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THE AMERICAN LAW INSTITUTE

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Dear Tom and Will,

I am writing to you concerning the ALI's Restatement of the Law, Liability Insurance (RLLI) project and ask that you please share this letter with the members of your Property and Casualty Insurance Committee specifically, and with your other members.

Throughout the project you both have sent Ricky and me letters explaining which sections of the drafts of the RLLI were of concern to NCOIL. The letters were helpful. We posted those letters on the project site so all ALI members could read them. We also, in other ways, brought to the attention of our Council the specific points you raised.

As you know, in response to many comments, including NCOIL's, ALI decided in May 2017 to take an extra year to review the entire project. In that final year the draft adopted some significant changes that your letters urged: a simple plain-meaning rule; greatly limited insurer liability for negligent selection of counsel; an added catch-all exception to the complaint-allegation rule; revised language to make it even clearer that an insurer may discontinue a defense without seeking a declaratory judgment; removal of language that would prevent insurers from asserting coverage defenses in cases of non-bad-faith breach; and removal of language that would require insurers to pay the attorneys' fees of the insured when the insured prevails in a suit against the insurer for non-bad-faith breach. There were many other changes to the draft and we would be happy to provide a complete list.

After Proposed Final Draft No. 2 was approved by members in May 2018, the editing to clarify language and ensure that the case citations were balanced continued. We do not want to mislead readers by presenting something other than an accurate representation of how the law varies across jurisdictions. We placed additional case citations into the already voluminous Notes so that judges and lawyers may read the cases for themselves. We also took care to identify areas of law that in many states are

controlled by statute rather than only by the common law. While we now expect the official text to be published in June, I have the official text on hand and write this letter to let you know that we would be happy to share any portions that your members may have questions about as they consider NCOIL model legislation and whether to introduce legislation in their states.

I have been urging people to wait for the official text before characterizing or believing characterizations of what is in the draft and I am glad to see that NCOIL has not adopted any model legislation yet. Recently, Will mentioned mitigation of damages, so I sent him RLLI language which, in fact, makes clear that the insured does have such an obligation. A recent article in the Penn Record quoted an attorney who said that the RLLI rejects the plain-meaning rule; I assume he was not intentionally misrepresenting what the RLLI says about plain meaning and that he had read only an earlier draft. Some insurer trade associations, ignoring the series of changes in the drafts, are still claiming that the RLLI is not a Restatement of the Law and that this Restatement is somehow an infringement of legislative prerogatives. Facts matter and this is just rhetoric. This Restatement follows the ALI rules for a Restatement. ALI has produced Restatements for nearly 100 years. Restatements provide in simple concise language general rules, along with commentary and extensive citations to case law and other authority from our various states. I urge your members to review for themselves the final official text of the RLLI.

In addition to offering to send relevant portions of the official text, I also write to address what I take to be NCOIL's overriding concern with the RLLI and with insurance law generally, which is to protect the authority of state legislators to regulate the business of insurance. Let me be clear – the ALI has no disagreement with NCOIL or its members about the primacy of state legislative bodies to establish the controlling law of their respective states. Restatements are meant to be guides for common law courts making common law decisions. When the ALI began writing Restatements in the 1920s, many areas of law were governed almost entirely by judicial decisions. Over time, traditional common law areas like torts and contracts have come to be regulated to a significant extent by state statutory law. The ALI has even had a hand in encouraging this development through our work on the Uniform Commercial Code. Our Restatements therefore now must navigate the intricate interplay between common law and statutory law, and it goes without saying that duly enacted statutes displace common law rules. When statutes control, courts must apply them. And the ALI has no stake in the content of a particular state's statutory law on liability insurance. The core of ALI's mission is to promote clarity in the law, and state legislative enactments tend to further that goal. If one consequence of the RLLI's publication is that some states enact statutes setting rules that differ from RLLI rules, then a shared goal of the ALI and of NCOIL – providing greater certainty in the complex field of liability insurance law – will have been accomplished.

Statutes and regulations, however, cannot address all of the issues in every case, so statutory and common law work together to form the rule of law across each state in this country. And as you know, common law is developed by judges in the course of deciding specific cases. The underlying principles of law often are obscured by the overwhelming volume of court decisions, by small and large variations among the many different jurisdictions, and by uncertainty about the relevance of older case law. Unlike the episodic occasions for judicial formulation presented by each particular case, Restatements

survey an entire legal field and render it intelligible by precise use of terms and well-established legal doctrines. With that overview, the courts in a particular state then can determine what the specific rule is in their state, whether it be found in statutes or in the precedents of that state. When the law is fractured or unclear, a Restatement assumes the perspective of a common law court – not a legislature – in selecting what the ALI believes to be the better rule. And the commentary explains the ALI's common law reasoning for selecting the rule as well as the arguments going against that selection. Ultimately, where statutory law leaves room for common law adjudication, it is up to the courts in the course of resolving specific cases to decide how to develop the law of their state, subject to subsequent revision by the legislature if it believes the court-made rule is erroneous. It is our firm belief that Restatements continue to be vitally useful tools for courts resolving disputes under our Anglo-American system of law.

In your letter to Ricky and me dated January 16, 2018, you cited examples of RLLI sections you believed posed conflicts with state statutory law. We considered those comments carefully, and we believe that the official text of the RLLI does not pose a threat to state legislative prerogatives in these areas. Section 8 defines materiality with respect to policyholder misrepresentations. In discussing existing law on this issue, the Note expressly states that, "[b]ecause many states define materiality by statute, courts in those jurisdictions may have to determine whether the statutory text can be read to include the substantiality requirement set forth in this Section." And of course, state legislatures are able to amend statutory language to avoid such an interpretation. Your letter also notes concerns about punitive damages. Section 45 states that, "[e]xcept as barred by legislation or judicially declared public policy, a term in a liability insurance policy" providing coverage for punitive damages is enforceable and, generally, insurers may sell policies with such coverage. Section 27 includes a Comment relating to insurer liability for punitive damages against insureds in cases that could have been settled by the insurer but-for the insurer's breach of the duty to make reasonable settlement decisions. This Comment transparently identifies the "tension" that arises in states with a public policy against insuring punitive damages (Section 45), and it explains the decisions of the five courts that have thus far addressed that tension. No judge reading the RLLI will be misled into making an uninformed decision on this issue. But in any event, state legislators concerned about this Comment may enact statutory law making clear that in their states an insurer is not liable for punitive damage awards in this narrow circumstance. Section 35 concerns notice and reporting conditions. It first states the baseline rule, applied in nearly every state of the country, under which an insured's failure to satisfy a notice-of-claim condition excuses an insurer from its contractual obligations only if the insurer has suffered prejudice. The Section goes on to state an exception to that prejudice requirement – for late-reported claims – and then an exception to that exception. The exception to the exception is based on recent judicial authority applying the equitable common law doctrine of disproportionate forfeiture. In states that do not mandate extended reporting periods and when legislatures determine that policyholders must strictly comply with existing reporting periods, legislators can avoid the application of common law equitable rules by enacting a statute addressing this issue. Finally, the fee-shifting rules in Sections 47 and 48 were replaced with a simple statement deferring to existing state law on fees. And the remaining fee-shifting rule in Section 50 relates only to cases of bad faith, which is consonant with the law in almost every state, as detailed in

an exhaustive Reporters' Note featuring citations to both case law and statutes. To the extent legislators do not like the common law development in this area, a statute would control.

I was the head of litigation at a major insurance company. Insurers handle thousands of claims every day. The goal generally is to resolve cases promptly and without spending more than is necessary on legal fees. When there is clarity on the applicable law, cases can be settled, or the decision to take a case to trial is more easily made. When judges have no research tools, the courts have huge backlogs and the result in any particular case may depend on the luck of the draw. Lack of clarity and stability in the law is litigation fuel. Lawyers may thrive in chaos, but businesses, policyholders and insurers do not.

The mission of ALI is not in conflict with that of NCOIL or of any state legislature. We all are interested in clear and stable laws. Legislation with clear rules can promote clarity and stability. Legislation stating, for example, that courts in the state must interpret terms according to their plain meaning does not create confusion. Legislation that broadly rejects the RLLI and the common law rules described therein, by contrast, may be interpreted by courts to be a rejection of, for example, sections on the rules about contribution, multiple insurers having a duty to defend, the insured's duty to cooperate, timing of events that trigger coverage, subrogation, exclusions, assignment of rights, exhaustion and drop down, indemnification from multiple polices, the effect of partial settlement on amounts owed by non-settling insureds, and the pro-rata allocation rule. Litigants, when it helps their cases, will make the argument in any event. Of the approximately 110 statements of common law in the RLLI, about 90 are well-established contract and tort rules; approximately 20 are statements on which different states disagree or where the law is undeveloped. Much of the RLLI delves into complex coverage situations involving multiple insurers and multiple claimants and suggests a framework to help courts understand the competing interests. In the end, there are a few sections in the RLLI that policyholder lawyers do not like and a handful of sections or words in the black letter and comments that some insurers continue to criticize (some are mentioned above). On these issues, reasonable lawyers and judges may disagree on how to read the body of case law. But the transparency in the RLLI ensures that courts will have information about the variety of approaches that exist across jurisdictions.

Providing clarity in the law is the ALI's mission and our Restatements of common law rules pose no challenge to legislation that provides clarity. I hope suggested model legislation that would do the opposite or that is simply a gratuitous attack by certain trade associations on the ALI or the judiciary will find no traction at an independent organization such as NCOIL. My request is that you share my offer to provide accurate and specific information about the RLLI and the ALI in whatever way would be helpful to your members.

Sincerely,

Stephanie

cc: Richard L. Revesz