

## Choice of Law:

# Has the Value of Your Insurance Been Left to Chance?



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Policyholders are forced to play a game of Russian Roulette every time they submit a sizeable claim to their insurance company. They have no way of knowing whether the claim will be paid or coverage will be arbitrarily denied, leaving the company (or its risk manager) to take a bullet in the head. This uncertainty results from two things: (1) insurance companies routinely deny all manner of valid claims; and (2) whether the policyholder can enforce its rights in court or through settlement often depends upon which state's law governs the claim.

### *Two States, Two Different Results*

Consider the following example: two companies purchase the same standard form comprehensive general liability coverage from the same insurance company. Each one is sued separately for property damage caused by defective products. The claims are small, so each company decides to handle the suit without notifying its insurance company. Two months later the plaintiffs amend their complaints against the companies in order to assert claims for bodily injury, and to seek punitive damages. Faced with potentially large exposures, both companies give notice to the insurance company, which denies coverage claiming that the companies had not provided timely notice of occurrence. The companies then commence actions against the insurance company. One of the actions is decided under New York law, and the insurance company prevails under New York's general rule that often leads to the forfeiture of coverage for late notice. The other claim is decided under California law, which upholds coverage

unless the insurance company can demonstrate prejudice from late notice. The policyholder prevails in that action. Thus, as is often the case, identical coverage claims under the same standard form insurance lead to strikingly different results.

Late notice is not the only insurance coverage issue that is addressed in a variety of ways by the different states. Commonly used exclusions have been subject to varying interpretations, and the states apply a number of different standards for deciding whether an insurance company has acted properly in its denial of coverage. These issues not only dictate the way courts resolve coverage cases, but can also influence insurance company's behavior when they make coverage determinations.

As the above example demonstrates, a policyholder has the greatest chances of (sooner or later) recovering from its insurance company when favorable law is applied to its insurance claims. Typically, the policyholder waits until a coverage claim arises, and then argues for the law of a state in the context of that claim. This approach offers the benefit of allowing the policyholder to make an "up to the minute" determination of which state's law is most favorable at the time that law is to be applied. The policyholder can argue its position under choice-of-law principles and assert that the failure of insurance policies to contain a choice-of-law provision creates an ambiguity that should be construed in favor of the policyholder's choice-of-law. For some policyholders this may be the best approach. However, typically this approach is followed simply because the policyholder is unaware that it may be able to take steps earlier to influence choice-of-laws outcomes, rather than on the basis of informed decision-making.

### *Negotiating a Better Policy*

In order to decide what, if anything, to do proactively about the problems created by differing court decisions, a company must evaluate coverage law in light of its greatest potential exposures. That analysis requires the involvement of the risk manager and legal counsel. When important issues have been identified, they can be addressed in two ways. First, the policyholder can negotiate with its insurance company for the inclusion or alteration of policy language to eliminate the problems. For example, a company that is concerned about late notice could seek a provision which states that late notice will not result in the forfeiture of coverage except to the extent that the insurance company can demonstrate prejudice.

### *Consider the Options Carefully*

Second, policyholders who lack the bargaining power to insist on such provisions can consider attempting to influence the choice-of-law determinations of courts before a claim arises. It is impossible to predict with great accuracy how any given state will address legal issues in the future, and settled law may change. Therefore, pre-selecting applicable law has its risks. However, the law may be sufficiently well developed in a state on a number of important issues to convince the policyholder to attempt to lock in applicable law when coverage is purchased. For example, some jurisdictions allow for the award of punitive damages based upon an insurance company's bad faith in the denial of claims. Others provide for the award of attorneys fees. These remedies can be of significant value to policyholders when they are forced to sue to enforce their insurance coverage. Also, many jurisdictions have enunciated basic principles used in resolving coverage disputes which provide an indication of whether the policyholder can expect favorable or unfavorable treatment when novel issues are raised.

When looking for favorable law on important coverage issues, the policyholder should consider states which have some logical nexus to its operations, or its insurance coverage, such as the state where it is headquartered or has major manufacturing facilities, or where the insurance company selling the primary coverage is headquartered or incorporated. Many courts resolve choice-of-law issues based upon which state has the greatest interest in, or connection with the dispute. Courts have concluded, and insurance companies have

argued, that a significant presence of a policyholder or insurance company in a state is an important factor in that analysis. The policyholder may benefit from being able to make the same argument, and point out the insurance companies' successful reliance upon the same factors in other cases.

### *Influencing Choice of Law*

Once the policyholder has selected a policyholder-friendly state (the "friendly state"), the policyholder can do a number of things at the time it purchases insurance to increase the chances of having favorable law applied to its coverage claims. Policyholders may be able to influence choice of law decisions by buying their insurance in the friendly state. Many courts consider the place of contracting as one factor in their choice of law analysis, and some courts still look almost exclusively to *lex locus contractus*. Insurance companies often argue the importance of the place of contracting. Courts often consider the place of contracting to be the place where the policy is countersigned, typically by the broker. Some courts also consider where negotiations took place and where the contracting parties were located. Therefore, if a company decides to influence choice-of-law at the time of purchasing insurance, it might consider using a broker who is located in the friendly state and conduct its face-to-face negotiations there. That should not be a problem in this era of mega-brokerages with offices all over the country.

Policyholders who wish to influence choice-of-law outcomes may also consider buying insurance from a company headquartered or incorporated in the friendly state. Choice-of-law considerations should not be the tail wagging the dog of insurance purchasing decisions. However, all other things being equal, there is a potential advantage to selecting an insurance company from the friendly state. Many courts decide choice-of-law issues based upon which state has the greatest interest in the dispute, and every state has an interest in upholding the integrity of insurance policies entered into by its corporate citizens. This is particularly true when the citizen is an insurance company, which is subject to regulation by the state.

### *The Last Word on Choice of Law Decisions*

Pursuing these strategies will not assure the application of favorable law to coverage disputes. The location of the loss or liability has influenced

many choice-of-law determinations, and that cannot be controlled by the risk manager. Also, choice-of-law decisions may be influenced by laws of the forum where the coverage dispute is adjudicated. Nonetheless, policyholders should at least consider making an effort to improve the chances that favorable law will be applied to their coverage disputes. It may mean the difference between getting the insurance coverage you paid for and getting a bullet in your head. ■

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