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Defending the Restatement of the Law, Liability Insurance: "Regulatory Considerations"

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Introduction

As the *Restatement of the Law, Liability Insurance* ("the Restatement") has progressed through the rigorous drafting process of the American Law Institute (the "ALI"), insurance industry organizations have pursued an "inside and outside" strategy regarding the project. Insofar as we are aware of these efforts in our role as Reporters for the Restatement, the industry's "inside" efforts have consisted of the invited participation of a liason to the project from the American Insurance Association, and communications to the Reporters from Advisers and ALI members who are knowledgeable about insurance industry concerns; and the "outside" efforts have consisted of lobbying of the Reporters by non-ALI members, letters sent to the ALI leadership by senior officials in liability insurance companies, the retention of Yale Law Professor George Priest to prepare a public critique of the Restatement from a law and economics perspective that will be published in the *George Mason Law Review*, the retention of Wharton Healthcare Management Professor Scott Harrington to prepare a similar critique, and the retention of two attorneys from the law firm Debevoise & Plimpton, Eric Dinallo and Keith Slattery ("D&S"), to prepare a white paper criticizing the Restatement based on "regulatory considerations."[1]

The inside efforts have been consistent with what we understand to be the regular practices of the ALI, and, like other of the regular practices of the ALI, they have contributed to both the content and the quality of the Restatement. Some of the outside efforts – specifically, the detailed, on-the-merits analyses of specific aspects of drafts provided to us by lawyers retained by insurers for this purpose – have also been constructive. We of course took into account that the authors of the analyses were not ALI members and that they were paid for their efforts. Nevertheless, their analyses contributed to our understanding of practical considerations and of gaps between drafting intent and possible interpretation, and the Restatement is better drafted as a result.

By contrast, the public critiques of the Restatement have not been helpful to the drafting process. That is no surprise, since their obvious intent is to tarnish the reputation of the Restatement, not to improve it. We have written a detailed response to Professor Priest's critique that will be published shortly that describes his criticisms and our responses as follows:

> Priest's written critique of the Restatement, which he candidly acknowledges was paid for by the American Insurance Association, contains bold (and this essay will argue,

[1] Eric J. Dinallo and Keith J. Slattery prepared a critique dated January 17, 2017 that was distributed to the ALI Council shortly before the Council met to consider whether to approve the final sections of the Restatement. D&S have also prepared two shorter documents that have been more widely distributed. The January 17 document did not disclose that their work was funded by the National Association of Mutual Insurance Companies. The later summary documents do make that disclosure. The circulation of the shorter summary documents separate from the longer document seeks to create the impression that there is serious research and real analytical force in the longer document. See e.g. footnote one of the February 17, 2017 "executive summary" ("This executive summary summarizes the January 17, 2017 thirty-nine page paper prepared by the authors") and footnote one of the Febuary 17, 2017 "synopsis" ("This Synopsis is a condensed version of the January 17, 2017 thirty-nine page paper prepared by the authors"). This response seeks to dispel that misimpression. Unless stated otherwise, all citations in this response are to the relevant pages in the thirty-nine page D&S white paper.

groundless and unsubstantiated) assertions about the Restatement and about us. It goes on at length about basic principles of insurance economics that anyone who took micro-economics in college will remember, thereby not-so-subtly seeking to create the (erroneous) impression that the Restatement is somehow inconsistent with, and written in ignorance of, those economic principles. Further, it claims that the Restatement will undermine the stability of insurance markets. The basic structure of his argument can be summarized as follows:

(1) In drafting the Restatement, Baker and Logue have chosen many new rules that radically depart from existing case law.

(2) These radical new rules have a clear "pro-policyholder" bias, a bias that is misguided because it is premised on mistaken assumptions about how insurance markets work and fails to take into account well-known principles of the "economics of insurance."

(3) The radical pro-policyholder rules that Baker and Logue have proposed will harm policyholders by causing liability insurance premiums to skyrocket and the availability of coverage to evaporate, harming all policyholders but especially the poor.

Our responses to these assertions are straightforward:

(1) All of the rules that the Restatement adopts are grounded in existing case law. In that sense, none of them are new, and certainly none are radical. Most of the rules in the Restatement have in fact been adopted by a majority of U.S. jurisdictions that have considered them. The Restatement follows a minority rule in only a few instances and only when the minority rule is better reasoned and will likely lead to better consequences than the alternatives. This is a common practice among ALI Restatement projects.

(2) Like the law on which it is based, the Restatement is not premised on mistaken assumptions about how insurance markets work; nor does it fail to take account of basic principles of insurance economics. Instead, it is Priest who either misunderstands or intentionally ignores basic facts about insurance markets. Specifically, Priest ignores the insights, accumulated over many decades now by psychologists and empirical economists, regarding how people actually behave, facts that are contrary to the largely discredited perfectly-rational-actor model on which Priest's arguments are premised.

(3) Therefore, expanding the geographical application of the rules that the Restatement follows, thereby creating greater national uniformity in liability insurance law, would support, not disrupt, insurance markets.

(4) Finally, Priest provides no evidence to the contrary. Because all these rules, or some variant of them (in some cases, a more pro-policyholder alternative rule), have been adopted in some jurisdiction in this country, if those rules were disruptive to the market, there should be evidence of that fact in those jurisdictions. So far as we know, there is no such evidence.[2]

[2] See Tom Baker and Kyle D. Logue, *In Defense of the Restatement of Liability Insurance Law*, -- GEORGE MASON L. REV. --- (forthcoming 2017 and presently available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2952804); George Priest, *A Principled Approach Toward Insurance Law: The Economics of Insurance and the Current Restatement Project* --- GEORGE MASON L. REV. --- (2017, earlier draft available at: http://dx.doi.org/10.2139/ssrn.2631123).

In this paper we address the D&S white paper, which covers some of the same ground as Professor Priest's article. Their overarching claim is that the Restatement adopts a series of rules that are not based on the existing case law and that, if adopted by the ALI, would greatly expand the coverage owed by property-casualty insurers and encroach on the regulatory function of state insurance regulators. The result will be a disruption in insurance markets, including premium increases, coverage withdrawals, significant additions to loss reserves, and general market instability.

As we will demonstrate, these assertions are false, unsupported by any proffered evidence, or confused and misleading. Every rule of insurance law adopted in the Restatement is grounded in existing case law; most of the rules have been adopted in a majority of jurisdictions; and all of the rules, as well as all of the commentary supporting those rules, are the product of the famously thorough and rigorous ALI Restatement process, which includes many opportunities for experts in the field to review, comment on, and suggest revisions to the many drafts of the document. Further, D&S offer no evidence (none) that any rule or any combination of rules contained in the Restatement would adversely affect insurance markets in any way. All they offer is their opinion, which is built on a faulty foundation.

In this response we first summarize and respond to D&S's criticisms of the Restatement rules that they assert depart from existing authority and will lead to negative regulatory and market consequences. We then address those alleged negative consequences.

1. **The Restatement's rule regarding liability insurers' settlement duties—which the Restatement articulates as a duty to make reasonable settlement decisions—is not grounded in the case law, which generally requires bad faith rather than negligence, and amounts to the imposition of "quasi-strict liability" for any insurer that rejects a within-limits settlement offer.**[3]

This argument – which serves as the primary foundation for their assertions about the negative impact of the Restatement on liability insurance markets – is false. Restatement § 24 articulates liability insurer's "duty to make reasonable settlement decisions" as follows:

> § 24. The Insurer's Duty to Make Reasonable Settlement Decisions
>
> (1) When an insurer has the authority to settle a legal action brought against the insured, or the authority to settle the action rests with the insured but the insurer's prior consent is required for any settlement to be payable by the insurer, the insurer has a duty to the insured to make reasonable settlement decisions to protect the insured from a judgment in excess of the applicable policy limit.
>
> (2) A reasonable settlement decision is one that would be made by a reasonable insurer who bears the sole financial responsibility for the full amount of the potential judgment.
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> …

It is obvious from this text that the standard set forth in the Restatement for determining the breach of an insurer's settlement duty does not sound in strict liability, but rather in reasonableness. For an insurer to avoid liability under this rule, it need only act as a reasonable insurer facing the entire risk would act under the circumstances. Further, the rule is thoroughly grounded in the case law. Some cases expressly identify this rule as being a "negligence" standard. In other cases, courts use the language of "good faith

[3] D&S, White Paper, p.2.

and fair dealing," but both sets of cases evaluate the insurer's conduct against the standard of commercial reasonableness that the Restatement adopts.[4] Taking both types of cases into account, this rule is the majority position.[5]

D&S base their entire argument regarding § 24 on a false dichotomy between courts that employ a "bad faith" standard and courts that employ a "negligence" standard in relation to insurers' settlement decisions. For example, D&S cite a leading insurance law treatise, *Appleman on Insurance*, and characterize the relevant passages in that treatise with the following parenthetical: "(commenting that majority view adopts bad faith standard while minority view adopts negligence standard)."[6] However, if one actually reads the cited passage in *Appleman*, it makes clear that a majority of courts apply the reasonableness standard adopted in the Restatement. *Appleman* concludes that, whereas only a minority of jurisdictions have *expressly* adopted a negligence standard with respect to the duty to settle, many other courts that purport to apply a bad faith standard *in fact* apply a reasonableness test. Here is the relevant quotation:

> Authorities generally agree that the significance of any distinction between the two tests [negligence and bad faith] is minimal in most jurisdictions, with similar evidence being relied upon under both tests. As one court stated: "In practice, however, these formulations of the test of the insurer's conduct tend to coalesce; courts claiming to hold an insurer liable only for bad faith have held insurers liable for failure to settle in an appropriate case, even though the failure was attributable solely to negligence." *Thus, many courts that purport to follow a bad-faith standard apply a negligence standard in practice*.[7]

The mischaracterization of the *Appleman* treatise is not their only troubling citation. In *Jones v. Secura Ins. Co.*, 638 N.W. 2d 575, 586 (Wis. 2002), for example, there is nothing to suggest that the court's holding requires any showing other than a lack of commercial reasonableness to establish the breach of the insurer's settlement duty. Further, the court in that case expressly held that a breaching insurer can be held liable for all of the damages that proximately result from the breach, thereby providing support for § 27 of the Restatement, which D&S also criticize (as discussed further below).

Similarly, *Birth Center v. St Paul Cos. Inc.* 787 A.2d 376, 407-08 (Pa. 2001), cited by D&S in support of the claim that the weight of the case law requires showing of more than unreasonabless, did not in fact address whether a showing of greater wrongdoing was necessary to justify excess-of-limits damages. The *Birth Center* court held only that when bad faith has been shown, damages should include

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[4] See Reporters Note to Comment a of § 24.

[5] This point is made expressly in the Restatement as follows:

> Because of its origins in the duty of good faith and fair dealing, courts in many jurisdictions refer to the standard for breach of the duty to make reasonable settlement decisions as one of "bad faith." That formulation suggests the need to prove some bad intent on the part of the insurer that goes beyond the reasonableness standard stated in this Section, and some courts do require such a showing. In most breach-of-settlement-duty cases, however, even those that invoke the language of bad faith, the ultimate test of liability is whether the insurer's conduct was reasonable under the circumstances.

Restatement, § 24, Comment a.

[6] D&S, White Paper, P.12, fn 45.

[7] 3-23 APPLEMAN ON INSURANCE LAW § 23.02[2][a]-[c] (emphasis added) (citation omitted).

all foreseeable harms. What's more, the court in *Birth Center* discussed bad faith in terms of failure of the insurer to make a reasonable settlement decision, which is the standard adopted in the Restatement.[8]

Their citation to *Crisci v. Security Ins.* 426 P.2d 173, 178 (Cal. 1976) is especially puzzling. *Crisci* is *the* classic example of a case that uses the language of good and bad faith while applying a reasonableness standard. Here is the key quotation from the opinion:

> [L]iability based or an implied covenant exists whenever the insurer refuses to settle in an appropriate case and that liability may exist when the insurer unwarrantedly refuses an offered settlement *where the most reasonable manner* of disposing of the claim is by accepting the settlement. *Liability is imposed not for a bad faith breach of the contract but for failure to meet the duty to accept reasonable settlements, a duty included within the implied covenant of good faith and fair dealing.*[9]

It is obvious that the *Crisci* court meant to adopt a standard that imposes a duty on liability insurers to make reasonable settlement decisions. D&S's mischaracterization and misuse of these authorities, which constitute the central support for their primary critique of the Restatement, calls into question that critique.

But there is more. For example, D&S also cite *Bollinger v. Nuss*, 449 P.2d 502, 508 (Kan. 1969), seemingly for the proposition that the vast majority of courts require more than negligence to establish liability for an excess verdict. In fact, *Bollinger* explicitly held that a lack of "due care" in deciding not to settle is sufficient to subject the insurer to liability for an excess verdict, and it cited more cases in favor of that position than against it. The relevant quote follows:

> In the vast majority of cases passing upon the question, the courts have held that a liability insurer, having assumed control of the right of settlement of claims against the insured, may become liable in excess of its undertaking under the policy provisions if it fails to exercise good faith in considering offers to compromise the claim for an amount within the policy limits. (See, Anno. 40 A.L.R.2d 168 s 4.) While some courts have expressly rejected the negligence test and permitted recovery only if the insurer has failed to exercise good faith [citing cases], we are not inclined to do so. Public policy dictates that the insured's interests be adequately protected, and we believe this may be best accomplished by holding that both due care and good faith are required of the insurer in reaching the decision not to settle. [citing a greater number of cases].[10]

Many other of their citations have similar mischaracterization problems. We recommend that any readers who doubt our analysis take the time to read the cases themselves and then compare the actual holdings to the way D&S use them.

Indeed, the ability of D&S to wave the banner of "bad faith" to mischaracterize the standard that most courts apply when analyzing insurers' settlement decisions demonstrates why the Restatement's rule is so important. Because the term "bad faith" can summon up visions of egregious conduct, an inexperienced

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[8] *Birth Center,* 787 A.2d 376, 407-08 (Pa. 2001) ("Today, we hold that where an insurer acts in bad faith, *by unreasonably refusing to settle a claim*, it breaches its contractual duty to act in good faith and its fiduciary duty to its insured. Therefore, the insurer is liable for the known and/or foreseeable compensatory damages of its insured that reasonably flow from the insurer's bad faith conduct.") (emphasis added).

[9] *Crisci v. Security Ins*. 426 P.2d 173, 178 (Cal. 1976) (emphasis added).

[10] *Id*.

judge or litigant could easily be confused or misled into thinking that the insured must do more than show that the insurer unreasonably chose not to settle. Section 24 prevents that confusion, informing courts and litigants that the standard that most courts apply when determining whether to hold an insurer responsible for a verdict that is excess of the policy limits is that of the "reasonable insurer." The primary goal of a Restatement is to clarify the law, which is exactly what § 24 does.

To support their strict-liability characterization of § 24, and to further support their argument that the Restatement rule contradicts the weight of the case law, D&S also contend that the Restatement rule defines "reasonableness" incorrectly. The following extended quote captures their argument:

> The Draft rules significantly depart from existing case law regarding the insurer's duty to settle and the availability of extra-contractual damages by applying a quasi-strict liability standard to the insurer's decision whether to accept a settlement offer, completely disregarding the *likelihood* of an excess judgment at the time the offer was refused. Specifically, Section 24 mandates that the insurer has a duty to the insured if there is a mere "*potential* for a judgment in excess of the applicable policy limit." Illustration (1) highlights Draft's problematic approach. Notably, the insurer can be found liable by a "trier of fact" for the judgment beyond limits because it failed to settle when the plaintiff had a mere thirty (30%) percent chance of success at trial because the Draft reduces the insurer's duty to settle to a simple formula: probability of liability times potential damages. This simplistic approach can lead to absurd results. For example, if the potential damages are sufficiently high, insurers would be forced to settle a claim with a five (5%) percent chance of success, or be liable for a potential excess judgment…
>
> The proposed Draft standard contradicts well-settled case law that requires the insurer to accept a demand within policy limits when there is a great risk of recovery beyond the policy limits. Other jurisdictions utilize similar tests focused on the claimant's probability of success, such as the "substantial or significant likelihood of an excess verdict" test….[11]

On careful analysis, D&S make three distinct claims here. First, the Restatement rule would obligate an insurer to settle a claim whenever the expected value of the case (i.e., the probability of losing multiplied by the likely magnitude of the judgement if a loss occurs) is greater than the settlement offer. Second, most courts permit an insurer to ignore a settlement offer if the probability of a defense loss at trial is below some unspecified threshold. Third, the latter rule is the better rule. All three arguments are wrong.

First, § 24 does not apply a formulaic rule that treats as per se unreasonable (for which the insurer is "strictly liable") any decision by an insurer to reject a settlement offer that has an expected value equal to or higher than the expected value of the underlying claim. Although a comparison between the expected value of the claim and the settlement offer is certainly a factor (as it is for the courts tasked with making this determination), the Restatement makes clear that there is no algebraic formula for determining whether an insurer has breached its settlement duties.[12] Further, Comment d to § 24 explicitly states that it is not enough for the insured to show that the settlement offer was reasonable in pure expected value terms; the insured must also show that "a reasonable insurer would have accepted the offer."

[11] D&S, White Paper, Pp. 13-14 (emphasis in original).
[12] Restatement, § 24, Comments c & d.

Second, the cases that D&S cite to support their argument that the weight of the case law creates a special exception for low-probability/high-magnitude cases do not in fact support that position. Although some cases contain language suggesting that a finding of a "great risk" or a "substantial likelihood of an excess verdict" may be *sufficient* to establish the breach of an insurer's settlement duty, none of those cases hold that such a showing is *necessary*.[13] Moreover, the cases that contain such language are especially unclear about precisely what standard they are establishing or applying.[14] Finally, there is no "substantial likelihood" or "great risk" test that has been adopted in the case law. D&S have simply found a few imprecisely worded decisions and lumped them together as if they represented a clear majority rule that insurer can ignore settlement offers in low-probability/high-magnitude cases. No such rule exists.[15]

Third, if such a rule were adopted, it would produce perverse incentives for insurers and bad outcomes for policyholders, contrary to the fundamental objective of the legal duty, which is to align the insurer's interests with those of the policyholder's. To see this point, consider a claim against an insured in which there is a 50% chance of $0 damages, a 40% chance of $ 1 million in damages, and a 10% chance of $2 million in damages. Assume that the plaintiff offers a settlement of $500,000, the policy limit is $1 million, and the insurer reasonably believes that this is the best settlement offer it can possibly get from the claimant. Given these facts, the $500,000 offer is attractive from the standpoint of a defendant who would be responsible to pay all the damages, since it is well below the $600,000 expected value of the claim. What is more, the $500,000 offer is for the same reason also clearly attractive from the standpoint of what would be in the joint best interests of the insurer and the policyholder. Accepting the $500,000 settlement offer would produce lower overall costs to the insurer/policyholder unit than would going to trial. Under the rules adopted in §§ 24 and 27 of the Restatement, the insurer would have an incentive to accept the $500,000 offer, or face the risk of an excess judgment.

But what if the jurisdiction instead adopted the "great risk" or "substantial probability" test recommended by D&S? Under such a rule, the insurer would not be subject to potential duty-to-settle liability for rejecting the $500,000 settlement offer, because under such a rule the insurer could ignore the 10% risk of the $2 million outcome, since 10% is not a "substantial probability." As a result of that rule, there would be an incentive for insurers in such cases to reject such an offer. Clearly, this is a bad

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[13] See, e.g., *Archdale v. American Intern. Specialty Lines Ins. Co.*, 154 Cal. App. 4th 449, 470-71, Cal. Rptr. 3d 632, 650-51 Ct. App. (2007) ("An insurer's failure to accept an offer of a reasonable settlement within policy limits when there is a great risk of liability in excess of the policy limits may, 'in the ordinary course of things,' result in a judgment against the insured beyond the policy limits."); *Allstate Ins. Co. v. Herron*, 634 F.3d 1101, 1109 (9th Cir. 2011) (In Alaska, "[w]hen a plaintiff makes a policy limits demand, the covenant of good faith and fair dealing places a duty on an insurer to tender maximum policy limits to settle a plaintiff's demand when there is a substantial likelihood of an excess verdict against the insured.") (quoting *Jackson v. Am. Equity Ins. Co.*, 90 P.3d 136, 142 (Alaska 2004).

[14] For example, the *Archdale* case included the following statement: "a reasonable settlement offer exists when, in light of the nature and scope of the victim's injuries and the probable liability of the insured, the ultimate judgment is likely to exceed the amount of the offer." What does this mean? The court obviously did not mean to suggest that it would be reasonable for an insurer to reject an offer of $10, if there were a 51% chance of a $9,000 judgment and a 49% chance of an $80,000 judgment, even though the more "likely," or more probable, outcome in some sense would be no excess judgement. As a result, it is not clear what precise test the court had in mind.

[15] D&S also cite *Rupp v. Transcon. Ins. Co.*, 627 F. Supp. 2d 1304, 1324 (D. Utah 2008), another loosely worded decision that uses not the phrase "substantial likelihood" or "great risk" but "significant likelihood." Again, the effort is to find similar sounding language, ignore the differences between the phrases, and then characterize the cases as if they establish a unified test, which they do not.

outcome. The insurer should not be encouraged to reject this offer and thereby expose the insured to a 10% risk of a catastrophic loss, a result that would be inconsistent with the widely accepted underlying justification for the duty to make reasonable settlement decisions, which is to align the interests of the insurer and the insured.

2. The Restatement's rule regarding damages for the insurer's breach of the duty to make reasonable settlement decisions includes punitive damages that are assessed against the policyholder as a result of such breach, even though the possibility of such punitive damages against the policyholder cannot possibly be reasonably foreseen by the insurer at the time of contracting.[16]

In this case, D&S correctly state the Restatement rule, but their statement about forseeability is wrong, and much of their analysis is confused. Under § 27 of the Restatement, "[a]n insurer that breaches the duty to make reasonable settlement decisions is subject to liability for the full amount of damages assessed against the insured in the underlying legal action, without regard to the policy limits, as well as any other foreseeable harm caused by the insurer's breach of the duty." Comment d to § 27 states, "[i]f a liability insurer's unreasonable failure to settle a legal action against the policyholder results in a compensatory damages award in excess of the policy limits and a punitive damages award against the policyholder in that action, the amount of that punitive damages award is included in the consequential damages owed for breach of the insurer's duty." Such a rule is unproblematic, indeed self-evident, in states that permit liability insurance coverage for punitive damages. The reason is simple: when a liability insurer enters into a contract with a policyholder, it is reasonably foreseeable that a case might be brought against the policyholder that could give rise to punitive damages against that policyholder. D&S do not appear to disagree with that conclusion.

Comment d also makes the anodyne observation that the same fact about forseeability is true in states in which liability insurance against punitive damages is considered a violation of public policy. That is because the forseeability of a punitive damages verdict against a policyholder does not turn on whether that punitive damages verdict will be insured or not. Therefore, even in the jurisdictions in which punitive damages verdicts are uninsurable, the Restatement rule would allow a policyholder who proves that the insurer's breach of the duty caused the insured to incur a punitive damages award to recover the amount of that award as part of the damages for breach of that duty (provided of course that the courts in those jurisdictions chose to follow the Restatement rule). This conclusion is simply a restatement of the old and basic rule of contract damages for foreseeable consequences.[17]

D&S object to this result because, on their view, '[p]unitive damages cannot be 'reasonably foreseeable at the time of contracting' to an insurer that excluded punitive damages from coverage."[18] This statement is self-evidently false. Whether a possible punitive damage award against the policyholder is foreseeable at the time of contracting with the insurer—which it clearly is in at least some cases (consider automobile insurance and drunk driving for example)—has nothing to do with whether such an award is insurable.

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[16] D&S, White Paper, p.19 ("Punitive damages cannot be 'reasonably foreseeable at the time of contracting' to an insurer that excluded punitive damages from coverage.").

[17] Nevertheless, the small number of courts that have considered this issue, have come out the other way. Two of the three state supreme courts that considered the issue did so with 5-4 split decisions, with strong dissents that were more consistent with the underlying contractual nature of the insurance law remedy in question. See RLLI, Reporters' Note to Comment d to§ 27.

[18] *Id.*

D&S further reveal their confusion (unintentional or not) regarding punitive damages when they say this:

> Courts have applied a much different standard for punitive damages award for failure to settle than is provided under Section 27, which simply complements the quasi-strict liability standard under Section 24. Although standards vary, in order to justify an award of punitive damages the insurer's breach of the duty of good faith and fair dealing must be shown to have been particularly outrageous.[19]

Here D&S have conflated two totally different legal rules: (1) the rule regarding an insurer's liability to compensate its policyholder for the punitive damages *that the policyholder incurs* because the insurer breached the duty to make reasonable settlement decisions; and (2) the rule regarding an insurer's liability for punitive damages *that the insurer incurs itself* because of an especially egregious breach of its duties to the policyholder. Section 27 of the Restatement covers only the former situation; it has nothing to do with the latter. The rule governing punitive damages assessed to punish an insurer for egregiously bad faith behavior is covered in § 51, Comment c, which includes the following statement of the standard of liability:

> There are no special liability insurance law rules governing the standard for or the amount of punitive damages in an insurance bad-faith case. As with punitive damages generally, the purpose of awarding punitive damages for liability insurance bad faith is primarily to punish the insurer for its wrongful conduct and also to deter this insurer and other insurers from engaging in similar conduct in the future. Bad-faith conduct that has the potential to evade detection is particularly deserving of punishment on deterrence grounds, among other reasons to provide a level playing field for insurers that do not engage in such conduct. Bad-faith conduct that denies the dignity of the people that the insurer promised to protect is deserving of punishment on retributive grounds.
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> The legal standard for awarding punitive damages is worded differently in almost every state. In many states there is a statute that provides the legal standard for awarding punitive damages. With very few exceptions, every state requires proof of something more than the evidence required to prove an unreasonable failure to settle under § 24 of this Restatement. Such unreasonable settlement decisions are often called "bad faith," even though they often do not involve subjective bad faith. See § 51. But where an insurer is shown to have acted in true bad faith, meaning that the level of culpability extended beyond a merely unreasonable settlement decision, punitive damages are generally a jury question.[20]

As this excerpt makes clear, § 51 of the Restatement incorporates well-established rules from the common law of torts regarding punitive damages for egregious misconduct. How D&S could have missed this fact, and how they could have conflated the question of whether compensatory damages for breach of settlement duties should include foreseeable punitives assessed against the policyholder with the question regarding the standard for punitive damages assessed against the insurer, is a mystery.[21]

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[19] *Id*. at p.21.

[20] Restatement, § 51, Comment c.

[21] Yet further deepening the conflation, D&S, in the section of their paper dealing with § 27, cite to a number of cases that apply standards for punitive damages against insurers that are different from the standard articulated in §27. Of course they do, since § 27 addresses a different legal rule. Those cases,

3. The Restatement's rule regarding liability insurers' duty to defend is not grounded in the case law and greatly expands their obligations to provide a defense.

Here D&S are concerned with the rule in § 13 that requires the insurer to defend any legal action brought against an insured that is based in whole or in part on any allegations that, if proven, would be covered by the policy, without regard to the merits of those allegations, including not only allegations contained in the complaint but also any information not alleged in the complaint that a reasonable insurer would regard as a basis for adding an allegation to the action.[22] D&S call this an expansion of the duty to defend "beyond case law precedent that either limits the insurer's duty to defend to the actual pleadings or information beyond the pleadings that the insurer has actual knowledge."[23]

While it is true that some cases have limited the duty to defend to the allegations in the pleadings, most have not.[24] We expect that courts ordinarily will hold insurers liable for breach of the duty to defend only when the insurers ignore allegations that they know about – among other reasons because policyholders and the underlying claimants have an incentive to provide notice of potentially covered allegations to the insurers. Neverthless, it would be irresponsible to adopt a rule that gave insurers an incentive to put their heads in the sand, and D&S provide no authority suggesting that courts have

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however, articulate standards for punitive damages against insurers that are entirely consistent with §51. The following is a direct quote from D&S footnote 91, where they compile numerous cases, again trying to make the point that the rule the Restatement adopts in § 27 is against the vast weight of many accumulated cases from many different jurisdictions, which is not true:

> See *Amadeo v. Principal Mut. Life Ins. Co.*, 290 F.3d 1152, 1164 (9th Cir. 2002) (Under California law, punitive damages are available on an insured's bad faith claim against an insurer "if in addition to proving a breach of the implied covenant of good faith and fair dealing proximately causing actual damages, the insured proves by clear and convincing evidence that the insurance company itself engaged in conduct that is oppressive, fraudulent, or malicious") (quoting *PPG Indus.*, 975 P.2d at 658); *Mitchell v. State Farm Fire and Cas. Co.*, 799 F. Supp. 2d 680, 695 (N.D. Miss. 2011) (punitive damages requires insured to prove that there was no arguable or legitimate reason to deny coverage and the insurer acted willfully, maliciously, or with gross and reckless disregard for the insured's rights) (applying Mississippi law); *Medical Protective Co. v. Pang*, 606 F. Supp. 2d 1049, 1064 (D. Ariz. 2008) ("the insured may recover punitive damages when, 'and only when, the facts establish that [the insurer's] conduct was aggravated, outrageous, malicious, or fraudulent.'") (quoting *Lange v. Penn Mut. Life Ins. Co.*, 843 F.2d 1175, 1183 (9th Cir. 1988)); *Eccobay Sportswear, Inc. v. Providence Washington Ins. Co.*, 585 F. Supp. 1343, 1344 (S.D.N.Y. 1984) ("New York courts routinely dismiss claims for punitive damages against insurers when there has been no allegation or showing that the carrier… had engaged in a fraudulent scheme evincing such a 'high degree of moral turpitude and ... such wanton dishonesty as to imply a criminal indifference to civil obligations.'") (quoting *Leidesdorf v. Fireman's Fund Ins. Co.*, 470 F. Supp. 82, 85 (S.D.N.Y. 1979) (internal quotations omitted))…

These cases have nothing to do with § 27 of the Restatement. They address the legal rule in §51, and they are consistent with that rule.

[22] Restatement, § 13(2)(b).

[23] D&S, White Paper, p.4.

[24] D&S do not appear to disagree that the majority rule requires the insurer to look beyond the complaint. See D&S, White Paper, p.25.

adopted such a rule. Instead, the cases they cite simply state that an insurer that does know about a potentially covered allegation must defend the case.[25]

4. The Restatement creates "presumed coverage for intentionally harmful conduct" under liability insurance policies. [26]

This is so obviously incorrect that it is among the most puzzling claims in the D&S white paper. D&S never explain exactly how the Restatement creates this presumed coverage, but they complain later in their white paper that what is now § 46 of the Restatement would "make the insurer a financial guarantor."[27] That is not true, either. What § 46 does is simple. The black letter rule states that coverage for "liabilities involving aggravated fault" is, in the first instance, "a question of interpretation governed by the ordinary rules of insurance-policy interpretation." If the insurance policy contains a provision that does provide such coverage, then courts will enforce it, unless that coverage is "barred by legislation or judicially declared public policy." Therefore, under § 46, there would be coverage for intentional harm if (and only if) (a) state law did not prohibit such coverage and (b) the insurer *elected* to include such coverage in its policy. That's hardly a presumption of liability insurance coverage for intentionally harmful conduct.

5. The Restatement's rules regarding insurance policy interpretation allow unambiguous policy terms to be disregarded, if extrinsic evidence demonstrates that the policyholder's interpretation is more reasonable.[28]

This is true, and it is supported in the case law. Under § 3 of the Restatement, there is a presumption in favor of the plain meaning of the text, if there is one, but that presumption can be overcome by extrinsic evidence.[29] To overcome the presumption, the policyholder must demonstrate that her meaning is the more reasonable one, based on that extrinsic evidence. This approach to contract interpretation differs from the plain language approach used in some recent New York cases, but it is consistent with the more contextual approach used in other jurisdictions, including California, as well as the rule adopted in the Restatement Second of Contracts.[30] The Restatement of Liability Insurance approach gives more

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[25] See *Fitzpatrick v. American Honda Motor Co*., 575 NE. 2d 90 (NY 1991) (holding that the insurer was obligated to defend in that case because there were facts outside the complaint that indicated the potential for coverage. The other case they cite, *Scottsdale Ins. Co. v. MV Transport*, 115 P. 3d 460 (Cal. 2005) did not even concern a situation in which coverage turned on the presence of extrinsic facts. Rather the court simply stated in dicta "the duty [to defend] also exists where extrinsic facts known to the insurer suggest that the claim may be covered."

[26] D&S, White Paper, P.2.

[27] *Id*. at p.26.

[28] *Id*. at p.4.

[29] Restatement, § 3(2)(" An insurance policy term is interpreted according to its plain meaning, if any, unless extrinsic evidence shows that a reasonable person in the policyholder's position would give the term a different meaning. That different meaning must be more reasonable than the plain meaning in light of the extrinsic evidence, and it must be a meaning to which the language of the term is reasonably susceptible.").

[30] See Restatement Second, Contracts § 212, Comment b ("It is sometimes said that extrinsic evidence cannot change the plain meaning of a writing, but meaning can almost never be plain except in a context."). See also U.C.C. § 2-202, Comment 2 ("[W]ritings are to be read on the assumption that the course of prior dealings between the parties and the usages of trade were taken for granted when the document was phrased. Unless carefully negated they have become an element of the meaning of the words used."); *Pac. Gas & Elec. Co. v. G.W. Thomas Drayage Co*., 442 P.2d 641, 644 (Cal. 1968) ("The

weight, however, to the plain language than does the California approach, and perhaps even than the approach of the Restatement Second of Contracts. Moreover, as explained in Comment b to § 3, the Restatement rule is consistent with the strict plain meaning rule *as that rule is applied* in many cases:

> The rebuttable presumption has the potential to bring the legal rule more in line with the actual practice of interpretation even in jurisdictions with a very strict plain-meaning rule, especially when courts determine the meaning of insurance-policy terms on summary judgment. This is because the efficient practice in summary-judgment proceedings is to include any potentially relevant extrinsic evidence as supporting material to summary-judgment motions, typically in the form of affidavits with exhibits. This practice is efficient even under a strict plain-meaning rule because courts do not generally engage in two rounds of summary judgment: a first round in which the court determines whether the term in question is ambiguous and a second round in which the court considers the extrinsic evidence. Rather, courts ordinarily decide the meaning of insurance-policy terms based on a single round of briefing and argument. This practice means that courts have the extrinsic evidence in hand when they interpret the policy and, moreover, that parties refer to that evidence in their briefing, if only as an argument "in the alternative" in the event that the court determines that the relevant policy term is ambiguous. This means that the increased administrative costs of the plain-meaning presumption, as opposed to the plain-meaning rule, are less than might be imagined and that, as a practical matter, courts already may be influenced by extrinsic evidence even in a strict plain-meaning jurisdiction. Thus, the plain-meaning presumption is likely to be more closely in line with the actual practice in many cases, to the benefit of increased transparency in the rule of law.

6. The Restatement's rules regarding insurance policy interpretation seek to impose an unqualified reasonable expectations standard that is not supported by the case law.

This is false, and strangely so, given that one of the notable things about the Restatement is that it explicitly rejects the doctrine of reasonable expectations famously formulated by Professor (later Judge) Keeton and traditionally much admired by some law professors.[31] Comment b to § 4 states: "By requiring that the meaning be one to which the words are reasonably susceptible, this Restatement does not follow the strong formulation of the reasonable-expectations doctrine, pursuant to which an insurance

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test of admissibility of extrinsic evidence to explain the meaning of a written instrument is not whether it appears to the court to be plain and unambiguous on its face, but whether the offered evidence is relevant to prove a meaning to which the language of the instrument is reasonably susceptible."); *London Mkt. Insurers v. Super. Ct.*, 53 Cal. Rptr. 3d 154, 160-164 (Ct. App. 2007) (applying Pacific Gas to a liability-insurance-coverage action and considering, inter alia, some of the drafting history of the term in question and noting the relevance of that drafting history to the decision of the trial court on remand); *Hessler v. Crystal Lake Chrysler-Plymouth, Inc.*, 788 N.E.2d 405, 413 (Ill. 2003) ("Illinois law does not require a finding of ambiguity as a condition for the admission of extrinsic evidence").

[31] See Robert Keeton, *Insurance Law Rights At Variance With Policy Provisions*, 83 HARV. L. REV. 961, 966-67 (1970); See Roger C. Henderson, *The Doctrine of Reasonable Expectations in Insurance Law After Two Decades*, 51 OHIO ST. L.J. 823, 828 (1990); Kenneth S. Abraham, *The Expectations Principle as a Regulative Ideal*, 5 CONN. INS. L.J. 59, 63 (1998) (written for a symposium on the doctrine of reasonable expectations after three decades). Cf. Daniel Schwarcz, *A Products Liability Theory for the Judicial Regulation of Insurance Policies*, 48 WILLIAM & MARY L. REV. 1387 (2007) (proposing a new product liability theory that would function similarly to a strong doctrine of reasonable expectations).

policy is to be interpreted according to the reasonable expectations of the insured even if the insurance policy language is to the contrary."

Notwithstanding this clear rejection of the reasonable expectations doctrine, D&S (inexplicably) assert the following:

> The Draft seeks to impose an unqualified "reasonable expectations" standard that is not supported by case law precedent…
>
> Cases assessing the "reasonable expectations" doctrine have rejected the concept outright or applied the doctrine to resolve ambiguous language or to protect the insured against terms that are "buried in fine print," unlike the Draft's unqualified application. The application of the reasonable expectations doctrine is typically limited to cases in which the policy is ambiguous and the mutual intent of the parties. [32]

Yet, nowhere in the black letter of the Restatement is the phrase "reasonable expectations" even mentioned. It is true that, in various places in the Comments, the Restatement discusses the longstanding tradition of courts' taking into account or considering the reasonable expectations of policyholders in circumstances in which the insurance policy is ambiguous.[33] Given the extent to which courts talk about the reasonable expectations of policyholders in that context, it would hardly be a restatement of the law if we ignored this important principle of interpretation.[34] But the Restatement contains no unqualified reasonable expectations doctrine.

7. The Restatement's rules regarding misrepresentation limit insurers' ability to rescind coverage following misrepresentation in a way that is inconsistent with existing case law.

This is also false. The rules regarding misrepresentation adopted in the Restatement follow the law in the majority of jurisdictions. Section 7 states the basic rule that an insurer may rescind a policy, or deny a claim, if there has been a misrepresentation, in the application or renewal process, if that misrepresentation was material and was reasonably relied upon by the insurer to its detriment. Section 8 then states the materiality requirement as follows:

> A misrepresentation by or on behalf of an insured during the application for, or renewal of, an insurance policy is material only if, in the absence of the misrepresentation, a reasonable insurer in this insurer's position would not have issued the policy or would have issued the policy only under substantially different terms.

D&S seem to have a problem with the use of the phrase "substantially different terms" rather than merely "different terms." The point of adding the word "substantially" is simply to rule out the possibility that an insurer might attempt to rescind and policy or deny coverage on misrepresentation grounds because of a trivial difference in terms. For example, a misrepresentation in a liability insurance policy would not be considered material if its only effect was to change the amount of premium charged by a few dollars.[35] We have yet to hear from any serious commentators disagreeing with that specific example.

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[32] D&S, White Paper, p.30.
[33] See, e.g., Restatement, § 4, Comment b ("This Section is broadly consistent with the principle that insurance policy terms are to be interpreted according to the reasonable expectations of the insured.").
[34] For a lengthy survey of court cases applying, and commentary discussing, the idea of reasonable expectations, see the sources cited in the Reporters' Note to Comment b, Restatement § 3.
[35] The Restatement includes the following illustration to make the point:

8. The Restatement's rules regarding the policyholders' contractual duty to cooperate with the insurer depart from established case law by requiring the insurer to show that the failure to cooperate was "outcome determinative" before the insurer may avoid coverage.[36]

This is false. The Restatement follows the majority rule in requiring the insurer to demonstrate prejudice before it can avoid coverage on the basis of a breach of the insured's duty of cooperation.[37] While D&O apparently agree that this is the majority rule, they quibble that comment b to § 30 erects too high a prejudice standard by requiring the insurer to prove that the failure to cooperate was "outcome determinative." Yet, here is what comment b states, in full:

> Courts differ in how they apply the prejudice requirement. The approach that is most protective of insureds uses the "substantial likelihood" test, which requires the insurer to demonstrate a substantial likelihood that the insured's cooperation would have allowed the insurer to defeat the legal action brought against the insured. The approach that is least protective of insureds employs a presumption that a breach of the duty to cooperate causes prejudice to the insurer, with the insured bearing the burden of rebutting the presumption, and an undemanding standard for prejudice to the insurer (for example, increased costs or difficulty in investigating or defending the legal action, even if the failure to cooperate did not affect the outcome of the action). In practice, this least protective approach can become the functional equivalent to the strict-condition rule and, accordingly, is inappropriate for the reasons stated in Comment d. Most courts articulate an intermediate position that requires the insurer to prove that it has or will suffer significant harm from the breach of the duty to cooperate, but does not require that the insurer demonstrate that the cooperation would have allowed it to defeat the legal action.
>
> Courts rarely specify whether an increase in the cost of defending the legal action, alone, would be sufficient prejudice. Close examination of the facts in the case law reveals that, in practice, there must be some harm to the insurer that goes beyond increased defense costs before an insurer is able to avoid coverage on the basis of a breach of the duty to cooperate. Accordingly, it is appropriate to conclude that the prejudice determination focuses primarily on the impact of the failure to cooperate on the outcome of the action. It is not ordinarily enough that the insured's failure to cooperate increased the cost or difficulty of the defense. Rather, that failure must be one that has affected or will affect the outcome of the action for the insurer—for example, by depriving the insurer of a full or partial defense to liability, substantially increasing the

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> On an application for a standard automobile insurance policy, the policyholder is asked how far she commutes to work each day. The policyholder answers "two miles," when the correct answer is "five miles." The insurer issues the policy with a premium of $1000 for six months. Had the insurer known the truth with respect to this question, it would have charged $50 more for a policy. The policyholder's misrepresentation was not material.

Restatement, § 8, Comment e, illustration 2.

[36] D&S, White Paper at P.2.

[37] 22 ERIC MILLS HOLMES, HOLMES' APPLEMAN ON INSURANCE 2D § 138.8 (2003) ("[I]n the majority of jurisdictions, an insurer must establish that there is a substantial prejudice to the defense of the claim [before it will be relieved of obligations under a policy]."); 1 ALLAN D. WINDT, INSURANCE CLAIMS AND DISPUTES § 3:2 (6th ed. 2012) ("[T]he majority of jurisdictions . . . insist that the [insurer] demonstrate that it was prejudiced as a result of the lack of cooperation [in order for the insurer's coverage obligation to be affected].").

> amount of the judgment, or depriving the insurer of an opportunity to settle the action for a substantially lower amount than the insured damages ultimately awarded.

The use of the qualifier "ordinarily" in the comment signifies to the careful reader that courts could adopt a different test in an appropriate case. Moreover, the comment takes a capacious view of what constitutes an "impact of the failure to cooperate on the outcome of the action." D&S complain, for example, that the comment ignores the fact that the loss of subrogation rights or the loss of a coverage defense seriously harms an insurer.[38] Yet, there is nothing in comment b that states that those two impacts could not constitute sufficient prejudice in an appropriate case. D&S also assert that the Restatement "neglects prejudice recognized as a result of collusion between the plaintiff and the insured."[39] Yet, the Restatement explicitly recognizes the problem of collusion, going so far as to conclusively presume prejudice in cases in which "an insured's collusion with a claimant is discovered before prejudice has occurred." Restatement § 30(2). Clearly, D&S didn't read § 30 or comment b carefully enough.

9. Because of the aforementioned ways that the Restatement expands the obligations of liability insurers beyond what is required by the case law, the Restatement in effect ignores the role of state regulators in maintaining an efficient, accessible, and competitive insurance market while ensuring that insurance consumers are adequately protected.[40]

As the title of their white paper suggests, D&S's overall critique focuses on "regulatory considerations."[41] Although it is not entirely clear what this means, the overarching argument seems to be that some of the rules adopted in the Restatement interfere with or usurp the function of state insurance regulators as the protectors of insurance policyholders. More specifically, they argue that the ALI has chosen rules of insurance not based on what the law actually is but on the basis of identifying the rule that is most likely to result in a finding of coverage, with the result that the insurer is made, in effect, the guarantor of all claims brought against the policyholder.[42]

In this essay we already have shown that, contrary to D&S's assertions, all of the rules adopted in the Restatement find ample support in existing case law. The point to be made here, however, is different. Leaving entirely aside their complaints about the liability insurance rules that the Restatement has chosen, D&S have a deeply flawed understanding of the interplay between the common law of insurance and the public regulation of insurance companies and insurance markets. While insurance regulators have an obviously important role to play in protecting insurance purchasers (from insurance company insolvencies, unfair trade practices, unskilled or unscrupulous sales agents or claims adjustors, insurance policies with unreasonable or hidden terms, and so on), that fact is not inconsistent with the possibility that some insurance law doctrines might also have a role in protecting policyholders.

For one obvious example of such a doctrine, consider the rule of contra proferentem, which says that an ambiguous insurance policy term is construed against the drafter of that term, which in the insurance context usually is the insurer. In an important sense, that doctrine protects policyholders against the risk

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[38] D&S, White Paper, p.36.
[39] *Id.*
[40] *Id.* p.2.
[41] The title of the white paper is, literally, "ALI's Restatement of the Law Liability Insurance: Regulatory Considerations." Mr. Dinallo is a former Superintendent of Insurance for the State of New York.
[42] The white paper contains numerous references to insurers as "guarantors" under the Restatement. See, e.g., D&S, White Paper, pp. 1, 2, 4, 6, 7, 11, 26, 32, and 38.

of ambiguously worded contract terms. Notice further that contra proferentem is the prevailing rule in every jurisdiction in the country and has been deployed by courts in countless cases to decide disputes in favor of policyholders. Yet it would be silly to conclude that the doctrine of contra poferentem amounts to a usurpation of the function of state insurance regulators. While it is true that state regulators have the authority to approve or reject particular insurance forms and even specific policy terms, that authority is not incompatible with the role of the common law courts as interpreters of insurance contracts. Regulator-approved policy terms can still be ambiguous when applied to a particular claim. Indeed, the vast majority insurance policy terms that are found to be ambiguous were in fact approved by a regulator.

A similar point can be made with respect to many of the Restatement's rules that D&S say ignore the role of state insurance regulators. Perhaps the central example—which we discuss in detail above—involves the duty to make reasonable settlement decisions. That duty has long been understood to serve the function of helping to align the incentives of insurers and their policyholders in situations in which their incentives might otherwise diverge. The relevant point here is that the well-accepted incentive-aligning effect of the rule in no way impinges on or undermines the regulatory role of state commissioners or superintendents of insurance.

The one case D&S cite for the proposition that the Restatement's rule regarding settlement encroaches on the regulator's role as exclusive monitor of unfair claims practices is Roldan v. Allstate Ins. Co., 149 A.D.2d 20, 43 (N.Y. App. Div. 1989). The relevant language in the opinion, quoted by D&S, is this: "We conclude that the allegations that an insurance company is engaging in a persistent course of conduct involving fraud or unfair claims practices may more properly be evaluated and, if proved, be redressed by the Superintendent of Insurance, who is charged by law with the regulation of this industry, rather than by private litigants." D&S seem to be arguing that the NY court held that imposing liability beyond the policy limits for breach of the duty to settle was an impermissible interference with the role of the Superintendent of Insurance. What D&S fail to point out, however, is that the court was not in fact objecting to the rule imposing liability on the insurer for compensatory damages for breach of the settlement duty. Rather, the court was objecting to the imposition of *punitive damages* against the insurer in that case. The court assumed the appropriateness of common law courts imposing above-limits compensatory damages for breach of an insurer's settlement duty (as provided under Restatement §§ 24 and 27), but it regarded the imposition of punitive damages as stepping beyond the appropriate role of a court and stepping into the role of the regulator. With regard to punitive damages assessed against insurers, the Restatement does not in fact take a position, deferring instead in § 51 to the punitive damages rule of each state, so the Restatement does not even wade into that controversy.[43]

10. Finally, as a result of the above-listed departures from existing case law and failure to recognize the role of state regulators, approving the Restatement will lead to dire consequences for insurance markets, as liability insurers will be forced to increase their premiums, change their loss reserves, and alter their claims-adjusting practices.

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[43] In that regard, it is at least worth noting that a majority of jurisdictions that have addressed the issue do permit punitive damages to be assessed against liability insurers. Catherine M. Sharkey, *Revisiting the Noninsurable Costs of Accidents*, 64 MD. L. REV. 409 (2005) (discussing jurisdictions' differing approaches to the insurability of punitive damages, including an appendix with a 50-state survey); BARRY R. OSTRAGER & THOMAS R. NEWMAN, HANDBOOK ON INSURANCE COVERAGE DISPUTES, ch. 14 *Insurance Coverage for Punitive Damages Assessed Against an Insured*, and § 14.06 *Survey of the Insurability of Punitive Damages in Various Jurisdictions* (18th ed.).

A surprising amount of the D&S white paper is devoted to a parade of horribles. The following quote comes from the introduction of the paper:

> Market disruption and turmoil is possible in the form of an uncertain and unpredictable pricing and reserving environment, increased claim handling costs and litigation, inflated settlements, increased premiums, and the potential for market exits by insurers and reinsurers as well as carrier insolvencies…
>
> The Draft changes longstanding and fundamental precepts in key areas that form the foundation for policy coverages, rates, reserving, claim handling and reinsurance. Insurers are recast as quasi-governmental financial guarantors under the Draft's proposed rules which are designed to force insurers to defend and pay for all claims. While the objectives of promoting access to compensation for injured parties and protecting policyholders are important, they should not be at the expense of insurers by turning them into financial guarantors. Absent corrections, adoption of the Draft will likely result in the cost of insurance becoming more unaffordable to many, leaving people and companies uninsured or underinsured.[44]

The white paper returns to these themes again and again, on almost every page. What one does not read on any of those pages is any citation to evidence in support of these predictions. D&S offer no empirically grounded reason to believe that any of these premium-increasing, coverage-reducing consequences will take place. And there are good reasons for that omission. First, as this essay has repeatedly demonstrated, the assertion that the rules adopted in the Restatement are not based in actual case law is false. To repeat: every rule of insurance law adopted in the Restatement is well grounded in existing case law; most of the rules have been adopted in a majority of jurisdictions. That fact alone creates problems for the assertion that the adoption of the Restatement's rules will wreck the insurance market. There is simply no evidence that property-casualty insurance markets are being disrupted in the jurisdictions that already apply the rules adopted by the Restatement, and no evidence that prices are higher or coverage less available in those jurisdictions.

Second, the idea that the adoption of a Restatement would radically affect nationwide insurance markets fundamentally misunderstands what a Restatement is and how it functions. A Restatement is not a federal statute imposing a new set of rules on the entire country. A Restatement restates the rules as they exist, not in every jurisdiction (because the jurisdictions are not uniform) but generally in most jurisdictions and always in at least some. In the states that have already adopted a rule that is contrary to a rule adopted by the Restatement, the state's existing rule will obviously continue to apply unless and until the highest court in that jurisdiction chooses to change it, a process that will not occur quickly, if at all. In the states that already apply a rule that is consistent with the rule adopted by the Restatement, that rule will continue to apply. Any changes that do come—for example, if a state that has not addressed a particular issue decides to follow the Restatement approach—will come gradually, one court at a time, perhaps over the course of many years. This is hardly the sort of abrupt, disruptive and radical reform that D&S seek to portray in their inflammatory and misleading white paper.

Third, as many economic studies have demonstrated, and the insurance trade press continuously monitors, the liability insurance market is subject to the insurance underwriting

[44] D&S, White Paper, p.1

cycle – a longstanding insurance business cycle that has a much greater impact on short term changes in liability insurance prices than any change in the underlying costs or in the legal rules that affect those costs.[45] In our academic research, we have each made contributions to the literature on the underwriting cycle.[46] That research has made us, like other researchers who have seriously examined this subject, profoundly skeptical about the link between changes in legal rules and insurance prices, except perhaps in the long run. Even then, the long-term growth in GDP turns out to be such an excellent single variable predictor of long term growth in liability insurance premiums that one has to wonder how much individual legal rules matter to liability insurance markets and prices at all.[47]

This is hardly to say that the legal rules don't matter. Of course they do. That is the premise of this Restatement and every other project of the ALI. Liability insurance law rules matter to people who buy and sell liability insurance, to their lawyers, and to the judges who labor to understand and apply those rules so that cases reach the proper outcome. Our job as Reporters for the Restatement has been to get those rules right and to craft clear and well reasoned explanations so that lawyers and judges can understand and apply them.

[45] For academic studies see, e.g. Scott E. Harrington, *Tort Liability, Insurance Rates, and the Insurance Cycle*, in BROOKINGS-WHARTON PAPERS ON FINANCIAL SERVICES: 2004 (Robert E. Liton & Richard Herring eds., 2004); Neil A. Doherty & James R. Garven, *Insurance Cycles: Interest Rates and the Capacity Constraint Model*, 68 J. BUS. 383, 386 (2001); Ralph A. Winter, *The Dynamics of Competitive Insurance Markets*, 3 J. FIN. INTERMEDIATION 379 (1994). For trade press reports about the state of the cycle, see, e.g., Rob Lenihan, Insurance buyers see favorable rates as soft market continues, Business Insurance October, 26, 2016. See also, Insurance Information Institute, Property/Casualty Insurance Cycle, http://www.iii.org/fact-statistic/property-casualty-insurance-cycle (last visited March 29, 2017).

[46] See Tom Baker, *Medical Malpractice and the Insurance Underwriting Cycle*, 54 DEPAUL L. REV. 393 (2005); Kyle D. Logue, *Toward a Tax-Based Explanation of the Liability Insurance Crisis*, 82 VA. L. REV. 895, 909 (1996).

[47] See, Tom Baker, *The Shifting Terrain of Risk and Uncertainty on the Liability Insurance Field*, 1 J. OF FIN. PERSPECTIVES 29 (2013)