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When "Reasonable" is Unreasonable: ALI's Proposed Final Draft of the Restatement of Law Liability Insurance[1]

The vast majority of members of the Illinois Association of Defense Trial Counsel have an especially keen interest in the law of liability insurance as it affects our clients and our practice. The American Law Institute ("ALI") is currently engaged in a project involving defining liability law in the United States. The ALI effort started in 2010 as a Principles Project to express what academics thought the law of liability insurance should be. However, in 2014, this project morphed into a Restatement Project. At that point, the reporters should have abandoned their aspirational efforts and, instead, focused on existing law and majority rules as has been the case in most past Restatements.

Instead of starting over, the authors and proponents of the Restatement of the Law of Liability Insurance adhered to the prior drafts but now referenced them as if they were reports of the majority view on the variety of aspects of liability insurance law. Today, the ALI and the authors and proponents recognize that many of the provisions in the "final" draft reflect the aspirations of the reporters rather than majority law but they persist with the project of a Restatement of Law.

Current Procedural Status

Many parts of the proposed Restatement have already been adopted. More recently, many diverse groups of insurers and attorneys have raised questions about the ALI authors' wish-list as a Restatement from ALI. As a result, the ALI postponed a final vote on the Restatement of the Law of Liability Insurance that had been scheduled for the ALI annual meeting in May 2017, and instead delayed the final vote until the ALI meeting next spring.

Restatement or Aspirations?

We recognize that the ALI and its respective Restatements of the Law have been a major influence in the development of the law on a variety of issues. It is respectfully submitted, however, that the reliance by attorneys and the courts on these respective Restatements, and the legitimacy and reputation of the ALI itself, are based upon the Restatement's discernment and presentation of the law as it stands. Recent changes in the policy of the Institute have allowed for the introduction of a reform-oriented approach to the law including recommendations for change rather than a recapitulation of the law as it exists. Unfortunately, these types of recommendations are prevalent in the proposed Restatement of the

Law of Liability Insurance. It is a misnomer to call the proposed document a Restatement of the Law. The impact of the ALI's departure from a focus on established law to the authors' aspirations cannot be overstated.

The ALI's insistence upon proceeding with a wish-list, rather than a recapitulation of the majority law, calls into question the very purpose of the Restatement at its inception. Justice Scalia recognized the problem with this approach:

> [M]odern Restatements . . . are of questionable value, and must be used with caution. The object of the original Restatements was "to present an orderly statement of the general common law." . . . Over time, the Restatements' authors have abandoned the mission of describing the law, and have chosen instead to set forth their aspirations for what the law ought to be. . . . Restatement sections [with little support in caselaw] should be given no weight whatever as to the current state of the law, and no more weight regarding what the law ought to be than the recommendations of any respected lawyer or scholar. And it cannot safely be assumed, without further inquiry, that a Restatement provision describes rather than revises current law.

Kansas v. Nebraska, 135 S. Ct. 1042 (2015) (Scalia, J., concurring in part and dissenting in part) (internal citations omitted). Surely, a Restatement in this context does not promote an orderly statement of the common law or a clarification and simplification of the law. The impact of this discussion is not theoretical. Despite the successful efforts to delay the final adoption of the Restatement, a United States District Court in the Southern District of Indiana has cited the "Discussion Draft" of the Restatement in a decision on May 26, 2017. *Selective Ins. Co. of Am. v. Smiley Body Shop, Inc.*, No. 1:16-cv-00062-JMS-MJD, 2017 WL 2306364, at *5 (S.D. Ind. May 26, 2017).

It is unclear whether ALI will undertake a review of the proposed Restatement to determine whether it is appropriate. The ALI could rename the project as Principles or revise it to reflect current law if it is to remain a Restatement. However, if the authors' past actions regarding criticisms of the project are any indication, the ALI may well move forward with the current draft as a Restatement even though much of it reflects the authors' aspirations rather than a capitulation of current law. If this happens, attorneys must be ready to explain to courts the shortcomings of the Restatement as cited by Justice Scalia, and the ALI must be ready to weather the resulting storm.

Key Proposals are Contrary to Illinois Law

Illinois, along with Texas, California, Florida, Pennsylvania, and New York, has the most developed insurance law in the country. This development allows for a stable, consistent application of the law that insurers, insureds, and their respective counsel can plan for and rely on. Illinois has unique features to its body of insurance law, such as the estoppel doctrine articulated in *Employers Ins. of Wausau v. Ehlco Liquidating Trust*, 186 Ill. 2d 127 (1999), and the targeted tender rule, *John Burns Construction Co. v. Indiana Insurance Company*, 189 Ill. 2d 570 (2000). We may disagree about the wisdom or efficacy of these decisions, as many courts around the country have, but they are the law of Illinois. While the Restatement does not directly impact those particular decisions, other less controversial, but no less fundamental decisions, may. As will be seen, "reasonableness" is the mantra throughout this draft, leaving open wide swaths of the law to wild interpretation in an industry that benefits from certainty, not uncertainty.

Adoption of an Expectation test for policy interpretation—Proposed § 3

One of the most fundamental changes sought by the ALI is an adoption of the expectations test for policy interpretation. The proposed section is as follows:

> (1) The plain meaning of an insurance-policy term is the single meaning, if any, to which the language of the term is reasonably susceptible when applied to the claim at issue, in the context of the insurance policy as a whole without reference to extrinsic evidence regarding the meaning of the term.
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> (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.

The first section is the law. It is the law of interpretation of any contract. The second section however, is anathema to the interpretation of contracts as it imposes the use of extrinsic evidence even where the policy language is not ambiguous. Under this draft, every policy provision would be subject to extrinsic evidence based upon what a policyholder "reasonably expected" and then what a court thinks is more reasonable.

The current rule, that if a policy provision is susceptible to more than one reasonable interpretation, it is construed against the insurer, generally precludes the use of extrinsic evidence and creates a bright line rule for all to follow. The approach that the ALI has put forth as a "restatement" is directly contrary to current Illinois law which has rejected the expectations test. *Continental Cas. Co. v. Howard Hoffman & Assocs.*, 2011 IL App (1st) 100957, ¶¶ 76-78. Further, the proposed rule would allow other possible interpretations to be suggested, beyond reasonable interpretations, which is the opposite of current Illinois law. *Erie Ins. Exch. v. Triana*, 398 Ill. App. 3d 365, 368 (1st Dist. 2010).

Adoption of "Substantial" Requirement for Rescission—Proposed § 8

In a direct assault of what is most often the subject of legislation, and which, if misunderstood by state legislatures, could lead to changes in statutes, the ALI has proposed requiring that in order for a rescission to be effective, the misrepresentation would have caused the policy to be issued on "substantially different terms." The proposed section is:

> 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 after substantially different terms.

Currently, Section 154 of the Illinois Insurance Code, like many such codes around the country, simply requires that there be a material difference in the premium to be charged. That is, any difference in the issuance of the policy, even a few dollars, is sufficient to support a rescission. It is fundamental to the concept of insurance that the risks within the pool be properly priced. Insurers and insureds alike are harmed when a proper premium is not changed for a risk, or a risk is covered that would not have been had the insured not misrepresented the risk to be insured. Giving courts the opportunity to decide what is sufficiently substantial to warrant a rescission will lead to inconsistent judgments that will jeopardize insurers and lead to higher premiums for insureds.

Further, the rule injects further uncertainty with what a "reasonable insurer in this insurer's position." Such a rule would lead to endless discovery regarding the underwriting principles for each insurer, their profit margins, and all manner of issues that are irrelevant to whether the insured failed to truthfully answer a question on an application. The current rule in Illinois is that a misrepresentation is material if a reasonable person would consider the information likely to increase the likelihood of the activity insured against and accordingly require the insurer to seek a higher premium, different terms of issuance, such as exclusion, or to decline to insure the risk at all. *See* 215 ILCS 5/154; *Safeway Ins. Co. v. Duran*, 74 Ill. App. 3d 846, 850-851 (1st Dist. 1979). Injecting more facts into the analysis of misrepresentation is a usurpation of current law, not a restatement of it.

Adoption of Reasonableness Approach for Duty to Settle—Proposed § 24

Contrary to current Illinois law in *Haddick v. Valor Ins. Co.*, 198 Ill. 2d 409 (2001), the Restatement seeks to impose a "reasonableness" standard for settlement decisions. The proposal is as follows:

> (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 the duty to the insured to make reasonable settlement decisions to protect the insured from a judgment in excess of the applicable policy limit.
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> (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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> (3) An insurer's duty to make reasonable settlement decisions includes the duty to make its limits available to the insured for the settlement of a covered legal action that exceeds those limits if a reasonable insurer would do so in the circumstances.

This proposed rule essentially creates a quasi-strict liability standard for failure to settle. It is necessarily backward looking following an excess judgment. And like so many other parts of the proposal, it imposes a reasonableness standard. In this circumstance, in Sections 2 and 3, the proposed rule attempts to define reasonableness but does so in a circular fashion by using reasonableness to define reasonableness.

More importantly, it is contrary to Illinois law. In *Haddick*, the Illinois Supreme Court created a bad faith standard for determining if an insurer failed in its duty to settle. Simply being unreasonable is insufficient under Illinois law, actual bad faith is required. *Haddick*, 198 Ill. 2d at 306. The Restatement should not be recommending policy for courts and state legislatures, but rather should set forth what the policy is that has been created by the court and the state legislatures.

Adoption of Damages for Failure to Make "Reasonable Settlement Decisions"—Proposed § 27

Ignoring the well-established and statutory schemes for determination of damages for failure to settle, the Restatement seeks to impose broad damages on insurers. The proposal is:

> An 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.

Like many states, the damages recoverable for bad faith are defined by statute. Section 155 of the Illinois Insurance Code provides for a penalty, attorneys' fees, and costs. 215 ILCS 5/155. In addition, an insured in a given circumstance could seek damages beyond Section 155. *Cramer v. Ins. Exch. Agency*, 174 Ill. 2d 513, 530 (1996). What would constitute "other foreseeable harm" seems to go well beyond what is currently allowed under Illinois law.

Conclusion

Insurance law is a delicate balance between fairness and efficiency. The law must never lose sight of its fundamental purpose to require payment of valid claims while at the same time protecting the pool of insureds from insolvent insurers and higher premiums that will come if the correct balance is not struck. Relative certainty in the law of insurance is key to maintaining the insurance system that is essential to a well-functioning economy. The proposed Restatement threatens to upset that balance and harm the very insureds it is intending to help. But more fundamentally, as seen by the short recitation of diversions from Illinois law above, the Restatement is not a restatement of law at all, but the hopes of its authors.

[1] The views expressed are those of Mr. Eckler and Mr. Mifflin and not of their respective firms or clients.

About the Authors

R. Mark Mifflin of *Giffin, Winning, Cohen and Bodewes, P.C.* in Springfield has extensive experience in all levels of court work—from state administrative agency through the Illinois Supreme Court. Mr. Mifflin is also a registered lobbyist with the State of Illinois and has a proven track record of working with legislators and administrators at all levels of state government. Mr. Mifflin earned his B.A., with honors from Western Illinois University and his J.D., *magna cum laude* from Southern Illinois University School of Law. Mr. Mifflin is a former Legislative Staff Intern to the Illinois General Assembly, Clerk for the US District Court for the Central District of Illinois, Clerk for the Illinois Supreme Court and Assistant US Attorney for the Central District of Illinois. Mr. Mifflin served as the president of the Illinois Association of Defense Trial Counsel in 2016-2017 and was selected as the recipient of the 2017 Fred H. Sievert Award, presented by DRI in recognition of exceptional service as a defense bar leader.

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About the IDC

The Illinois Association Defense Trial Counsel (IDC) is the premier association of attorneys in Illinois who devote a substantial portion their practice to the representation of business, corporate, insurance, professional and other individual defendants in civil litigation. For more information on the IDC, visit us on the web at www.iadtc.org or contact us at PO Box 588, Rochester, IL 62563-0588, 217-498-2649, 800-232-0169, idc@iadtc.org.