of a "reasonable *person* who bears the sole financial responsibility for the full amount of the potential judgment." RESTATEMENT OF THE L., LIAB. INS. § 24(2) (AM. L. INST., Discussion Draft 2015) (emphasis added). The Discussion Draft de-emphasizes the specific knowledge and business concerns held by insurers.

[170] RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. d (AM. L. INST. 2019).

[171] *Id.* § 24 cmt. d, illus. 1 (emphasis added).

[172] *Id.* § 24 cmt. e:

> By the same token, it may also be appropriate in some cases for the trier of fact to consider procedural factors that affect whether the claimant in fact would have accepted a reasonable offer to settle within the policy limits. . . . If the trier of fact concludes that the claimant would not have accepted a reasonable settlement offer within the policy limits, then the causation element required to recover for a breach of the duty to make

underinsured as compared to the losses they cause, it may be in the claimant's interest to goad the insurer into rejecting the initial settlement offer and setting up a bad faith claim.[173] The *RLLI* therefore allows courts to expressly consider whether the claimant's—rather than the insurer's—conduct was the proximate cause of the failure to reach a settlement.[174] These changes expressly move the *RLLI* away from what even in Marrkand's updated article charges as the "Restatement's firm focus . . . on numbers" at the expense of other factors.[175]

Where Marrkand finds the *RLLI* too solicitous of insurer liability, Professors Jeffrey Thomas and Leo Martinez attack it as too restrictive.[176] They agree that recoveries can be predicated on unreasonableness as measured by the expected value of the claim, but do not think these claims should be privileged over those sounding in negligent claims management or procedural defects.[177] Thomas proposes shifting the emphasis away from the fear an insurer will gamble with the insured's money and advocates instead for an "equal consideration" standard that takes all decisions made by a liability insurer into account.[178]

The critics are right to focus on the inevitable imprecision the *RLLI*'s scheme creates around the edges. But this is endemic to a body of law whose conceptual foundations remain uncertain and where the caselaw does not yield clean results. And this criticism can be equally leveled at the alternative reconstructions of this body of law offered by these writers. The advantage of the *RLLI* is that, in focusing on the unique structure of the insured/insurer relationship, it reconciles settlement law with other areas of private law,

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> reasonable settlement decisions will not be satisfied and, thus, the insurer's liability will be limited to the policy limits.

[173] *See* BAKER, LOGUE & SAIMAN, *supra* note 156, at 614–28.

[174] RESTATEMENT OF THE L., LIAB. INS.§ 24 cmt. e (AM. L. INST. 2019). The Reporters' notes cite to well-known "bad faith set-up" holdings where the combination of low-limits policies and high-damage injuries means that claimant's best chance for meaningful recovery lies in winning a bad faith action against the insurer. *See id.* § 24 reporters' note to cmt. e.

[175] Marrkand, Koster & Nolette, *supra* note 162, at 109.

[176] *See* Thomas, *Extra-Contractual Liability, supra* note 132, at 5, 18–20132; Martinez, *supra* note 80, at 183.

[177] *See* Thomas, *Extra-Contractual Liability*, *supra* note 132, at 15–18; Martinez, *supra* note 80, at 173 (owing to § 24's focus on conflict of interest rationale: "[T]he Reporters necessarily arrive at a more *pro-insurer* position than would otherwise be the case." (emphasis added)).

[178] Thomas, *Extra-Contractual Liability, supra* note 132, at 21.

offering a rationale for why good faith looms much larger in substantive insurance law than in general contract law.

When a claim is wholly covered, few conflicts of interest arise and the insurer's duties of good faith are correspondingly narrow. In a case of a potential excess verdict, however, though decisional authority remains solely with the insurer the financial liability can fall on the insured. This mimics a classic fiduciary structure where the fate of one party lies in the discretion granted to a party with potentially adverse interests. Just as fiduciary (not contract) law calls for oversight to prevent abuses of trust, liability insurance law slides from the purely contractual paradigm towards the fiduciary model.[179] The same analysis applies to the questions of causation. When a fiduciary breach is proven, questions of causation and damages typically are resolved in favor of the entrusting party.[180] The *RLLI* adopts this model to explain that when the insurer's breach is predicated on the conflicts of interest, the ensuing causation questions are generally adjudicated in favor of the insured.[181]

RLLI § 24 responds to the distinctive features of liability insurance relationships. The more the financial conflict of interest hovers over a case, the greater reason to lean on fiduciary principles, which assume the insurer's questionable decisions were motivated by placing its financial interest ahead of the insured's interests.[182] However, when the claims derive from the allegedly poor quality of the insurer's claims-handling techniques, the presumption reverts back to the more typical approach where claimants carry

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[179] *See, e.g.*, Robert Cooter & Bradley J. Freedman, *The Fiduciary Relationship: Its Economic Character and Legal Consequences*, 66 N.Y.U. L. REV. 1045, 1055–56 (1991) (fiduciary law alters the usual rules of tort liability by shifting the burden of proof from a plaintiff to a defendant).

[180] *See* RESTATEMENT (THIRD) OF THE L. OF TRUSTS § 100 cmt. f (AM. L. INST. 2012) ("[I]n matters of causation . . . when a beneficiary has succeeded in proving that the trustee has committed a breach of trust and that a related loss has occurred, the burden shifts to the trustee to prove that the loss would have occurred in the absence of the breach.").

[181] The fiduciary analogy is only partial since true fiduciaries must give "sole" or "paramount" consideration to the interests of their beneficiaries, while insurance law usually demands no more than giving "equal" consideration to each parties' interests. *See* Richmond, *supra* note 83, at 25–34. The *RLLI* operationalizes this quasi-fiduciary concept in terms of the "disregard the limits rule." *See* RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. c (AM. L. INST. 2019).

[182] RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. b (AM. L. INST. 2019).

the burden of showing how the insurer's conduct caused the excess verdict.[183]

V. REMEDIES FOR BREACH OF SETTLEMENT OBLIGATIONS

The complexities regarding the substantive basis of settlement liability flow into the remedies available upon breach assessed in *RLLI* § 27.[184] Courts have little difficulty concluding the primary remedy is to find the insurer liable for the excess verdict.[185] Recoveries beyond this amount, or what the *RLLI* labels "other foreseeable loss,"[186] however, remain both undertheorized and uncertain. The *RLLI* does a reasonable job of making sense of this complicated area of law. Nevertheless, it oversteps its mandate on one issue and missed an opportunity to speak with greater clarity on others.

A. EXPANDED DAMAGES

What the *RLLI* terms other foreseeable loss are potentially available in two basic settings:

> ***Emotional damages*** suffered by the insured due to the potential financial insecurity of having to pay the excess verdict.[187] These may include emotional harm from the loss of reputation or negative publicity from the insured's conduct in the underlying case.[188]
>
> ***Consequential damages*** such as lost profits, loss of business reputation or business opportunities that arise as a

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[183] *See* RESTATEMENT OF THE L., LIAB. INS. § 24 cmt. e (AM. L. INST. 2019) ("[I]t may be appropriate in some cases for the trier of fact also to consider procedural factors that affected the quality of the insurer's decision making . . . . Such factors . . . can make the difference in a close case by allowing the jury to draw a negative inference from the lack of information that reasonably should have been available . . . ."). *See also id.* § 24 cmt. e, illus. 3.

[184] *See id.* § 27.

[185] *See generally* 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 2.03.

[186] RESTATEMENT OF THE L., LIAB. INS. § 27 cmt. c (AM. L. INST. 2019).

[187] *See id.* § 27 cmt. c, illus. 1; *id.* § 27 reporters' note to cmt. c.

[188] *See id.* § 27 cmt. c, illus. 4–5; *id.* § 27 reporters' note to cmt. c.

> consequence of the insurer's failure to accept a reasonable settlement offer.[189]

It is difficult to draw a clear line between harms caused to the insured because of its own conduct and harms that flow specifically from the insurer's breach of settlement duties. A baseline level of risk attaches whenever a defendant is sued for injuring a third-party. The ensuing suit and investigation may reveal embarrassing details or generate negative publicity resulting in loss of income, profits, reputation, or opportunities. Corporate defendants may be distracted by the litigation or find their trading partners withdrawing, while individual insureds may face considerable anxiety over the trial outcome and erosion of their personal or professional reputation.

In most cases, these costs are held to arise from tortious conduct by the insured and is not covered under standard liability policies.[190] Though insurers are obligated to resolve the claims in good faith, they have no obligation to restore the policyholders to the pre-claim status quo.[191] Likewise, insurers are not responsible for uninsured harms that arise on account of the underlying conduct or litigation.[192] While policyholders certainly hope their insurers will mitigate these costs and quickly settle within policy limits, as long as the litigation and settlement strategy are conducted in good faith, insurers are not required to sacrifice their own interest to mitigate these harms.[193]

The conceptual difficulty is that these uninsured harms can be significantly exacerbated if the insurer *un*reasonably refuses to settle the claim and protracts litigation beyond where a reasonable insurer would have taken it. In these scenarios, courts tend to permit recovery for negative

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[189] *See id.* § 27 reporters' note to cmt. c.

[190] *See* 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 9.03[3] ("Where insurance against punitive damages is against public policy, an insured cannot shift to the insurance company its responsibility for punitive damages awarded to a claimant based on the insured's egregious conduct."). *See also id.* § 9.04[3] ("The insurer's bad faith conduct must be the cause of any damages to permit recovery. . . . No recovery will be permitted for injury to interests of the insured unrelated to the contract . . . .").

[191] *See id.* § 9.03. *See also* Apollo Educ. Grp., Inc. v. Nat'l Union Fire Ins. Co. of Pittsburgh, PA, 480 P.3d 1225, 1232 (Ariz. 2021) ("The insurer may however, discount considerations that matter only or mainly to the insured—for example, the insured's financial status, public image, and policy limits—in entering into settlement negotiations.").

[192] *See* RESTATEMENT OF THE L., LIAB. INS. § 27 cmt. C, illus. 3 (AM. L. INST. 2019).

[193] *See id.* §24, cmt. b, cmt. c.

publicity, loss of income or emotional harms even though drawing a line between damage caused by the insured's underlying conduct, and the insurer's failure to reasonably settle remains conceptually and practically elusive.[194]

1. State of the Law

The absence of clear distinctions leaves many issues in this area unsettled and in need of restating. Commentators have even offered different assessments as to whether such remedies are available. In the 1990s, two of the most respected insurance academics noted that only a handful of cases imposed liability for noneconomic loss.[195] More recently, commentators explain that a policyholder may "generally recover damages for emotional distress caused by the insurer's misconduct . . . ."[196] The current *New Appleman* treatise on bad faith litigation states, "there is little question that economic damages resulting from entry of an excess judgment are recoverable."[197]

Courts and commentators are similarly divided as to whether the cause of action for an insurer's breach of settlement obligations is best conceptualized as a tort, contract, a species of professional liability, or grounded in state-specific statutory provisions.[198] While it is generally assumed that the tort conception dominates,[199] this does not answer whether

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[194] *See* 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 1.06[2] ("Most jurisdictions now authorize tort recovery for breach of the duty to settle. . . . Under the tort theory, an insured can therefore recover damages for emotional distress, as well as economic loss, suffered in consequence of the insurer's tortious conduct, regardless of whether the specific consequences were foreseeable at the time of contracting.").

[195] Abraham, *supra* note 131, at 1302 n.30 (citing the "handful of reported cases" that have allowed non-economic damages); Syverud, *supra* note 75, at 1121 n.18 (noting emotional damages available in three states: California, Colorado, and Montana).

[196] STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY & DAMAGES § 8:4 (2d ed., Westlaw, database updated through Oct. 2021).

[197] 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 9.03[3]. *See also* 12 COUCH ON INSURANCE, *supra* note 133, § 172:31.

[198] *See* Jeffrey E. Thomas, Crisci v. Security Insurance Co.: *The Dawn of the Modern Era of Insurance: Bad Faith and Emotional Distress Damages*, 2 NEV. L.J. 415, 425–28 nn. 80–98 (2002) (citing sources).

[199] *See* Richmond, *supra* note 83, at 21 n.122 (citing STEPHEN S. ASHLEY, BAD FAITH ACTIONS: LIABILITY & DAMAGES § 5A:02, at 5A-7 to 5A-8 (2d ed. 1997).

such claims must fit into the general tort law rubric for emotional harms;[200] whether special, somewhat more permissive, rules apply uniquely to the insurance context;[201] or what standards are used to determine the availability of such damages.[202] Further uncertainty surrounds whether these claims are limited to third-party liability insurance or are also available in first-party insurance; and, if the latter, is there a meaningful difference between the two scenarios?[203]

These issues are no less complex under the contract route. Are claims for expanded damages basic extensions of standard contract law, or do they depend on the specific characteristics of the insurance relationship?[204] If the latter, are these unique to the settlement context of liability insurance, or relevant to other insurance lines?[205]

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[200] Under traditional tort law, emotional damages are not recoverable unless the claimant can show they resulted from physical harms caused by defendant's conduct. *See* RESTATEMENT (THIRD) OF TORTS: LIAB. FOR PHYSICAL & EMOTIONAL HARM § 4 cmt. c–d (AM. L. INST. 2010). Some courts work around this rule by allowing evidence of physical manifestations of emotional harm (e.g., sustained nausea, headaches, panic attacks) to satisfy the physicality requirement. *See id.* § 4 reporters' notes to cmt. c–d.

If physical harm cannot be shown, courts have allowed direct claims for emotional damages as claims for either intentional or negligent infliction of emotional distress. *See id.* §§ 46–47. Most relevant to the insurance setting are claims for negligent infliction which are typically limited to "specified categories of activities, undertakings, or relationships in which negligent conduct is especially likely to cause serious emotional harm," to a reasonable person. *Id.* § 47(b). *See id.* § 47 cmt. f., cmt. i. Framed in insurance law terms these cases usually veer closer to bad faith than to commercial unreasonableness. *See id.* § 47 reporters' notes to cmt. f. *See also* John H. Bauman, *Emotional Distress Damages and the Tort of Insurance Bad Faith,* 46 DRAKE L. REV. 717, 722–32 (1998).

[201] *See* Thomas, *supra* note 198, at 437–41. *See also* Bauman, *supra* note 200, at 754.

[202] *See* Thomas, *supra* note 198, at 428 (showing a variety of standards).

[203] *See, e.g.*, Braesch v. Union Ins. Co., 464 N.W.2d 769, 778 (Neb. 1991) (recognizing the crossover nature of first and third-party damages).

[204] *See, e.g.*, Birth Ctr. v. St. Paul Cos., 787 A.2d 376 (Pa. 2001) (discussing the extent of damages available). *See also* Bauman, *supra* note 200, at 747; *Braesch*, 464 N.W.2d at 774–75, *overruled on other grounds* by Wortman v. Unger, 578 N.W.2d 413, 417 (1998).

[205] *See, e.g.*, Anderson v. Cont'l Ins. Co., 271 N.W.2d 368, 375 (Wis. 1978) ("The rationale which recognizes an ancillary duty on an insurance company to exercise good faith in the settlement of third-party claims is equally applicable and of equal importance when the insured seeks payment of legitimate damages from his own insurance company.").

There is even disagreement regarding whether the tort or contract route offers claimants more fertile grounds for recovery.[206] Emotional harms are more common in tort than contract,[207] but at least some courts demand enhanced showings of insurer recklessness/willfulness prior to awarding damages in tort.[208] But others disagree.[209] By contrast, consequential damages foreseeable at the time of contracting are part of the standard suite of contract awards.[210] Therefore, to the degree courts frame insurance policies as contracts specially designed to protect the insured against "mental distress which might follow from the losses,"[211] emotional damages may be seen as foreseeable and more easily recoverable under contract than tort. Yet even this conclusion is hardly universal, as at least some courts hold that emotional damages are not recoverable for breach of contract absent evidence of bad faith.[212]

Because few of these questions are definitively settled,[213] any attempt to restate the law will be open to critique. Indeed, whereas Professors Thomas and Martinez fault the *RLLI* for presenting too narrow a view of expanded remedies, Professor Victor Schwartz writing with Christopher Appel, and Kim Marrkand, argue the opposite.[214] Perhaps the most accurate description is simply to state that the more egregious the insurer's conduct,

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[206] *Compare* 1 NEW APPLEMAN INSURANCE BAD FAITH LITIGATION, *supra* note 133, § 9.03 (noting jurisdictions that treat bad faith claims as a contract offer more restricted consequential damage remedies), *with* RESTATEMENT OF THE L., LIAB. INS. § 27 cmt. e (AM. L. INST. 2019) (noting damages in contract law terms offers a broader set of remedies).

[207] RESTATEMENT (SECOND) OF CONTS. § 353 cmt. a (AM. LAW. INST. 1981) ("Damages for emotional disturbance are not ordinarily allowed.").

[208] *See, e.g.*, Bauman, *supra* note 200, at 742 (giving an example from Arizona courts).

[209] *See, e.g.*, *id.* (giving an example from an Alabama court).

[210] RESTATEMENT (SECOND) OF CONTS. § 351 (AM. LAW. INST. 1981).

[211] Crisci v. Sec. Ins. Co. of New Haven, 426 P.2d 173, 179 (Cal. 1967). *See* Farmers Grp., Inc. v. Trimble, 691 P.2d 1138, 1141 (Colo. 1984) ("By obtaining insurance, an insured seeks to obtain some measure of financial security and protection against calamity, rather than to secure commercial advantage.").

[212] *See* Bauman, *supra* note 200, at 751–52.

[213] *See* Thomas, *supra* note 198, at 425 (noting that "it is difficult to generalize about the case law allowing emotional distress damages.").

[214] *Compare* Thomas, *Exploring the Alternatives*, *supra* note 88, Thomas, *Extra-Contractual Liability, supra* note 132, at 15–20, *and* Martinez, *supra* note 80, 178–83, 187–91, *with* Marrkand, *supra* note 140, Marrkaand, Koster & Nolette, *supra* note 163 *and* Schwartz & Appel, *supra* note 4.

the more likely for a court to allow expanded damages beyond the excess verdict.

2. The *RLLI*'s Approach to Expanded Damages

Because *RLLI* § 27 continues its overall approach of characterizing settlement law as sui generis insurance law, it side-steps the contract vs. tort debate arguing that doctrinal labels make little difference anyway.[215] Analysis of the caselaw bears this out.[216]

More debatable is the *RLLI*'s reluctance to hierarchically order liability for the excess verdict itself with liability for expanded damages that may follow. *RLLI* § 27 blackletter states a breaching insurer "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."[217] Though the excess verdict is emphasized, it is fundamentally on par with other forms of expanded damages. The comments likewise descriptively note that liability for the excess verdict is "the paradigmatic measure of damages"[218] whereas emotional or consequential damages are supported by "at least a plurality of jurisdictions."[219] Yet the text does not suggest a normative difference between them.

There undeniably is caselaw conforming to the *RLLI*'s framing of expanded damages.[220] But explicitly or subtly, the courts tend to rely on the nature and degree of the insurer's improper conduct to draw the line between damages said to be caused by the underlying tortious actions and harms attributable to the insurer's unreasonable settlement practices.[221] This point

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[215] RESTATEMENT OF THE L., LIA. INS. § 27 cmt. c (AM. L. INST. 2019).

[216] *See id.* § 27 reporters' notes to cmt. c.

[217] *Id.* § 27(1).

[218] *Id.* § 27 cmt. a.

[219] *Id.* § 27 cmt. c.

[220] *See, e.g.*, Larraburu Brothers, Inc. v. Royal Indem. Co., 604 F.2d 1208, 1215 (9th Cir. 1979) ("An unreasonable refusal to accept a settlement offer causes the insurer to be liable for consequential damages, such as mental suffering or economic loss . . . ."); Gibson v. W. Fire Ins. Co., 682 P.2d 725, 731 (Mont. 1984) ("[F]ailure to settle may have been the result of either bad faith or negligence, and there is no clear distinction in Montana between the two terms in such cases.").

[221] *See, e.g.*, Bauman, *supra* note 200, at 748–49 ("Emotional distress damages mark the point at which the insurer's conduct crosses the line from the negligent error in judgment as to the settlement value of the case to the more egregious and

is especially relevant in light of the *RLLI*'s efforts to draw a distinction between the negligence/unreasonable standard of § 24 and the "true bad faith" standard of § 49.[222] The *RLLI* should have nuanced its discussion, explaining that cases supporting expanded liability are not typically close calls under § 24, even if they do not reach all the bad faith requirements of § 49.

This tonal difference can be illuminated by comparing the *RLLI* with California Supreme Court's decision in *Crisci*, usually seen as the *ur*-text of this area of law.[223] *Crisci* presented a suit by tenant against the insured apartment owner alleging that a faulty staircase caused the tenant to fall through the stairs and hang fifteen feet off the ground, causing her psychosis.[224] Both insurance defense counsel and the claims manager thought liability was clear and foresaw potential damages in excess of policy limits.[225] The tenant offered to settle within policy limits and the insured even offered to contribute roughly thirty percent of the claim.[226] The insurer refused, however, since its litigation strategy was to minimize damages by showing the tenant's psychosis was preexisting.[227] The jury returned a verdict of more than ten times policy limits.[228] Post-verdict, the parties settled for roughly twenty percent of the verdict in cash along with insured transferring forty percent of her stake in the apartment building—insured's primary asset—to the tenant.[229] Insured's financial and mental condition thereafter substantially worsened, leading to a decline in physical health, hysteria, and suicide attempts.[230]

These facts starkly contrast with *RLLI* § 24 Illustration 1, in which the eventual verdict is more than three times the settlement offer, the insured's liability is estimated at only thirty percent, and the insured makes

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intentionally wrongful betrayal of the rights of the insured."); *id.* at 732 (comparing bad faith damages to damages in cases of professional malpractice in that both situations, a deliberate abuse of a special relationship is often unofficially required to find emotional damages).

[222] For discussion on this distinction see *supra* Section IV.A.

[223] *See* Thomas, *supra* note 198, at 415.

[224] Crisci v. Sec. Ins. Co. of New Haven, 426 P.2d 173, 175 (Cal. 1967) (en banc).

[225] *Id.*

[226] *Id.* at 175–76.

[227] *Id.* at 175.

[228] *Id.* at 176.

[229] *Id.*

[230] *Id.*

no offer of contribution.[231] The insured in *Crisci* had real assets to protect and paid real money to the plaintiff to satisfy the claim. Further, the verdict initiated a tangible shift to her standard of living and financial security, which served as the predicate facts for the emotional damages claims. The *RLLI*, however says little about the predicate facts used by courts to sustain findings of expanded damages.[232] Thus, would the liability established in *Crisci* apply when: (i) only insurance money changes hands; (ii) the insured has no assets to satisfy the claim such that the excess verdict does not materially change its financial condition;[233] or (iii) if the underlying plaintiff is willing to covenant not to sue the insured in exchange for an assignment of the insured's claims against the insurer?[234]

Lastly, the *RLLI* should have done more to guide courts in distinguishing between harms arising out of the policyholder's conduct and harms arising from the insurer's unreasonable failure to settle. Because at least some of the emotional/consequential harms that stem from the litigation fall on the insured, more guidance on this issue would have been helpful.

B. PUNITIVE DAMAGES AS CONSEQUENTIAL DAMAGES

RLLI § 27 also states that when the underlying case results in punitive damages, an insurer that has *unreasonably* failed to settle the case should be liable for the punitive amount as part of the consequential damages arising out of the breach.[235] This presentation has generated a host of criticism.[236] While most debates surrounding the *RLLI* turn on the subtleties

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[231] RESTATEMENT OF THE L., LIA. INS. § 24 cmt. d, illus. 1 (AM. L. INST. 2019). Notably, Illustration 1 of § 27, which is based on *Crisci,* uses the 10:1 ratio drawn from the case and notes there is "a high likelihood that the insured will be found liable for the harm." *Id.* § 27 cmt. c., illus. 1. Since § 27 does not otherwise account to the severity of the insurer's conduct, it is fair to conclude that any violation of § 24 entitles the claimant to the remedies of § 27.

[232] *See generally id.* § 27 cmt. c., illus. 1.

[233] While the *RLLI* rejects the so-called "payment rule" that limits the insurer's liability for the *excess verdict* to the amounts the insured could realistically pay to the tort-claimant, it is less clear whether this rationale should apply with the same force to claims for expanded emotional damages.

[234] *See* Bauman*, supra* note 200, at 747 ("The ability to assign the third-party bad-faith claim to the holder of the excess judgment in exchange for a release from the threat of excess liability cuts against the notion that the insured is necessarily being made to suffer great emotional torment.").

[235] RESTATEMENT OF THE L. OF LIAB. INS. § 27 cmt. e (AM. L. INST. 2019).

[236] *See, e.g.*, George L. Priest, *A Principled Approach Toward Insurance Law:*

of categorizing holdings and discerning trend lines,[237] here the clash is more direct. Every reported case on the topic has ruled contrary to the *RLLI*.[238]

From an analytical perspective, insureds and their insurers approach this issue with different narratives. Policyholders favor the *RLLI* position noting that a reasonable insurer should have settled the entire claim by avoiding trial and the imposition of punitive damages. Because insureds are contractually barred from settling claims without the insurer's permission, the punitive liability only exists because the insurer placed its own interests ahead of its insured's when it failed to settle the claims.[239]

Insurers respond that punitive damages do not attach unless the insured's underlying conduct is sufficiently egregious to qualify for punitive assessments,[240] and that state law prohibits insuring against such conduct since these damages are designed to both punish the insured and deter future malicious conduct.[241] Whatever shortcomings may attend to the insurer's

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The Economics of Insurance and the Current Restatement Project, 24 GEO. MASON L. REV. 635, 660 (2017); Schwartz & Appel, *supra* note 4, at 758–59; Marrkand, Koster & Nolette, *supra* note 162, at 112–15.

[237] *See* Feinman, *supra* note 6, at 10.

[238] *See* PPG Indus. Inc. v. Transamerica Ins. Co., 975 P.2d 652, 654 (Cal. 1999) ("Although the insurance company's alleged negligent failure to settle the third party lawsuit was a cause in fact of the punitive damages award against the insured, it was not a proximate cause of those damages."); Lira v. Shelter Ins. Co., 913 P.2d 514, 516–17 (Colo. 1996) (en banc); Soto v. State Farm Ins. Co., 635 N.E.2d 1222, 1223–24 (N.Y. 1994). *See also* Wolfe v. Allstate Prop. & Cas. Ins. Co., 790 F.3d 487, 494–95 (3d Cir. 2015) (applying Pennsylvania law); Magnum Foods, Inc. v. Cont'l Cas. Co., 36 F.3d 1491, 1506–07 (10th Cir. 1994) (applying Oklahoma law). At least one state trial court seems to have allowed punitive damages to be included in the claim for consequential damages against the insurer. Williamson–Green v. Interstate Fire & Cas. Co., No. 1684-CV-03141BLS2, 2017 WL 3080559, at *2–5 (Mass. Super. Ct. May 26, 2017).

[239] *See, e.g.*, *PPG Indus., Inc.*, 975 P.2d at 655 ("According to [the insured], settlement would have terminated that lawsuit, thus precluding any punitive damage liability, and therefore the insurer's failure to settle the lawsuit was a proximate cause of the award of punitive damages.").

[240] *See, e.g.*, *Soto*, 635 N.E.2d at 1225 ("[A]n insurer's failure to agree to a settlement, whether reasonable or wrongful, does no more than deprive the insured of a chance to avoid the possibility of having to suffer a punitive damage award for his or her own misconduct.").

[241] *See, e.g.*, *PPG Indus., Inc.*, 975 P.2d at 656 ("[T]he purposes of punitive damages . . . are to punish the defendant and to deter future misconduct by making an example of the defendant."). *See also Lira*, 913 P.2d at 517 ("The contract

settlement practices, the punitive damages flow from the insured's outrageous behavior and cannot be charged to the insurer.[242]

Given the tensions with state public policy and relevant decisional law, the *RLLI* should not have advocated for a new category of damages, notwithstanding the fact some of the central cases decided by state supreme courts were closely divided and elicited strong dissents.[243] The matter, however, is considerably more subtle than repeating the simple mantra that the *RLLI* invented aspirational rules of insurance law.[244] As with expanded damages, the issue turns on the elusive distinction between harms caused by the insured's conduct and harms caused by the insurer's breach of settlement duties.

Viewed from a post-verdict vantage point, punitive damages stand out as qualitatively different than ordinary compensatory damages. The former are relatively rare, correlate to the insured's distinctly reprehensible conduct, and, at least in theory, are intended to reflect the community's moral opprobrium. For this reason, about half the states hold these damages are uninsurable.[245] These stand in contrast with compensatory damages which generate limited social and political opprobrium and are freely insurable in all jurisdictions. From this perspective, it is easy to fault the *RLLI*'s rule for making insurers and, significantly, the risk pool of other insureds pay for the "[w]illful, malicious, or heinous acts [of the insured that] are not probabilistic and would not want to be insured against by normal policyholders."[246]

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between the parties expressly precluded recovery for punitive damages incurred by the insured. The insured may not later utilize the tort of bad faith to effectively shift the cost of punitive damages to his insurer when such damages are expressly precluded by the underlying insurance contract.").

[242] *PPG Indus., Inc.*, 975 P.2d at 658; *Lira*, 913 P.2d at 517.

[243] *See, e.g.*, PPG Indus., Inc. v. Transamerica Ins. Co., 975 P.2d 652 (Cal. 1999) (splitting 4–3); Lira v. Shelter Ins. Co., 913 P.2d 514 (Colo. 1996) (en banc) (splitting 4–3).

[244] *See, e.g.*, Marrkand, *supra* note 9, at 23 ("This one section [27] forcefully illustrates that the RLLI is *not* applying or describing—or even in line with an emerging trend of—existing law; it is simply a new social policy. . . ."). *See also* Priest, *supra* note 236, at 660.

[245] *See* Catherine M. Sharkey, *Revisiting the Noninsurable Costs of Accidents*, 64 MD. L. REV. 409, 422–23 (2005) (surveying state approaches to insurability of punitive damages).

[246] *See* Priest, *supra* note 236, at 660. *See, e.g.*, *PPG Indus., Inc.*, 975 P.2d at 656 ("[T]he purposes of punitive damages . . . are to punish the defendant and to deter future misconduct by making an example of the defendant."); *Lira*, 913 P.2d

Prior to verdict or settlement, however, damages are unclassified and their amounts unliquidated. In theory, compensatory damages are tied to specific losses and should not vary based on the degree of reprehensibility of the underlying conduct. Yet, participants in the tort system report how these damages frequently rise and fall based on a moral assessment of the defendant's wrongful conduct—the very same factors that generate punitive damages.[247] This is especially true for the more subjective categories of damages such as pain and suffering, emotional, and reputational harms.[248]

By avoiding the formal enumeration into compensatory versus punitive damages set forth on a verdict sheet, the settlement process allows

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at 517 ("The insured may not later utilize the tort of bad faith to effectively shift the cost of punitive damages to his insurer when such damages are expressly precluded by the underlying insurance contract."). *See also* Schwartz & Appel, *supra* note 4, at 758–59 (warning against the *RLLI*'s rule that would "shift [the insured's] entire punishment onto the insurer" and "plainly provide a windfall to policyholders" who have committed egregious acts).

The moral sting of these criticism is somewhat blunted by the fact that many major corporate policyholders often purchase policies with choice of law provisions designed to enable such coverage, and the degree it is not available or insurable on the domestic market so called "difference in conditions" insurance is purchased offshore and designed to provide such coverage. *See* Sharkey, *supra* note 245, at 439 n.149; Gloria Gonzalez, *U.S. Insurers Broadening Side A Policies,* BUS. INS. (Oct. 31, 2004, 12:00 AM), www.businessinsurance.com/article/20041031/STORY/100015608. It would be strange to exclude such corporate consumers of insurance from the category of "normal policyholders."

[247] Tom Baker, *Transforming Punishment into Compensation: In the Shadow of Punitive Damages*, 1998 WIS. L. REV. 211, 226–28 (1998) (sharing lawyers' experiences that in clear liability cases compensatory damages are escalated instead of pursuing punitive damages). *See* Catherine M. Sharkey, *Crossing the Punitive-Compensatory Divide, in* CIVIL JURIES AND CIVIL JUSTICE: PSYCHOLOGICAL AND LEGAL PERSPECTIVES 79, 79–104 (Brian H. Bornstein, Richard L. Wiener, Robert F. Schopp & Steven L. Willborn eds., 2008) (noting that empirical analysis of mock and real juries showed that when a jurisdiction had a cap on punitive damages the jury was more likely to award higher compensatory damages). *See also* Thomas Koenig, *The Shadow of Punitive Damages on Settlements*, 1998 WIS. L. REV. 169, 176–78 (1998) (main impact of punitive damages is the leverage provided in settlement negotiations).

[248] *See, e.g.*, Sharkey, *supra* note 247, at 98 ("Dignitary and emotional harm cases present a fertile ground for crossover, or overlap, between punitive and compensatory damages. In these cases, the defendant's motives and the nature of its conduct—typically relevant for the determination of punitive damages—assume a relevance to compensatory damages . . . ." (footnotes omitted)).

parties to transform undefined and uncovered punitives into sums-certain of (presumably higher) insurable compensatory damages.[249] Members of both defense and plaintiff bars note they are willing to negotiate these "trade-downs" due to the uncertainty over how juries may allocate damages.[250] Moreover, in cases where defendants have few assets from which to satisfy the judgment, both parties' interests are served by structuring the settlement to effectively convert uninsured punitive damages into compensatory sums-certain that will be covered by the insurer.[251]

The impact of these trade-downs makes arguments relying on the moral outrage of insuring punitive damages lose some of their sting. Moreover, seen in terms of the negotiation process, the amounts later denominated as punitive damages arise due to the parties' inability to settle the claims before trial. To the extent this failure can be charged to the insurer's unreasonable conduct, the *RLLI*'s view is considerably less exotic.

Nevertheless, the fluidity between punitive and compensatory damages cuts equally in the opposite direction. Kim Marrkand explains that when compensatory and punitive damages are demanded by the claimant, the *RLLI*'s rule effectively forces the insurer to overpay in settlement of compensatory damages to avoid judicial imposition and the insurer's own potential liability for the punitive amounts.[252] In real terms, this comes very close to forcing insurers to use insurance funds to cover damages expressly excluded under the policy. While credible arguments can be made to support the *RLLI*, the general trend in the caselaw is to draw sharp lines between punitive and compensatory damages. The *RLLI* should have restated this decisional law and denied recovery for this form of liability.

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[249] Baker, *supra* note 247, at 227 (describing interviews with plaintiff lawyers who would "[p]ut in all the inflammatory stuff you have [in the initial complaint], then drop your punitive damages line. Who needs a million dollar verdict with nine-hundred-thousand in punitives you can't collect? This way maybe you get your punitives on the compensatory line: five-hundred-thousand that you can collect.").

[250] *See id.* at 229.

[251] *Id.* at 223–25.

[252] *See* Marrkand, *supra* note 140, at 221–22. *See also* Scott, *supra* note 5 ("If sections 24 and 27 have their expected effect, systematic costs will increase as insurers either pay inflated settlement demands or settle cases where they perceive any risk that a jury might second-guess them about the reasonableness of the settlement demand."); DINALLO & SLATTERY, *supra* note 167, at 22 ("Ultimately, the insurer is pressured to pay unreasonable settlement demands to avoid potentially funding a 'foreseeable' punitive damages award, even where affirmatively excluded.").

CONCLUSION

To the extent the relevant legal doctrines are clear, and their underlying basis is uncontested, no Restatement is necessary. Such a project is only useful when it yields a scholarly reconstruction that restates the law along conceptually tighter and more doctrinally predicable lines. Unless one assumes that contemporary liability insurance law—in contrast to nearly every other area—is in some fundamental sense not "restate-able," the *RLLI* is useful precisely because it plugs doctrinal gaps, chooses between doctrinal alternatives, and sharpens understanding of the underlying principles.

Though its detractors decry the RLLI for "creating insurance law" when evaluating its work *in the law's gray areas*—such as settlement law—the relevant standards are whether it: (i) is transparent regarding the rules it explicitly and implicitly adopts and rejects in both blackletter and comments; (ii) offers reasoned and compelling arguments for its choices; (iii) on contested matters, provides resources to sustain positions that diverge from those adopted by the Restatement; and (iv) does not depart from the weight of authority or consistently favor one class of interests over the other. Despite quibbles noted along the law, measured by these standards the *RLLI*'s most consequential sections—including the treatment of settlement law—should be deemed a success.