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UNSETTLING THE LAW OF INSURANCE SETTLEMENTS: SECTIONS 24 AND 27 OF THE RESTATEMENT OF THE LAW LIABILITY INSURANCE

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> *"What has once been settled by a precedent will not be unsettled overnight, for certainty and uniformity are gains not lightly to be sacrificed."*[1]
>
> —Justice Benjamin Cardozo

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1. BENJAMIN CARDOZO, THE PARADOXES OF LEGAL SCIENCE 29–30 (1928).

I. INTRODUCTION

Under most general liability insurance policies, an insurance company has a duty to defend the insured against any suit where there is a potential for coverage; the commitment to defend is described in the policy as a "right and duty" of the insurer.[2] At the same time, the investigation and settlement of suits are left to the judgment of the insurer, which "may" undertake these efforts "at [its] discretion."[3] From the obligation to defend where there is a potential for coverage, a complex body of law has emerged whereby insureds seek to impose liability upon insurers for failing to settle an underlying case where liability and damages are reasonably clear, and the insured faces an excess verdict.

The concept of a "duty to settle" where an excess verdict is at issue, addressed in more than a century of case law and now in a recent Restatement of the Law Liability Insurance ("Restatement"),[4] did not evolve directly from policy language like that above that specifically addresses settlement. Instead, the duty began as a creature of contract law, drawn from the implied covenant of good faith and fair dealing that inheres in every contract.[5] When an excess verdict against an insured occurred after an insurer's decision not to settle within policy limits, courts weighed whether the insurer's actions breached the implied covenant and constituted bad faith.[6]

Over time, however, in some jurisdictions, the duty of good faith morphed into a duty of due care, and courts began to ignore the contractual roots of the implied duty of good faith and created a new cause of action—arising out of the insurance contract—as a tort.[7] In other jurisdictions, courts premised liability on the insurer's alleged bad faith—the willful and malicious disregard of the insured's interest.[8] Still, other courts spoke in the language of bad faith but applied a negligence standard that required no bad intent or misconduct by the insurer.[9]

Against this background, the American Law Institute's ("ALI") Restatement attempts—in Sections 24 and 27—to rationalize the law of the duty to settle, framed as "The Insurer's Duty to Make Reasonable

2. *See, e.g.*, *CGL Coverage A Bodily Injury and Property Damage Liability*, IRMI, https://www.irmi.com/online/cli/ch005/1l05c000/al001770/bl05a020.aspx (last visited Aug. 4, 2020).

3. *Id.*

4. RESTATEMENT OF THE L. OF LIAB. INS. §§ 24–27 (AM. L. INST. 2019).

5. *See infra* Section II.

6. *See infra* Section II.

7. *See infra* Section II.A.

8. *See infra* Section II.A.

9. *See infra* Section II.A.

Settlement Decisions."[10] In doing so, the Restatement departs from established principles, sometimes radically.[11] It adopts a negligent "reasonableness" test that completely fails to consider critical factors beyond simply the amounts of the rejected offer and the excess judgment.[12] Against majority rule, it also urges courts to impose on the insurer a duty to initiate settlement discussions and creates its own unprecedented conditions for when and how an insured may, despite explicit language to the contrary in the policy, settle with a claimant without the insurer's consent.[13] The scope of damages that the Restatement permits for breach of the newly created duty to make a reasonable settlement decision is extreme, most notably shifting to the insurer any punitive damages assessed against the insured—a novel outcome with virtually no support in the law.[14] For an undertaking that "aim[s] at clear formulations of common law and its statutory elements, and reflect[s] the law as it presently stands or might appropriately be stated by a court,"[15] the Restatement instead provides innovation and departure from well-settled existing law as recognized by the courts and legislatures.

Courts and counsel alike, therefore, should decline to adopt these sweeping changes and, instead, to paraphrase Justice Cardozo, respect the well-settled law governing an insurer's duty to settle where an insured faces an excess verdict.[16]

II. THE STATE OF THE LAW OF DUTY TO SETTLE

The insurer's duty to settle a suit against an insured where there is a likelihood of an excess verdict—and the insurer's consequent liability for improperly failing to do so—grew out of the implied covenant of good faith and fair dealing inherent in every contract.[17] Over time, courts read

10. RESTATEMENT OF THE L. OF LIAB. INS. § 24.
11. *See infra* Section III.
12. *See infra* Section III.A.
13. *See infra* Section III.B.
14. *See infra* Section III.C.
15. *How the Institute Works*, ALI, https://www.ali.org/about-ali/how-institute-works/ (last visited Oct. 9, 2020).
16. *See* CARDOZO, *supra* note 1.
17. *See, e.g.*, Connelly v. State Farm Mut. Auto. Ins. Co., 135 A.3d 1271, 1274 (Del. 2016) ("In the context of an insurance policy, the implied covenant has historically included a duty to 'settle [claims] within policy limits where recovery in excess of those limits is substantially likely.'"); *see also* Iowa Physicians' Clinic Med. Found. v. Physicians Ins. Co. of Wis., 547 F.3d 810, 812 (7th Cir. 2008) ("An insurer's duty to settle in good faith on behalf of its insured . . . arises from the covenant of good faith and fair dealing implied in an insurance contract.").

into this implied covenant an obligation on the part of the insurer to "settle [claims] within policy limits where recovery in excess of those limits is substantially likely."[18]

When the insurer receives a demand from the claimant to settle a case that the policy covers and that demand is within the policy limits, the insurer may accept or reject the demand or may counter-offer. If no further negotiation takes place, the case may go to trial and result in a verdict that exceeds the limits of the policy, making the insured, in the absence of excess coverage, liable for the excess verdict. The question—which arises in retrospect—is whether, in refusing the demand, the insurer breached a duty to the insured. If so, for what damages is the insurer responsible?

A. Contract Law or Tort Law

An insurance policy is a contract.[19] Thus, black letter principles of contract law and construction apply to insurance policies.[20] One such principle is the implied covenant of good faith and fair dealing—a duty that "[e]very contract imposes upon each party . . . in its performance and its enforcement."[21] This duty means "neither party will do anything which will injure the right of the other to receive the benefits of the agreement."[22]

Good faith is often defined in distinction to its converse, bad faith, which is understood as behavior involving moral fault and ill will.[23] Bad

18. *Connelly*, 135 A.3d at 1274 (citing STEVEN PLITT ET AL., COUCH ON INSURANCE § 203:13 (3d ed. 2008)).

19. *See, e.g.*, Bank of the W. v. Superior Court, 833 P.2d 545, 551–52 (Cal. 1992) ("While insurance contracts have special features, they are still contracts to which the ordinary rules of contractual interpretation apply.").

20. *See, e.g.*, Hobbs v. Hartford Ins. Co., 823 N.E.2d 561, 564 (Ill. 2005) ("[T]he general rules governing the interpretation of other types of contracts also govern the interpretation of insurance policies."); Tempelis v. Aetna Cas. & Sur. Co., 485 N.W.2d 217, 220 (Wis. 1992) ("Contracts of insurance are controlled by the same principles of law that are applicable to other contracts.").

21. RESTATEMENT (SECOND) OF CONTRACTS § 205 (AM. L. INST. 1981); *see also* Comunale v. Traders & Gen. Ins. Co., 328 P.2d 198, 200 (Cal. 1958) (citation omitted) ("There is an implied covenant of good faith and fair dealing in every contract that neither party will do anything which will injure the right of the other to receive the benefits of the agreement. This principle is applicable to policies of insurance.").

22. *Comunale*, 328 P.2d at 200; *see also* Uproar Co. v. Nat'l Broad. Co., 81 F.2d 373, 376–77 (1st Cir. 1936) (discussing the principle of the implied covenant of good faith and fair dealing).

23. *See, e.g.*, Lujan v. Gonzales, 501 P.2d 673, 680 (N.M. Ct. App. 1972) (commenting that bad faith "mean[s] an absence of good faith by an insurer in its relations with its insured"); Centennial Ins. Co. v. Liberty Mut. Ins. Co., 404 N.E.2d 759, 762 (Ohio 1980) ("A lack of good faith is the equivalent of bad faith . . . .").

faith is, in short, being unfaithful to one's duties or obligations.[24] Because breach of the implied covenant of good faith and fair dealing—"bad faith"—generally sounds in contract, not in tort, "the general rule" is that "tort recovery is unavailable" for its breach.[25] Some jurisdictions unequivocally declare that "breach of the implied covenant of good faith and fair dealing is not a tort; rather, it is a contract claim."[26] Other jurisdictions, however, have come to treat bad faith as a tort.[27]

The choice between contract and tort significantly changes the extent of any damages available to the insured. Whereas liability in contract extends only to those losses that are reasonably foreseeable at the time of contracting, liability in tort includes all losses that are proximately caused by the defendant's conduct.[28] Furthermore, tort liability departs from contract law limits on consequential damages and makes available punitive and exemplary damages, not generally recoverable in contract.[29]

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24. Hilker v. W. Auto. Ins. Co., 235 N.W. 413, 414 (Wis. 1931) ("Generally speaking, good faith means being faithful to one's duty or obligation; bad faith means being recreant thereto.").

25. *See* Wash. Fed. v. Countrywide Home Loans, Inc., No. C12-1820 RSM, 2013 WL 2285966, at *3 (W.D. Wash. May 23, 2013); *see also* Foley v. Interactive Data Corp., 765 P.2d 373, 389 (Cal. 1988) ("Because the covenant is a contract term . . . compensation for its breach has almost always been limited to contract rather than tort remedies.").

26. Smile Train, Inc. v. Ferris Consulting Corp., 117 A.D.3d 629, 630 (N.Y. App. Div. 2014) (internal quotation marks omitted); *see also* ClearOne, Inc. v. RSM US LLP, No. 2:16-CV-00736-DN, 2017 WL 923949, at *6 (D. Utah Mar. 6, 2017) ("[T]here is no reason to conclude that the breach of implied covenant claim sounds in tort" when based on written contract).

27. *See, e.g.*, *Wash. Fed.*, 2013 WL 2285966, at *3; *see also* Adam M. Smith & Rebecca A. Du Boff, *Bad Faith Under a Commercial General Liability Policy*, *in* THE REFERENCE HANDBOOK ON THE COMMERCIAL GENERAL LIABILITY POLICY 351 (Alan S. Rutkin & Robert Tugander eds., 2d ed. 2014) ("[T]here remains a split of authority regarding whether an insurer's breach of the implied duty of good faith and fair dealing may form the basis for an independent cause of action sounding in tort, or whether insurer bad faith is only actionable as a breach of contract.").

28. *Compare* Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 869 P.2d 454, 460 (Cal. 1994) ("Contract damages are generally limited to those within the contemplation of the parties when the contract was entered into or at least reasonably foreseeable by them at that time; consequential damages beyond the expectations of the parties are not recoverable."), *with* Fibreboard Paper Prods. Corp. v. East Bay Union of Machinists, Local 1304, 39 Cal. Rptr. 64, 81 (Ct. App. 1964) ("The measure of damages . . . for the commission of a tort . . . is that amount which will compensate the plaintiff for all detriment sustained by him as the proximate result of the defendant's wrong, regardless of whether or not such detriment could have been anticipated by the defendant.").

29. *See* WILLIAM T. BARKER & RONALD D. KENT, 3 NEW APPLEMAN ON INSURANCE LAW LIBRARY ED. § 23.09(1) (2020); RESTATEMENT (SECOND) OF CONTRACTS § 351 (AM. L. INST. 1981); RESTATEMENT (SECOND) OF TORTS §§ 281, 901 (AM. L. INST. 1979); *see also* Tackett v. State Farm Fire & Cas. Ins. Co., 653 A.2d 254, 264 (Del. 1995) (citation omitted) ("If the bad faith claim is viewed as an independent tort, the insured's recovery may include damages for emotional distress, as well as for economic loss. By contrast, if the bad faith

Some courts extended the implied covenant into tort to address "unscrupulous" conduct of insurers.[30] Yet, once established, the tort approach expanded to apply to insurer breaches, regardless of motivation.[31] Without any allegations of deceitful or unethical conduct, insurers who misjudge the probable outcome of a trial may become liable when an excess judgment results, calling the broad range of tort damages into play.[32] This approach, now adopted by Section 24 of the Restatement, shifts the balance of power not only between insurers and insureds but also between claimants and insurers (and between claimants and insureds as well).[33] The re-making of the test of liability and the opportunity for greater damages have given those making claims against insureds—and their insurers—a powerful tool.

Over time, the once sharp difference between the narrower "bad faith" arising out of the contractual breach of the implied covenant and the broader general tort liability for simple breach has become blurred.[34] The Second Circuit noted that, in insurance settlement cases, the distinction was harder to trace but recognized that "the more recent and better reasoned cases have opted rather clearly for the 'settlement in good faith' standard."[35] Other courts have echoed this conclusion.[36]

When the terms negligence and bad faith—which are not synonymous—are used to mean the same thing, both terms lose meaning.[37] The imposition of negligence is inapposite in the context of a contract which spells out specific rights and responsibilities. A duty for an insurer to act as an abstract "ordinary prudent person" toward its insured creates pressure on insurers to settle for inflated values within

claim is viewed as arising *ex contractu*, the damages generally are confined to the payment of money due, with interest for delay.").

30. Arnold v. Nat'l Cnty. Mut. Fire Ins. Co., 725 S.W.2d 165, 167 (Tex. 1987); *see also* WILLIAM T. BARKER, 5 NEW APPLEMAN ON INSURANCE LAW LIBRARY ED. § 55.02(1) (2020) (collecting cases).

31. *See* BARKER, *supra* note 30.

32. *See* BARKER, *supra* note 30, § 55.03(1).

33. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24 (AM. L. INST. 2019).

34. *See, e.g.*, Jessen v. O'Daniel, 210 F. Supp. 317, 326 (D. Mont. 1962), *aff'd sub nom.* Nat'l Farmers Union Prop. & Cas. Co. v. O'Daniel, 329 F.2d 60 (9th Cir. 1964); Openshaw v. Allstate Ins. Co., 484 P.2d 1032, 1034 (Idaho 1971); Bollinger v. Nuss, 449 P.2d 502, 510 (Kan. 1969); State Farm Mut. Auto. Ins. Co. v. White, 236 A.2d 269, 272 (Md. 1967).

35. Brown v. U.S. Fid. & Guar. Co., 314 F.2d 675, 677 (2d Cir. 1963).

36. *See, e.g.*, Manchester Ins. & Indem. Co. v. Grundy, 531 S.W.2d 493, 497 (Ky. 1975) (rejecting the approach of "the more recent cases [where] the two tests of 'good faith' and 'negligence' have tended to coalesce" and, instead, concluding that "Kentucky has adhered to the rule adopted by the majority of jurisdictions in requiring a finding of bad faith to create liability for the excess of policy limits, rejecting the concept of negligence").

37. *See* Hilker v. W. Auto Ins. Co., 235 N.W. 413, 414 (Wis. 1931).

policy limits because there is always a risk of an adverse verdict.[38] Only settlement avoids the risk to the insured, regardless of how small the risk or how costly the settlement. The liability becomes, in effect, strict, and the insurance policy, a guarantee. As Professor Robert F. Keeton noted, however, courts "have consistently stated that the mere fact that the case could have been but was not settled within policy limits is insufficient to establish [an insurer's] liability."[39]

Bad faith, on the other hand, fits more easily into the contractual context. The insurer's bargained-for discretion in making settlement decisions is preserved, while behavior that is dishonest or that willfully deprives the insured of what it bargained for is penalized. The focus is on the insurer's motivation, not the amount of an unanticipated excess verdict. "Bad faith" cannot simply be collapsed into negligence, with the latter replacing the former.[40] To do so ignores the roots of bad faith in the contract-based covenant of good faith and fair dealing, expanding liability beyond what either party to the insurance contract bargained for.

B. Standards of Liability

Whether reviewing a settlement decision under the implied covenant of good faith and fair dealing or through an independent "duty to settle," courts have adopted different approaches to determining when liability should be imposed. Just as the bad faith and tort concepts have been conflated, so too have standards been applied that cut across the two legal constructs.

Liability for breach of the duty to settle is a largely fact-specific determination, taking into account the totality of the circumstances.[41] Court have adopted at least four different standards to assess the facts and determine liability.

The first test is "equal consideration" where the insurer's duty of good faith requires that it "give at least equal consideration to the insured's

38. *See* Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 690 P.2d 1022, 1024 (N.M. 1984); Best Bldg. Co. v. Emps.' Liab. Assurance Co., 160 N.E. 911, 912 (N.Y. 1928) ("Even when there was little likelihood of recovery, many reasonable persons would think it wise to settle rather than to take any chance with a jury.").

39. Robert E. Keeton, *Liability Insurance and Responsibility for Settlement*, 67 HARV. L. REV. 1136, 1145 (1954).

40. *See* Com. Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 164 (Mich. 1986) ("[B]ad faith should not be used interchangeably with either 'negligence' or 'fraud'. . . . '[B]ad faith' . . . [is] arbitrary, reckless, indifferent, or intentional disregard of the interests of the person owed a duty.").

41. *See, e.g.*, Clearwater v. State Farm Mut. Auto. Ins. Co., 792 P.2d 719, 722 (Ariz. 1990); Walbrook Ins. Co. v. Liberty Mut. Ins. Co., 7 Cal. Rptr. 2d 513, 518 (Ct. App. 1992).

interests as to its own when making settlement decisions."[42] This test reinforces the purpose of bad faith liability generally, which is "to induce an insurer to protect the insured's financial interests with the same diligence as it would its own[,]" and in so doing to ensure that both parties receive the benefit of their bargain.[43]

The second test is "disregard the limits" under which the insurer's duty of good faith requires that it decide whether to settle as if "there were no policy limits applicable to the claims and as if the insurer alone would be liable for the entire amount of any excess judgment."[44] A number of jurisdictions have endorsed this standard, although it is often conflated with the equal consideration rule.[45]

As expressed by Professor Keeton in his classic consideration of the settlement duty, the third test is the "ordinarily prudent insurer" test.[46] Under this test, "[w]ith respect to the decision whether to settle or try the case, the insurer . . . must use such care as would have been used by an ordinarily prudent insurer with no policy limit applicable to the claim."[47] This standard may ask whether the hypothetical insurer "would consider that choosing to try the case . . . would be taking an unreasonable risk."[48] A number of courts have endorsed or adopted this test, either by quoting Professor Keeton directly or by rephrasing his words.[49]

Finally, Massachusetts has introduced a variation on the ordinarily prudent insurer test.[50] "The test is not whether a reasonable insurer might have settled the case within the policy limits, but rather whether no reasonable insurer would have failed to settle the case within the policy limits."[51] This approach avoids a problem with the "ordinarily prudent insurer" test, namely that an insurer, acting reasonably in not settling, might nonetheless be held liable if another prudent insurer

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42. Peterson v. Allcity Ins. Co., 472 F.2d 71, 77 (2d Cir. 1972).

43. Lincoln Gen. Ins. Co. v. Access Claims Adm'rs, Inc., 596 F. Supp. 2d 1351, 1366 (E.D. Cal. 2009).

44. DeMarco v. Travelers Ins. Co., 26 A.3d 585, 614 (R.I. 2011).

45. *See, e.g.*, Christian Builders, Inc. v. Cincinnati Ins. Co., 501 F. Supp. 2d 1224, 1230 (D. Minn. 2007) (citation omitted) ("The insurer must give the same consideration to its insured's financial exposure that it gives to its own exposure. In deciding whether to settle or to go to trial, the insurer must evaluate the claim as if there were no policy limits applicable to it.").

46. *See* Keeton, *supra* note 39, at 1156.

47. *Id.* at 1147; *see also, e.g.*, Wash. Ins. Guar. Ass'n v. Ramsey, 922 P.2d 237, 243 n.20 (Alaska 1996) (quoting ROBERT E. KEETON, BASIC TEXT ON INSURANCE LAW 511 (1971)).

48. Keeton, *supra* note 39, at 1147.

49. *See, e.g.*, *Wash. Ins. Guar. Ass'n*, 922 P.2d at 243 n.20; Cotton States Mut. Ins. Co. v. Brightman, 580 S.E.2d 519, 521 (Ga. 2003); Am. Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842, 849 (Tex. 1994).

50. *See, e.g.*, Hartford Cas. Ins. Co. v. N.H. Ins. Co., 628 N.E.2d 14, 18 (Mass. 1994).

51. *Id.*

might have opted for settlement. Other courts have adopted similar approaches.[52]

While the four tests discussed above frame the issue of liability for failure to settle, they provide little guidance for how a judge or jury is to weigh whether an insurer has breached the duty. The risk of hindsight bias makes this question acute as courts decide the question of breach after an excess judgment has entered even though that question must be measured according to the facts at the time the settlement decision is made.[53] Liability is not premised on numbers: A comparison of the offer declined and the amount assessed against the insured cannot alone be a basis of an insurer's liability.[54] Even in jurisdictions treating failure to settle as a tort, courts have looked to a variety of factors to assess whether the insurer acted reasonably. These factors include the extent of the insurer's investigation, whether it had a reasonable opportunity to investigate, the reasonableness of its evaluation of the claim and of the risk of an excess judgment, the advice of counsel, its diligence in effecting a settlement, and the claimant's actual willingness to settle.[55]

Insurer conduct-based factors are central to a determination of whether the insurer has breached its duty. For liability, there must be some "specific evidence of bad faith," of some behavior in deviation from good practice.[56] An error in judgment standing alone is insufficient to impose liability on the insurer for failing to settle.[57]

52. *See* Baker v. Huff, 747 S.E.2d 1, 6 (Ga. Ct. App. 2013); Orion Ins. Co. v. Gen. Elec. Co., 493 N.Y.S.2d 397, 403 (Sup. Ct. 1985). The court in *Orion* viewed the situation as akin to a bad-faith refusal claim. *Id.* One treatise has observed that the *Hartford Casualty* test is "[a]rguably . . . what the 'disregard the limits' standard has always meant." 1 WILLIAM T. BARKER & RONALD D. KENT, NEW APPLEMAN INSURANCE BAD FAITH LITIGATION § 2.03[2][d][i] (Matthew Bender, 2d rev. ed., 2020). Another calls the *Hartford Casualty* approach "a particularly helpful formulation of the 'within the limits' rule." William T. Barker & Ronald D. Kent, 3 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 23.02[2][d] (Francis J. Mootz, III ed., 2020). Still, others have even considered the *Hartford Casualty* approach as "[t]he trend in 'failure to settle' cases." 1 Gregory P. Deschenes & Kurt M. Mullen, NEW APPLEMAN INSURANCE LAW PRACTICE GUIDE § 11.07[2] (Jeffrey E. Thomas et al. eds., 2020).

53. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 27 reporters' note b (AM. L. INST. 2019).

54. *See, e.g.*, Lira v. Shelter Ins. Co., 913 P.2d 514, 516 n.4 (Colo. 1996) (describing alternative factors that may be considered when analyzing whether an insurer has breached its duty to the insured or has acted in bad faith).

55. *See, e.g.*, *id.*; Am. Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842, 849–52 (Tex. 1994); Ins. Corp. of Am. v. Webster, 906 S.W.2d 77, 79 (Tex. Ct. App. 1995).

56. Oulds v. Principal Mut. Life Ins. Co., 6 F.3d 1431, 1442 (10th Cir. 1993) (emphasis added); *see* Toner v. GEICO Ins. Co., 262 F. Supp.3d 200, 208 (E.D. Pa. 2017) ("A plaintiff cannot merely say that an insurer acted unfairly, but instead must describe with specificity what was unfair.").

57. *See* State Farm Mut. Auto. Ins. Co. v. Freyer, 312 P.3d 403, 418 (Mont. 2013).

A critical problem in determining an insurer's liability for a decision not to settle is hindsight bias. As described in the Restatement, hindsight bias is "the tendency of triers of fact, faced with an excess judgment against the insured, to overestimate the ex ante likelihood of that judgment occurring and thus to overestimate the reasonableness of some settlement offers." [58] In other words, the factfinder must decide on the likelihood that something will happen after it has already occurred. Under the law, the factfinder must view the facts and the likelihood of an unfavorable outcome as they fairly appeared to the insurer and its agents and attorneys "at the time the offer was refused."[59] But despite that rule, the actual occurrence of an excess judgment will likely, if not certainly, color the factfinder's analysis.[60] "[W]ith the benefit of hindsight almost any settlement decision can be looked on as poor judgment."[61]

Some courts have taken steps to prevent the factfinder, with the inherent prejudice of hindsight, from acting as a "Monday morning quarterback[]."[62] Consideration of all the circumstances surrounding the decision is one way to reduce the influence of hindsight. Instead of looking at bare numbers and projected likelihoods, factfinders should be instructed to assess how the insurer went about making its decision.[63] This approach will help to distinguish those cases where the insurer acted reasonably and in good faith from those where the decision not to settle was without merit or in bad faith.

Consideration of factors pertaining to the insurer's conduct, discussed further below, may reduce that risk but not eliminate it.[64]

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58. RESTATEMENT OF THE L. OF LIAB. INS. §24 reporters' note b (emphasis added).

59. Glenn v. Fleming, 799 P.2d 79, 85 (Kan. 1990); *accord* Ross Neely Sys. Inc. v. Occidental Fire & Cas. Co., 196 F.3d 1347, 1352 (11th Cir. 1999) ("[An insurer's] decision not to settle before trial must be viewed in light of the facts available to it at the time, not in hindsight."); Howard v. Am. Nat'l Fire Ins. Co., 115 Cal. Rptr. 3d 42, 66 (Ct. App. 2010) ("[T]he finder of fact must take into account that information available to the insurer at the time of the proposed settlement." (quoting Camelot by the Bay Condo. Owners' Ass'n. v. Scottsdale Ins. Co., 32 Cal. Rptr. 2d 354, 361 (Ct. App. 1994))).

60. *See* Covill v. Phillips, 452 F. Supp. 224, 237–38 (D. Kan. 1978) (discussing how a "settlement offer viewed from the hindsight of a high verdict, inevitably tends to be colored thereby and look disproportionately low").

61. Keith v. Comco Ins. Co., 574 So. 2d 1270, 1279 (La. Ct. App. 1991).

62. Ferris v. Emps. Mut. Cas. Co., 122 N.W.2d 263, 268–69 (Iowa 1963). Or a "Tuesday morning quarterback[]." Noe v. Am. Fam. Mut. Ins. Co., No. CIV. 01-1217 ADM/SRN, 2002 WL 1634251, at *3 (D. Minn. July 17, 2002).

63. *See, e.g.*, Com. Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 165–66 (Mich. 1986) (delineating twelve "supplemental factors" beyond a plain definition of "bad faith" that the trial court could instruct the jury to consider "in determining whether liability exists").

64. *See id.* at 166 ("In applying any factors, it is inappropriate in reviewing the conduct of the insurer to utilize '20–20 hindsight vision.'").

Some courts have gone further, such as by instructing the jury to disregard the excess verdict.[65] Another possible approach is bifurcation of the proceedings between liability and damages, appropriate when the nature or amount of damages is immaterial to liability but threatens to overwhelm the factfinder's judgment on that issue.[66]

III. ASSESSING THE RESTATEMENT OF LAW LIABILITY INSURANCE

Section 24 of the Restatement seeks to address the very disparate body of law concerning an insurer's duty to settle. The formulations adopted, however, exacerbate rather than resolve important difficulties and, in some cases, present new ones.

Section 24 is captioned "The Insurer's Duty to Make Reasonable Settlement Decisions."[67] It provides in 24(1):

> When an insurer has the authority to settle a legal action brought against the insured, or the insurer's prior consent is required for any settlement by the insured to be payable by the insurer, and there is a potential for a judgment in excess of the applicable policy limit, the insurer has a duty to the insured to make reasonable settlement decisions.[68]

Section 24 defines a "reasonable settlement decision" as "one that would be made by a reasonable insurer that bears the sole financial responsibility for the full amount of the potential judgment."[69] Although it recognizes that the duty at issue here has "its origins in the duty of good faith and fair dealing," the Restatement nevertheless jettisons the requirement of "bad faith" in favor of a general reasonableness negligence

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65. *See, e.g.*, W. Cas. & Sur. Co. v. Fowler, 390 P.2d 602, 606 (Wyo. 1964) (affirming jury instructions). This approach is directly at odds with the Restatement's somewhat off-hand observation, without citations or supporting authority, that some appellate courts have required trial courts to instruct juries to consider the actual excess judgment as evidence of the expected value of the tort suit at the time the insurer's decision was made. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24 reporters' note b (AM. L. INST. 2019).

66. *See, e.g.*, Helminski v. Ayerst Lab'ys., 766 F.2d 208, 212 (6th Cir. 1985) ("Bifurcation of proceedings into separate trials concerning liability and damages is appropriate when 'the evidence pertinent to the two issues is wholly unrelated' and the evidence relevant to the damages issue could have a prejudicial impact upon the jury's liability determination."); Zofcin v. Dean, 144 F.R.D. 203, 205–06 (S.D.N.Y. 1992) (bifurcating proceedings where "introduction of evidence offered only to prove damages poses a substantial risk of impairing the jury's objectivity on the liability issue").

67. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24.

68. *Id.* § 24(1).

69. *Id.* § 24(2).

standard.[70] Significantly, the Restatement makes explicit that this reasonableness standard "is analogous to the negligence standard in tort law," a preference that is continued throughout the Restatement.[71]

The black-letter law of Section 24 adopts the "disregard the limits" test governing the insurer's conduct.[72] This standard "implements the equal-consideration requirement in actionable terms."[73] The Restatement thus adopts the approach of those cases that speak simultaneously of giving equal consideration to the interests of the insured and of acting as if no limits apply.[74]

A. Negligence vs. Bad Faith

Among the innovations created in Section 24 is the unmooring of the insurer's duty from its common law origins. Instead, the Restatement adopts a simple negligence standard for the imposition of liability, clothed in an objective reasonableness test—an approach at odds with that adopted by the majority of courts. The assertion in the Restatement that most courts apply a negligence test is incorrect.[75] As the Second

70. *Id.* § 24 cmt. a.

71. *Id.* § 24 reporters' note b; *see also id.* § 24 reporters' note d ("[T]he articulation of the duty to make reasonable settlement decisions in subsection (2) is consistent with the canonical formulation of the negligence standard in tort law generally . . . .").

72. *Id.* § 24 cmt. c.

73. *Id.*

74. *See, e.g.*, Commercial Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 164 (Mich. 1986) ("'[B]ad faith' . . . [is] arbitrary, reckless, indifferent, or intentional disregard of the interests of the person owed a duty.").

75. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24 reporters' note a. Of the jurisdictions to have addressed the question, twenty-two require more than negligence to support a claim of bad faith for failure to settle. *See, e.g.*, McDaniel v. Gov't Emps. Ins. Co., 681 F. App'x 614, 616 (9th Cir. 2017) (California law); Miel v. State Farm Mut. Auto. Ins. Co., 912 P.2d 1333, 1340 (Ariz. Ct. App. 1995); Campbell v. Gov't Emps. Ins. Co., 306 So. 2d 525, 530 (Fla. 1974); Kelly v. Iowa Mut. Ins. Co., 620 N.W.2d 637, 644 (Iowa 2000); Motorists Mut. Ins. Co. v. Glass, 996 S.W.2d 437, 451 (Ky. 1997); Combetta v. Ordoyne, 934 So. 2d 836, 842 (La. Ct. App. 2006); Fireman's Fund Ins. Co. v. Cont'l Ins. Co., 519 A.2d 202, 204 (Md. 1987); Commercial Union Ins. Co., 393 N.W.2d 161, 164 (Mich. 1986); Northfield Ins. Co. v. St. Paul Surplus Lines Ins. Co., 545 N.W.2d 57, 60, 63 (Minn. Ct. App. 1996); Zumwalt v. Utils. Ins. Co., 228 S.W.2d 750, 753 (Mo. 1950); Olson v. Union Fire Ins. Co., 118 N.W.2d 318, 321 (Neb. 1962); Miglicio v. HCM Claim Mgmt. Corp., 672 A.2d 266, 271–72 (N.J. Super. Ct. Law Div. 1995); Ambassador Ins. Co. v. St. Paul Fire & Marine Ins. Co., 690 P.2d 1022, 1023–25 (N.M. 1984); Best Bldg. Co. v. Emp'rs Liab. Assurance Co., 160 N.E. 911, 912 (N.Y. 1928); Hoskins v. Aetna Life Ins. Co., 452 N.E.2d 1315, 1319–20 (Ohio 1983); Badillo v. Mid Century Ins. Co., 121 P.3d 1080, 1093–94 (Okla. 2005); Crabb v. Nat'l Indem. Co., 205 N.W.2d 633, 635 (S.D. 1973); Johnson v. Tenn. Farmers Mut. Ins. Co., 205 S.W.3d 365, 371 (Tenn. 2006); Campbell v. State Farm Mut. Auto. Ins. Co., 840 P.2d 130, 138 n.16 (Utah Ct. App. 1992); Johnson v. Hardware Mut. Cas. Co., 1 A.2d 817, 820–22 (Vt. 1938); State Farm Mut. Auto. Ins. Co. v. Floyd, 366 S.E.2d 93, 97–98 (Va. 1988); Mowry v. Badger State Mut. Cas. Co., 385 N.W.2d 171, 180 (Wis. 1986). Only fifteen jurisdictions hold that negligence

Circuit observed, "there is sufficient difference between the two standards of obligation so that the more recent and better reasoned cases have opted rather clearly for the 'settlement in good faith' standard."[76] Thus, the majority rule remains "that an insurer's negligence is insufficient to breach the implied duty to settle."[77]

The decision whether to accept a settlement offer is, at base, a matter of judgment.[78] The insurer draws upon its experience in similar cases, its knowledge of the jurisdiction, the assessment by defense counsel of the parties as potential witnesses, and other factors, and then weighs the likelihood of an adverse verdict and the likely range of an award.[79] Absent any conduct-based issues (such as a failure to properly investigate), the insurer that uses its best judgment in deciding how to respond is acting within the law.[80] Sometimes it will be wrong. Juries may respond in wholly unexpected ways, leading to excess verdicts. The negligence test adopted in the Restatement wrongly exposes the insurer to liability for what are, at worst, errors of judgment. The bad faith test, however, "strikes a fair balance between two extremes by requiring more than ordinary negligence and less than a showing of dishonest motives."[81]

The New Mexico Supreme Court's reasoning supports the conclusion that the bad faith test is preferable to the lesser negligence test because, as the court noted, in *Ambassador Insurance Co. v. St. Paul Fire & Marine Insurance Co.*,[82] there is always a risk of excess judgment when a settlement is declined.[83] A negligence test would effectively subject the insurer to per se liability in the event of an excess verdict, even when the

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imposes sufficient liability on the insurer for failing to settle a third-party claim against the insured. *See, e.g.*, State Farm. Mut. Auto. Ins. Co. v. Hollis, 554 So. 2d 387, 391 (Ala. 1989); Jackson v. Am. Equity Ins. Co., 90 P.3d 136, 144–45 (Alaska 2004); Emp'rs Equitable Life Ins. Co. v. Williams, 665 S.W.2d 873, 873–74 (Ark. 1984); Farmers Grp., Inc. v. Trimble, 691 P.2d 1138, 1142 (Colo. 1984); Cotton States Mut. Ins. Co. v. Brightman, 580 S.E.2d 519, 521 (Ga. 2003); Truck Ins. Exch. v. Bishara, 916 P.2d 1275, 1278 (Idaho 1996); Founders Ins. Co. v. Shaikh, 937 N.E.2d 1186, 1192 (Ill. App. Ct. 2010); Miller v. Sloan, Listrom, Eisenbarth, Sloan & Glassman, 978 P.2d 922, 928 (Kan. 1999); Gibson v. W. Fire Ins. Co., 682 P.2d 725, 730–31 (Mont. 1984); Gelinas v. Metro. Prop. & Liab. Ins. Co., 551 A.2d 962, 966 (N.H. 1988); Me. Bonding & Cas. Co. v. Centennial Ins. Co., 693 P.2d 1296, 1299 (Or. 1985); Tyger River Pine Co. v. Md. Cas. Co., 170 S.E. 346, 348 (S.C. 1933); Universe Life Ins. Co. v. Giles, 950 S.W.2d 48, 60 (Tex. 1997) (Hecht, J., concurring); Hamilton v. State Farm Ins. Co., 523 P.2d 193, 195–97 (Wash. 1974); Shamblin v. Nationwide Mut. Ins. Co., 396 S.E.2d 766, 774–75 (W. Va. 1990).

76. Brown v. U.S. Fid. & Guar. Co., 314 F.2d 675, 677 (2d Cir. 1963).
77. *McDaniel*, 681 F. App'x at 616.
78. *See* Keeton, *supra* note 39, at 1168.
79. *See id.*
80. 1 BARKER & KENT, *supra* note 52.
81. Pavia v. State Farm Mut. Auto. Ins. Co., 626 N.E.2d 24, 28 (N.Y. 1993).
82. 690 P.2d 1022 (N.M. 1984).
83. *Id.* at 1024.

insured's case was "seemingly sound and grounded on solid case law," and the insurer's decision to litigate was therefore reasonable.[84] The negligence test, in effect, calls for settlement whenever a within-limits offer is on the table, which, the court concluded, is not what the law requires.[85]

The draconian approach to liability presented in Section 24 can only lead insurers to settle many cases, either unnecessarily or at inflated values, regardless of the weakness or value of the claim.[86] The winners of this approach will be claimants, who will get a powerful tool to force settlements of cases far above their value. The losers will be all policyholders, as the cost of paying meritless or inflated settlements will be passed on to them in the form of increased premiums.

The Restatement's approach, especially as demonstrated in the illustrations, tacks very close to strict liability. Although the Restatement concedes that a strict liability rule for duty to settle cases has not been adopted by courts, it acknowledges that the effects of such a rule "might not be substantially different from the effects of the reasonableness/disregard-the-limits rule."[87] Indeed, as presented in the Comments and Notes to Section 24, the chosen rule may be little more than strict liability under a different name—an outcome in conflict with the law of most jurisdictions.[88]

A further problem with the Restatement's approach to liability is that it emphasizes numeric factors instead of assessing insurer conduct. While conduct-based considerations are referenced, their use is described as appropriate only in some cases—such as "a close case," to "make the difference" where evidence of liability is otherwise insufficient.[89] Instead, the Restatement's firm focus is on numbers—the amount of the offer that was rejected, the reasonable settlement value, and the amount of the excess verdict.[90] But a court cannot simply look at the amount of the settlement offer that was rejected and decide in a vacuum whether it was reasonable.[91] Such an inquiry would not only be simplistic and reductive,

84. *Id.*

85. *See id.*

86. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24 (AM. L. INST. 2019).

87. *Id.* § 24 reporters' note b.

88. *See generally id.* § 24.

89. *Id.* § 24 cmt. e.

90. *See, e.g.*, *id.* § 24 cmt. d, illus. 1. Illustration 1 assumes a $45,000 settlement offer, likely damages of $150,000 and only a 30% chance of a verdict for the claimant. *See id.* Based on these assumed facts alone, the Restatement concludes that a trier of fact could find that the insurer breached its settlement duty by refusing the offer. *See id.*

91. *See* Schwartz v. Twin City Fire Ins. Co., 492 F. Supp. 2d 308, 330 (S.D.N.Y. 2007) ("The determination of whether an insurer has acted in bad faith is highly case specific and '[n]o pat formula applies to the wide variety of fact patterns that occur, or readily resolves

but would necessarily be subject to severe hindsight bias. Any number that was rejected will look reasonable when viewed from the perspective of an adverse judgment. Therefore, "a number of factors must be evaluated" for a trier of fact to determine whether an insurer has breached the duty.[92] Although the Restatement fails to recognize this, the majority of cases that have found insurers liable for failing to settle has involved some improper conduct by the insurer, such as failure to do a reasonable investigation or failure to follow the recommendations of adjusters or lawyers.[93] A meaningful inquiry into conduct is not marginal but rather is at the heart of determining an insurer's liability.

B. *Initiating Settlement Discussions*

Another problematic subject in Section 24 concerns its efforts to create and impose a duty to initiate settlement. Historically, the insurer's settlement-related duties did not require it to open settlement negotiations in the absence of a demand from a claimant.[94] As one court noted, it "is settled . . . that insurance companies are not required to initiate negotiations to settle a case," particularly because no other litigant is forced "into a negotiating disadvantage" by such an affirmative duty.[95] A few courts, however, have held insurers liable for a breach of the duty to settle when considering a range of factors, including the absence of a within limits demand. In *State Automobile Insurance Co. v. Rowland*,[96] the court, while rejecting a duty to negotiate in all cases, held that "a refusal to discuss a settlement may be considered along with other evidence in determining the issue of bad faith."[97]

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whether an insurer acted in good faith.'" (quoting Pinto v. Allstate Ins. Co., 221 F.3d 394, 399 (2d Cir. 2000), *aff'd* 539 F.3d 135 (2d Cir. 2008))); *see also* Berges v. Infinity Ins. Co., 896 So. 2d 665, 680 (Fla. 2004); Thomas v. Principal Fin. Grp., 566 So. 2d 735, 742 (Ala. 1990).

92. *Pinto*, 221 F.3d at 399.

93. *See, e.g.*, Rogers Cartage Co. v. Travelers Indem. Co., 103 N.E.3d 504, 525–26 (Ill. App. Ct. 2018) ("Courts consider a number of factors to decide whether an insurer's actions constitute bad faith, including (1) potential for an adverse verdict, (2) potential for damages in excess of policy limits, (3) refusal to negotiate, (4) communication with the insured, (5) adequate investigation and defense, and (6) advice of the insurance company's own adjusters and defense counsel.").

94. *See, e.g.*, Adduci v. Vigilant Ins. Co., 424 N.E.2d 645, 649 (Ill. App. Ct. 1981); *Rogers Cartage Co.*, 103 N.E.3d at 526.

95. *Adduci*, 424 N.E.2d at 649; *see also Rogers Cartage Co.*, 103 N.E.3d at 526 (internal quotation marks omitted) ("The duty of an insurance provider to settle . . . does not arise until a third party demands a settlement within policy limits.").

96. 427 S.W.2d 30 (Tenn. 1968).

97. *Id.* at 35.

Although a few jurisdictions sometimes impose an obligation to initiate settlement,[98] most jurisdictions that have considered the question have declined to adopt a blanket rule. In general, the decisions fall into three categories. First, some courts have found a qualified "duty to initiate," but only where liability is clear and the claimant's injuries are so serious that a judgment in excess of the policy limits is very likely.[99] In the second line of cases, an insurer's failure to initiate settlement discussions is one factor in a general assessment of whether the insurer's conduct constituted bad faith under the totality of the circumstances.[100] The third line of cases firmly rejects any duty to initiate.[101]

Section 24 addresses insurer liability for failure to initiate settlement discussions by applying a test of "what a reasonable insurer would do under the circumstances."[102] The Restatement recognizes that the law on this point is in conflict and that, with a failure to initiate claim, "causation remains in question" without proof that the claimant would have accepted an offer had it been made.[103] But the Restatement does not resolve this major concern about proof of causation. When a claimant does not make an offer, there is, at best, only tenuous evidence that the claimant would have settled for an amount within policy limits and that the insurer's failure to make an offer was the cause of the excess judgment.[104] If the claimant would not have accepted that amount, the insurer's refusal to make an initial offer is not a cause in fact of the excess judgment and no liability may attach.[105]

98. *See, e.g.*, Powell v. Prudential Prop. & Cas. Ins. Co., 584 So. 2d 12, 14 (Fla. Dist. Ct. App. 1991); Roehl Transp., Inc. v. Liberty Mut. Ins. Co., 784 N.W.2d 542, 554 (Wis. 2010) ("An insurance company cannot merely wait for a legally binding offer to settle; it has a positive duty 'to take the initiative and attempt to negotiate a settlement within the policy coverage.'" (quoting Alt v. Am. Family Mut. Ins. Co., 237 N.W. 2d 706, 713 (Wis. 1976))).

99. *See Powell*, 584 So. 2d at 14 ("Where liability is clear, and injuries so serious that a judgment in excess of the policy limits is likely, an insurer has an affirmative duty to initiate settlement negotiations."); *see also* Merrett v. Liberty Mut. Ins. Co., No. 3:10-CV-1195-J-12MCR, 2013 WL 1245860, at *3 (M.D. Fla. Mar. 27, 2013).

100. *See, e.g.*, Jurinko v. Medical Protective Co., 305 F. App'x 13, 21 n.10 (3d Cir. 2008); Hartford Ins. Co. v. Methodist Hosp., 785 F. Supp. 38, 41 (E.D.N.Y. 1992); Com. Union Ins. Co. v. Liberty Mut. Ins. Co., 393 N.W.2d 161, 165 (Mich. 1986).

101. *See, e.g.*, Hemphill v. State Farm Mut. Auto. Ins. Co., 805 F.3d 535, 540 (5th Cir. 2015) (applying Mississippi law); Naugle v. Allstate Ins. Co., 72 F. App'x 307, 310 (6th Cir. 2003) (applying Kentucky law); Wierck v. Frinnell Mut. Reinsurance Co., 456 N.W.2d 191, 195 (Iowa 1990); Am. Physicians Ins. Exch. v. Garcia, 876 S.W.2d 842, 850 n.17 (Tex. 1994).

102. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 24 cmt. f. (AM. L. INST. 2019).

103. *See id.* § 24 cmt. g.

104. *See id.* § 24 cmt. f.

105. *See, e.g.*, Stewart v. Federated Dep't Stores, 662 A.2d 753, 758 (Conn. 1995) ("[I]f the plaintiff's injury would have occurred regardless of the defendant's conduct, then the defendant's conduct was not a cause in fact of the plaintiff's injury.").

Proving causation, like liability, in hindsight is a dubious task. While the claimant could testify, after an excess judgment, that she would have been willing to accept some sum in settlement had it been offered, the interests of the claimant and the insured are too closely aligned at that point.[106] Liability should not be imposed on such questionable proof. An insurer's decision not to initiate might, at the most, be "merely one factor to consider."[107] As the Eleventh Circuit correctly recognized, liability in the absence of a within-limits settlement offer from the claimant should be rare, a principle the Restatement fails to reflect.[108]

C. Section 27 and the Recovery of Punitive Damages

Section 27 of the Restatement is a companion to Section 24, setting out the damages recoverable by the insured when the insurer has been found to have breached the duty to make a reasonable settlement decision. Subsection 27(1) provides that an insurer in breach is liable "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."[109] Comment a describes the measure of damages as "the difference between the policy limit and the underlying judgment."[110] However, comment c further states that an insured may also recover damages for all foreseeable loss arising out of the breach.[111] Noting the distinction between "foreseeability" in tort and in contract, the Restatement again tilts toward tort and the broader recovery of damages.[112] Further, against the weight of precedent, the Restatement maintains that the full amount of damages includes any punitive damages assessed against the insured.[113]

The most extreme innovation of Section 27 is the position that punitive damages assessed against the insured in the underlying action may be recovered as consequential damages from an insurer found liable under Section 24.[114] This position is deeply flawed and flaunts considerable authority against it, holding that the insured cannot shift liability for punitive damages to the insurer in failure to settle cases.[115]

106. RESTATEMENT OF THE L. OF LIAB. INS. § 24 cmt. g.
107. Hartford Ins. Co. v. Methodist Hosp., 785 F. Supp. 38, 40 (E.D.N.Y. 1992).
108. Delancy v. St. Paul Fire & Marine Ins. Co., 947 F.2d 1536, 1551 (11th Cir. 1991).
109. RESTATEMENT OF THE L. OF LIAB. INS. § 27(1).
110. *Id.* § 27 cmt. a.
111. *Id.* § 27 cmt. c.
112. *Id.*
113. *Id.* § 27 cmt. e.
114. *Id.*
115. *Id.*

In *Soto v. State Farm Insurance Co.*,[116] for example, punitive damages as well as compensatory damages were assessed against the insured in the underlying litigation.[117] In the failure to settle suit, the unanimous New York Court of Appeals held that punitive damages, not insurable in New York, are not recoverable damages against the insurer.[118] The purpose of such damages, to punish and deter the party culpable for the misconduct, would be frustrated if the economic punishment were diverted to the insurer because of an unrelated act.[119] The court emphasized that the insurer's breach was not the legal/proximate cause of the punitive damages, which were "directly attributable to the insured's immoral and blameworthy behavior."[120]

Other courts have followed this rule.[121] One court noted that "shifting punitive damages to insurers would result in insurers pricing up policies to factor in [insureds] who behave egregiously."[122] The perverse outcome would be that the costs are then borne by the public, the intended beneficiaries of the punitive damages award imposed for the insured's misconduct.[123] Commentary in respected treatises provides further support for this approach.[124] Effectively, the only contrary authorities are dissenting justices in some of those cases and one federal court sitting in diversity applying a literal reading of Arkansas law allowing recovery of "any judgment . . . in excess of such policy limits."[125]

In imposing this extreme rule, the Restatement disregards the proximate causation analysis in the cases that disapprove, instead maintaining that punitive damages should be transferrable because they

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116. 635 N.E.2d 1222 (N.Y. 1994).

117. *Id.* at 1223.

118. *Id.* at 1224–25.

119. *Id.* at 1225.

120. *Id.*

121. *See* Wolfe v. Allstate Prop. & Cas. Ins. Co., 790 F.3d 487, 489–93 (3d Cir. 2015); Magnum Foods, Inc. v. Cont'l Cas. Co., 36 F.3d 1491, 1498 (10th Cir. 1994); PPG Indus., Inc. v. Transamerica Ins. Co., 975 P.2d 652, 656–58 (Cal. 1999); Lira v. Shelter Ins. Co., 913 P.2d 514, 517–18 (Colo. 1996).

122. *Wolfe*, 790 F.3d at 493.

123. *See id.*

124. *See, e.g.*, Cont'l Cas. Co. v. Kinsey, 499 N.W.2d 574, 580 (N.D. 1993) ("The better position is that, absent specific language in the policy extending coverage for punitive damages, no coverage exists for such damages as it is against public policy to allow the insured wrongdoer to shift the burden of payment of punitives to its insurer." (quoting MARK S. RHODES, COUCH ON INSURANCE § 56:9, at 15–16 (2d ed. 1983))).

125. Carpenter v. Auto. Club Interinsurance Exch., 58 F.3d 1296, 1303 (8th Cir. 1995) (emphasis omitted) (quoting McChristian v. State Farm Mut. Auto. Ins. Co., 304 F.Supp 748, 750 (W.D.Ark. 1969)). As the Third Circuit in *Wolfe* recognized, however, the *Carpenter* Court's reading of Arkansas law was unduly literal and overlooked Arkansas's public policy that might lead to the opposite result. *Wolfe*, 790 F.3d at 495.

may be a foreseeable consequence of the breach.[126] However, courts have identified sound reasons that the insured cannot evade liability for punitive damages, which are intended as a punishment, simply because of the insurer's unrelated conduct regarding settlement.[127] As these courts have recognized, the insurer's breach is not the legal cause of the insured's punitive damages liability.[128]

The Restatement's position on punitive damages is also flatly at odds with other provisions of the Restatement. In Comment a to Section 25, which concerns settlement duties when the insurer has reserved its rights, the Restatement acknowledges that "[a]n insurer has no duty to settle noncovered legal actions."[129] It further affirms that, when a claim has both covered and noncovered components, the reasonableness of the insurer's settlement decisions must be evaluated, "taking into account the covered components alone."[130] Comment b of Section 25 specifically refers to a claim for punitive damages as an example of an uncovered claim.[131] Yet, in stark contradiction, Section 27, Note e states: "Even if an insurer is not liable for the punitive-damages portion of an award, it still maintains a duty to make reasonable efforts to settle all claims against its insured within the insured's policy limits."[132]

Thus, Section 25 specifically affirms that an insurer is required neither to settle uncovered matters nor to factor in noncovered components of a claim in assessing whether to settle.[133] However, Section 27 requires the insurer to try "to settle all claims against its insured" within the policy limits whether covered or not.[134] The error of this inconsistency is compounded by the fact that the latter assertion is against settled insurance law:

> An insurer clearly takes on the duty of protecting, defending, and indemnifying its insured with respect to the scope of coverage that was purchased and attendant duties (defense and settlement). The insurer does not, however, insure the entire range of an insured's well-being, outside the scope of and

126. *See* RESTATEMENT OF THE L. OF LIAB. INS. §27 cmt. e (AM. L. INST. 2019).
127. *See, e.g.*, Soto v. State Farm Ins. Co., 635 N.E.2d 1222, 1224–25 (N.Y. 1994).
128. *See id.* at 1225.
129. RESTATEMENT OF THE L. OF LIAB. INS. § 25 cmt. a.
130. *Id.* cmt. b.
131. *Id.* (explaining that punitive damages are noncovered components when "such damages are expressly excluded from coverage under the policy or the law in the jurisdiction treats such coverage as a violation of public policy").
132. *Id.* § 27 reporters' note e.
133. *See id.* § 25 cmt. a.
134. *Id.* § 27 reporters' note e.

> unrelated to the insurance policy, with respect to paying third party claims. It is an insurer, not a guardian angel.[135]

Therefore, on this point, the Restatement plainly does not capture and "restate" what the law is. Instead, it adopts an approach that has already been rejected by nearly every jurisdiction that has considered it.

D. Right to Settle Without Insurer's Consent

Another frank innovation of the Restatement is Section 27(2), which gives the insured the right to settle without the insurer's consent despite policy restrictions, such as the consent to settle and cooperation requirements.[136] The new rule, which applies when the insurer has breached the duty to make reasonable settlement decisions, sets out four conditions that, in effect, vitiate the consent to settle and duty to cooperate requirements.[137]

At the outset, whether an insurer has breached its settlement duty can be determined only after the parties have litigated the issue.[138] By permitting insureds to settle on the basis of a subjective ex ante conclusion that the insurer has breached the duty, the Restatement in effect encourages insureds to take the risk of breaching policy conditions in hopes that its action will be excused after the fact. As the Restatement acknowledges, if wrong about the insurer's breach the insured will not be excused from compliance with applicable policy conditions; its decision to settle could result in a breach of the policy by the insured, which would then be responsible for the whole settlement.[139]

While the black letter law sets out the novel specific conditions under which an insured may settle, these provisions are undermined by presenting the opening for undefined exceptions. The Comment states that "there may be a narrow set of circumstances after an insurer's breach of the duty to make reasonable settlement decisions in which it would be appropriate for a court to excuse the insured's failure to follow the procedural requirements" set out in the black letter.[140] An example of such a "narrow set of circumstances" is if the insurer is not prejudiced by the insured's failure to abide by the conditions.[141] This purportedly

135. Camelot by the Bay Condo. Owners' Ass'n v. Scottsdale Ins. Co., 32 Cal. Rptr. 2d 354, 364 (Ct. App. 1994) (emphasis added).
136. *See* RESTATEMENT OF THE L. OF LIAB. INS. § 27(2).
137. *See id.* § 27(2)(a)–(d).
138. *See id.* cmt. a.
139. *See id.* § 27 reporters' note b.
140. *Id.* § 27 cmt. b.
141. *Id.*

limited exception negates bargained-for policy conditions and threatens to swallow the rule. Even if the insured carries the burden to prove the absence of prejudice, proof either way will require determination of the likely outcome of a trial that was never held. The unspecified exceptions the Restatement allows create considerable uncertainty and invite litigation by insureds seeking to expand the exception for their benefit.

The Restatement frankly acknowledges that "these specific procedural requirements are an innovation" and suggest that courts apply them only prospectively following some vague concept of notice.[142] The Restatement here introduces yet another novel, untested rule that rewrites the insurance policy and seeks to unsettle well-settled precedent upholding the consent to settle and duty to cooperate provisions.

IV. POSTSCRIPT ON THE RESTATEMENT

The Restatement began in 2010, as a "Principles Project" on the law of liability insurance.[143] Whereas a Restatement, as the name suggests, is supposed to "aim at clear formulations of common law . . . and reflect the law as it presently stands," a Principles project can reject existing law in favor of whatever approach the authors believe preferable and commendable.[144] Thus, as initially conceived, the ALI's insurance project was more aspirational than descriptive.[145]

In October 2014, the Principles project was converted into a Restatement project.[146] With this transition, the draft, instead of proposing "the law as it should be," was supposed to "reflect the law as it presently stands."[147] A Restatement is not the forum for proposing innovations or major departures from established law. There should be a

142. *Id.* § 27 reporters' note b.

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

144. *How the Institute Works*, *supra* note 15.

145. *See generally* CAPTURING THE VOICE OF THE AMERICAN LAW INSTITUTE: A HANDBOOK FOR ALI REPORTERS AND THOSE WHO REVIEW THEIR WORK 13–15 (Am. L. Inst.ed., rev. ed. 2015), https://www.ali.org/media/filer_public/08/f2/08f2f7c7-29c7-4de1-8c02-d66f5b05a6bb/ali-style-manual.pdf [hereinafter 2015 ALI REVISED STYLE MANUAL].

146. *See* David L. Brown & David G. Harris II, *ALI Restatement Brings Change and Uncertainty for Carriers*, CARRIER MGMT. (Sept. 12, 2018), https://www.carriermanagement.com/features/2018/09/12/184059.htm#:~:text=In%20October%202014%2C%20the%20ALI,attorneys%20as%20support%20for%20their.

147. *Id.*; 2015 ALI REVISED STYLE MANUAL, *supra* note 145, at 3–4.

"very strong presumption in favor of restating the law" as it is "in the majority view of American courts."[148]

As the project continued, however, concerns arose that the conversion from the "Principles" to a "Restatement" had not followed these guidelines. In an extraordinary letter addressed to ALI President David F. Levi, six state governors stated:

> [W]e have serious concerns over the direction of the ALI's proposed publication. Indeed, the Draft Restatement goes beyond restating black-letter law; in some instances, it reinterprets and purports to modify existing insurance law . . . . Rather than offering a reliable and authoritative summary of existing law, the Draft Restatement proposes changes to established legal principles governing liability insurance contracts and disputes. Many of these proposed changes are properly within the prerogative of our state legislatures, at odds with established common law, or both.[149]

These governors were not alone, as many others have voiced similar concerns repeatedly since the project was converted.[150]

In light of this history, courts asked to apply Section 24 or 27 of the Restatement should be mindful of the late Justice Scalia's warning that "modern Restatements . . . must be used with caution," because "it cannot safely be assumed . . . that a Restatement provision describes rather than revises current law."[151] Because Sections 24 and 27 of the Restatement revise rather than describe current law, they are entitled to no more authority or deference "regarding what the law ought to be than the recommendations of any respected lawyer or scholar."[152]

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148. Ward Farnsworth, *Reflection on Collective Thought*, THE ALI ADVISER (Dec. 28, 2017), https://thealiadviser.org/inside-the-ali-posts/reflection-collective-thought/.

149. Letter from Henry McMaster, Governor, South Carolina, et al. to the Hon. David F. Levi, President, ALI (Apr. 6, 2018), http://ncoil.org/wp-content/uploads/2018/04/2018-04-062520Governors2520to2520ALI2520re2520Draft2520Restatement-2-1.pdf.

150. *See* Glenn G. Lammi, *Restate or Rewrite?: Stark Choice Faces ALI Leaders on Liability Insurance Law Project*, FORBES (Jan. 16, 2018, 9:57 AM), https://www.forbes.com/sites/wlf/2018/01/16/restate-or-rewrite-stark-choice-faces-ali-leaders-on-liability-insurance-law-project/#7a7fa8416b5b.

151. Kansas v. Nebraska, 574 U.S. 445, 475–76 (2015) (Scalia, J., concurring in part and dissenting in part).

152. *Id.* at 476.

V. CONCLUSION

The duty to make reasonable settlement decisions is an outgrowth of the implied covenant of good faith and fair dealing that, as provided in black-letter contract law, inheres within every contract, insurance policies included. Given this contract-law origin of the duty, contract rather than tort law better defines its contours and dictates the consequences of a breach.

Notwithstanding that some courts have looked at the parameters of the duty to settle differently, a number of guiding principles generally apply, the most important being that, for an insurer to be held liable for an excess verdict, there must be proof of causation and insurer bad faith. Further, where there are differences, there remain ascertainable majority approaches and clear minority viewpoints. This Article has explored a number of these differences and identified majority approaches on some fundamental issues—for instance, the majority approach that more than mere negligence is required for an insurer to be held liable for failing to settle.

The Restatement took a different approach, oftentimes stating rules that are clearly in the minority (if accepted at all) as if they were the "trend" or even the black-letter law. As shown above, courts and practitioners alike should approach Sections 24 and 27 of the Restatement with caution and decline to apply the Restatement's innovations in the face of well-developed law that continues to afford courts and parties both certainty and uniformity.