A TORT WITHOUT A CAUSE: SECTION 12 OF *THE RESTATEMENT OF THE LAW, LIABILITY INSURANCE*

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I. INTRODUCTION

The *Restatements* of the American Law Institute ("ALI") occupy a unique place in American jurisprudence. In a divided system of federal and state courts and other authorities, the ALI's *Restatements* have long sought to provide an authoritative distillation of what the law *is*.[1] This purpose, as the name "*Restatement*" suggests, is descriptive rather than prescriptive: The rules crafted and "reported" in the *Restatements* are understood to be rooted in extant case law, not to be creating new law.[2] For this very reason, judges often rely upon *Restatements* as reflecting the law as it is, and as providing a shorthand for a guiding and well-established legal principle.

In 2019, the ALI finalized a new restatement: *The Restatement of the Law, Liability Insurance* ("*RLLI*" or "*Restatement*").[3] Much ink was spilled along the path to this *Restatement*, with contentious debates over whether the "rules" articulated in the *RLLI* were supported by existing case law, and

1. *See Frequently Asked Questions, ALI Operations, "What Is the Difference Between Restatements, Principles, and Model Codes?,"* Am. L. Inst., https://www.ali.org/about-ali/faq (last visited Apr. 30, 2020).

2. *See* Am. Law Inst., Capturing the Voice of the American Law Institute: A Handbook for ALI Reporters and Those Who Review Their Work 5–6 (rev. ed. 2015), https://www.ali.org/media/filer_public/08/f2/08f2f7c7-29c7-4de1-8c02-d66f5b05a6bb/ali-style-manual.pdf [hereinafter ALI Style Guide] (stating that a Reporter may not adhere to what Herbert Wechsler called "a preponderating balance of authority," and noting that, "if a Restatement declines to follow the majority rule, it should say so explicitly and explain why").

3. Restatement of the Law, Liability Insurance (Am. Law Inst. 2019) [hereinafter RLLI].

how far the *RLLI* could go in blazing a new trail for the legal responsibilities of liability insurers. Among the 50 sections of the *RLLI* lies Section 12. Section 12, titled "Liability of Insurer for Conduct of Defense," breaks with the traditional understanding of what a Restatement does. Rather than "restating" an existing rule regarding an insurer's liability for the malpractice of defense counsel the insurer selects on behalf of its insured, Section 12 invents wholly new rules and a cause of action without either the support of existing case law or even a compelling policy rationale.

Section 12 purports to impose tort liability on insurers for the malpractice of defense counsel retained to represent an insured in two circumstances: (1) when the insurer fails to take reasonable care in selecting defense counsel, and defense counsel's malpractice is "within the scope of the risk that made the selection of counsel unreasonable"; and (2) when the insurer "directs the conduct" of defense counsel with respect to defense counsel's malpractice "in a manner that overrides the duty of the counsel to exercise independent professional judgment."[4] Both subsections of Section 12 suffer from the same shortcomings: Each is an innovation, more or less completely lacking support in existing case law and creating a new tort; each lacks a compelling, real-world justification for the innovation—i.e., presenting no actual problem that it is needed to solve; and each ignores that a remedy to the insured already exists if an insurer breaches its duty to defend.

Part I of this article explores the *RLLI*'s origins as a principles project and situates Section 12's innovation of a new tort in this context. Part II explains that the tort liability imposed by Section 12 finds no support in pre-existing case law—which is not surprising given its principles project origins—yet also lacks a compelling policy justification. Part III analyzes Section 12's new tort in relation to the existing contractual obligation for an insurer to provide a defense, concluding that the conduct for which Section 12 purports to hold the insurer liable in tort is already fully redressed through a contractual claim. Part IV explores the consequences of introducing new tort liability, most substantially by expanding available damages in a way that directly contradicts the foundational legal principle embodied in the economic loss rule. Part V discusses the three cases that have applied Section 12 to date. Finally, this article concludes that courts should not adopt Section 12 as stating a tort or permitting any damages for an insurer's breach of its duty to defend beyond damages that may apply to a breach of the duty to defend.

4. *Id.* §12.

II. THE ORIGINS OF SECTION 12 AND *THE RESTATEMENT OF THE LAW, LIABILITY INSURANCE*

A. *The Troubled History of* The Restatement of the Law, Liability Insurance

The *RLLI* finds its roots in an intended "Principles of Liability Insurance" ("PLI") publication by the ALI.[5] First proposed in 2010, the document's initial approved purpose was to advocate a particular position regarding how the law *should* exist as it relates to the topic of liability insurance.[6] The ALI drastically shifted its direction in 2014, when, in an unprecedented development, the ALI elected to turn the PLI into a restatement of law. Unlike principles projects—which are intended to advocate for a shift in the law and "are primarily addressed to legislatures, administrative agencies, or private actors,"—restatements "are primarily addressed to courts and aim at clear formulations of common law and its statutory elements, and reflect the law as it presently stands or might appropriately be stated by a court."[7] To successfully restate the law, restatements must rely on existing case law, or they run the risk of blurring the distinction between a restatement and a principles document, without any clear warning to the reader and, in particular, to the judge whom restatements were designed to serve.[8]

The *RLLI*'s move from a principles project to a restatement was initially perceived as a potentially positive development, because the ALI's

5. *See* Kim Marrkand, *ALI Shouldn't 'Teach' Insurance Restatement in a Courthouse*, Law360 (Feb. 11, 2019), https://www.law360.com/articles/1127838/ali-shouldn-t-teach-insurance-restatement-in-a-courthouse (explaining RLLI origins). According to its founding document, the purpose of the ALI is "to promote the clarification and simplification of the law and its better adaptation to social needs, to secure the better administration of justice, and to encourage and carry on scholarly and scientific legal work." Certificate of Incorporation, Am. L. Inst. (Feb. 23, 1923), https://www.ali.org/media/filer_public/10/62/106284da-ddfe-4ff4-a698-0a47f268ee4c/certificate-of-incorporation.pdf.

6. *See* ALI Style Guide, *supra* note 2.

7. *See Frequently Asked Questions*, *supra* note 1; *see also Past and Present ALI Projects*, Am. L. Inst. (Mar. 2019), https://www.ali.org/media/filer_public/c5/38/c5387be9-980a-4d69-af6d-ad4d4a067606/past-present-3-19.pdf. Principles projects seek "to unify a legal field without regard to whether the formulations conformed precisely to present law . . . mak[ing] clear the extent to which the black-letter principles correspond to actual law and, if not, how they might most effectively be implemented as such." ALI Style Guide, *supra* note 3, at 4, 13. Because the primary purpose of principles projects is to advocate for a shift in the law, not only do such publications not have to rely on case law to support their assertions, but they often cannot rely on case law because it may not exist. Instead, they primarily rely on public policy arguments to persuade legislators and administrators to enact laws in accordance with the ideas set forth in the document. *See, e.g.*, Principles of the Law, Aggregate Litigation (Am. Law Inst. 2003–2010); Principles of the Law, Family Dissolution: Analysis and Recommendations (Am. Law Inst. 1989–2002); Principles Projects, Software Contracts (Am. Law Inst. 2004–2010).

8. *See, e.g.*, *Frequently Asked Questions*, *supra* note 1 ("Restatements typically synthesize existing case law from across U.S. jurisdictions, and they offer commentary explaining varying approaches."); ALI Style Guide, *supra* note 2.

standards governing restatements—stating the law *as it is*—in contrast to the aspirational qualities endemic to a principles project, would apply. This hope that the new *RLLI* would articulate the law of liability insurance as it exists, rather than as some think it should be, was short-lived, so much so that, at its annual meeting on May 23, 2017, the ALI stated that it would not vote on the *RLLI* to allow the Reporters an additional year to address the mounting concerns.[9] Nevertheless, three months later, in August of 2017, the Reporters released an updated draft of the *RLLI*, which failed to address or respond to the dissenting concerns, and did not materially change the document.[10] The *RLLI* was subsequently approved by the ALI and its final version released in 2019.[11]

B. *Section 12*

Section 12 of the *RLLI*, "Liability of Insurer for Conduct of Defense," appears in the second chapter of the *RLLI*, "Management of Potentially Insured Liability Claims," within the first topic thereunder, "Defense." The first Comment on Section 12 explains its purpose:

> When a defense counsel selected by an insurer to represent an insured commits professional malpractice, the insured may recover from that attorney for any harm that results, subject to meeting the standard elements of a tort claim for professional malpractice. Under the rule stated in this Section, an insured may also seek recovery in tort for harms caused by that malpractice from the liability insurer in two limited sets of circumstances.[12]

Section 12 is accordingly divided into two subsections, one for each "limited set[] of circumstances." Subsection 12(1) provides for insurer liability for harm caused to the insured due to the insurer's negligent selection of counsel:

> If an insurer undertakes to select counsel to defend a legal action against the insured and fails to take reasonable care in so doing, the insurer is subject to liability for the harm caused by any subsequent negligent act or omission of the selected counsel that is within the scope of the risk that made the selection of counsel unreasonable.[13]

Subsection 12(2) provides for insurer liability for harm to the insured if the insurer overrides the duty of counsel to exercise independent professional judgment:

9. *See* Marrkand, *supra* note 5 (outlining timeframe for RLLI's publication).
10. Restatement of the Law, Liability Insurance, Reporters' Memorandum (Am. Law Inst. Council Draft No. 4, Dec. 4, 2017).
11. *See* Marrkand, *supra* note 5.
12. RLLI, *supra* note 3, § 12, cmt. *a*.
13. *Id.* § 12(1).

> An insurer is subject to liability for the harm caused by the negligent act or omission of counsel provided by the insurer to defend a legal action when the insurer directs the conduct of the counsel with respect to the negligent act or omission in a manner that overrides the duty of the counsel to exercise independent professional judgment.[14]

III. SECTION 12 CREATES A NEW TORT WITHOUT ANY LEGAL OR POLICY JUSTIFICATION

A. *Section 12's Tort Cause of Action Finds No Support in Pre-*RLLI *Case Law*

Given that, for nearly four years, the *RLLI* proceeded with the understanding that, as a principles project, it could set forth aspirational rules, Section 12's innovative rather than jurisprudential quality is not surprising. As a practical matter, because the stated purpose of a principles project is to advance an argument that the law ought to be a certain way, it makes sense that the existing *RLLI* suffers from the vestiges of that process and thus lacks support. But when the PLI project became the *RLLI*, the document as drafted should have been evaluated to determine which of its sections in fact capture the law as it is, and which sections should have been stricken as purely aspirational and suitable only for a principles project. Section 12 falls into this latter category.

The Reporters' notes accompanying Section 12 repeatedly acknowledge the dearth of any case law supporting either Subsection 12(1) or Subsection 12(2).[15] The notes state that "there are no published cases expressly dealing with a situation in which the liability insurer hires counsel who turns out to have insufficient liability insurance coverage, and as a result is unable to pay a malpractice claim brought by insured against counsel."[16] The notes further acknowledge that "a thorough research of the case law reveals that insurers are rarely held liable in this way" (referring to "direct insurer liability for negligent supervision of counsel representing the insured"), and that "no cases were found holding a liability insurer liable for the torts of counsel on a theory of apparent authority or negligent supervision."[17]

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14. *Id.* § 12(2).

15. Reporters' Note *a* refers readers to section four of the *Restatement Third, Torts: Liability for Economic Harm*, for the general proposition that attorneys (not insurers) are responsible for the "economic harms that they negligently cause their clients in the performance of their professional obligations." RLLI, *supra* note 3, § 12, Reporters' Note *a*. But it fails to offer any support for extending insurer liability for defense counsel's malpractice, referring only to the *Restatement Third, Torts: Liability for Economic Harm* for the general proposition that "lawyers are liable for the economic harms that they negligently cause their clients in the performance of their professional obligations to those clients." *Id.* In turn, that section of the *Economic Harm Restatement* makes no mention of insurance companies. *See* Restatement Third, Torts: Liability for Economic Harm, § 4, cmt. *b* (Am. Law Inst. 2020).

16. *See* RLLI, *supra* note 3, § 12, Reporters' Note *c.*

17. *Id.* Reporters' Note *d.*

Indeed, the notes concede that "very few cases can be found even hinting at insurer liability for the misconduct of counsel retained on behalf of an insured."[18] One commentator whose work is cited in the Reporters' notes, Professor George Cohen, observed that he could not find a single case "addressing the issue of whether a liability insurer can be liable for negligent selection of defense counsel if the insurer fails to require that the defense counsel maintain liability insurance."[19] Moreover, the cases cited in the notes to Section 12 do not lend support to either Subsection 12(1)[20] or Subsection 12(2).[21]

18. *Id.*

19. George M. Cohen, *Liability of Insurers for Defense Counsel Malpractice*, 68 Rutgers L. Rev. 119, 134 n.77 (2015); *see* RLLI, *supra* note 3, § 12, Reporters' Note *b*.

20. For example, the Reporters' Notes cite a number of cases for the proposition that an insurer's duty to defend "entails an obligation on the insurer to select competent and qualified counsel." RLLI, *supra* note 3, § 12, Reporters' Note *b*. None of these cases fully supports this proposition. *See* R.C. Wegman Constr. Co. v. Admiral Ins. Co., 629 F.3d 724, 728 (7th Cir. 2011) (recognizing that an insurer has a duty to notify the insured of a conflict of interest if and when it learns of such a conflict arising, not recognizing a duty to hire "competent counsel"); Merritt v. Rsrv. Ins. Co., 110 Cal. Rptr. 511, 527 (Ct. App. 1973) (rejecting the extension of vicarious liability to an insured, and holding instead that "if trial counsel negligently conducts the litigation, the remedy for this negligence is found in an action against counsel for malpractice and not in a suit against counsel's employer to impose vicarious liability"); *see also* Aetna Cas. & Surety Co. v. Protective Nat'l Ins. Co. of Omaha, 631 So. 2d 305, 306 (Fla. Dist. Ct. App. 1993) (applying vicarious liability, which Section 12 explicitly rejects); Hackman v. W. Agric. Ins. Co., No. 104-786, 2012 Kan. App. Unpub. LEXIS 311, at *21, 29 (Apr. 2, 2012) (upholding lower court's finding that the insurer did not breach its duty to provide a defense to plaintiff). The Reporters' Notes also cite to three cases that the notes claim "suggest[] the possibility of such a cause of action," but do not actually suggest the possibility of a cause of action for negligent selection of counsel. *See* RLLI, *supra* note 3, § 12 Reporters' Note *b* (citing Brown v. Lumbermens Mut. Cas. Co., 369 S.E.2d 367, 372 (N.C. Ct. App. 1988) (analyzing under what circumstances an attorney is an independent "actor" for purposes of establishing vicarious liability, and emphasizing that the "right to control the details of a person's work is primarily characteristic of an agency relationship," which is not the type of relationship at issue in Section 12)); *see also* Pac. Emps. Ins. Co. v. P.B. Hoidale Co., 789 F. Supp. 1117, 1122 (D. Kan. 1992) (analyzing whether an insurer was liable for the acts of defense counsel under a theory of agency and therefore vicarious liability, which Section 12 explicitly rejected); Evans v. Steinberg, 699 P.2d 797, 799 (Wash. Ct. App. 1985) (dismissing the plaintiff's negligent selection of counsel claim in a single sentence). In accepting the duty to defend, an insurer recognizes that it may also have a duty to indemnify. As such, it has every incentive to hire competent defense counsel, relying upon defense counsel to decline the representation if counsel lacks the competency to handle the matter.

21. The only case the Reporters' Notes cite as offering an inkling of support for Subsection 12(2)'s concept of insurer liability for overriding defense counsel's professional judgment is Lloyd v. State Farm Mutual Automobile Ins. Co., 860 P.2d 1300, 1301 (Ariz. Ct. App. 1992). In *Lloyd*, the court observed that, "when an insurer has assumed the defense of its insured, the failure to file a timely answer can be negligence." *Id.* at 1305. The court analyzed this issue in relation to the plaintiffs' contention that the insurer acted negligently in discharging its duty to defend and concluded that there was no evidence that the insurer overrode defense counsel's independent professional judgment. *Id.* at 1306. The court declined to resolve at summary judgment whether the insurer was negligent in failing to file an answer, because there were disputed factual issues, including whether the insureds caused the delay by belatedly notifying the insurer about the claim. *Id.* at 1305. Finding support in Arizona's Rules of

This undisputed lack of case law supporting the liability articulated in Section 12 reveals that this section of the *RLLI* did not make the transition from a principles project to a restatement, and does not belong in the *RLLI*.

B. *Section 12's Tort Claim Lacks a Compelling Justification for Its Innovation*

Even if an innovative legal standard were appropriate for a restatement, Section 12 lacks a supported policy rationale for the tort liability it imposes. Neither Subsection 12(1) nor Subsection 12(2) identifies or addresses a real-world problem justifying its extension of tort liability to insurers for defense counsel's misconduct.

1. Subsection 12(1)

Subsection 12(1) attempts to remedy a problem that—as far as anyone who has looked into it can discern—does not exist, and if it does, is already redressed by existing solutions that do not necessitate the creation of a new cause of action and collateral litigation about what Subsection 12(1) does and does not provide. Aggrieved insureds already have remedies against defense counsel for their malpractice: They may file a grievance with the state bar association, which could result in bar sanctions,[22] or bring a malpractice action against the attorney.[23] Subsection 12(1) thus seems to be concerned with insurers hiring attorneys who do not have enough

Professional Conduct, the court granted summary judgment for the insurer on the plaintiffs' claim that the insurer was negligent in failing to notify them about a settlement offer because it was the attorney, not the insurer, who had the obligation to notify the insureds of the settlement offer. *Id. Lloyd* thus stands for a far narrower principle that the Reporters' Notes attribute to it, going no further than stating that an insurer's liability for defense counsel's conduct is concurrent with its liability for breaching the contractual duty to defend the insured, and does not include additional tort liability.

22. In most states, an insured—like any individual or entity represented by an attorney—is able to file a grievance with the state bar association. *See, e.g.*, *Filing a Complaint Against an Attorney*, Mass. Bd. of Bar Overseers, https://www.massbbo.org/Complaints (last visited May 5, 2020); *Filing a Grievance*, N.C. State Bar, https://www.ncbar.gov/for-the-public/i-am-having-a-dispute-with-a-lawyer/filing-a-grievance; *File a Grievance*, State Bar of Tx., https://www.texasbar.com/Content/NavigationMenu/ForThePublic/ProblemswithanAttorney/GrievanceEthicsInfo1/File_a_Grievance.htm (last visited May 5, 2020). If the grievance demonstrates conduct that potentially violated a rule of professional conduct, state bar associations complete an investigation, and then may impose sanctions ranging from a letter of caution to disbarment.

23. An attorney who violated a rule of professional conduct may also have committed legal malpractice if the attorney failed to exercise reasonable care in his or her representation of a client and that failure was the proximate cause of the client's unfavorable legal result. A plaintiff in a malpractice action must prove that his or her attorney "failed to exercise the ordinary reasonable skill and knowledge commonly possessed by a member of the legal profession; and . . . that the attorney's breach of the duty proximately caused the plaintiff actual and ascertainable damages." *See* Schurz v. Bodian, 92 A.D. 753, 753 (N.Y. App. Div.2012); *see also* Dina M. Cox & Neal Bowling, *Malpractice v. Misconduct*, LewisWagner (May 2012), https://www.lewiswagner.com/9C8985/assets/files/News/malpractice%20article%20-%20national%20-%20marketing%20-%205162012%20_2_.pdf.

malpractice insurance.[24] In theory, the purpose of Subsection 12(1) is to provide aggrieved insureds with the full damages awarded to them in a malpractice action against defense counsel, if defense counsel (or her malpractice carrier) is unable to satisfy the full judgment.[25] Subsection 12(1) purports to allow insureds to recover this award against the insurer who appointed defense counsel.[26]

This rationale for the "solution" devised by Subsection 12(1) assumes that there is a problem of insureds being left without remedies for the malpractice of defense counsel. But there is no indication that lawyers are carrying insufficient malpractice insurance to cover judgments entered against them or that aggrieved insureds are routinely unable to collect on malpractice judgments against defense counsel.[27] We could find no studies or data indicating that there is an epidemic of judgment-proof defense counsel. We could find no articles or cases noting that insureds are being left without remedies for the malpractice of defense counsel.[28] In other words, there is no documented problem with insureds—or anyone—being unable to recover against their malpracticing attorneys.[29] This lack

24. *See* RLLI, *supra* note 3, § 12, cmt. *c*.

25. In comment *a*, the Reporters note that an insured may recover against defense counsel for professional malpractice and that, under Section 12, "an insured may also seek recovery in tort for harms *caused by that malpractice* from the liability insurer in two limited sets of circumstances." RLLI, *supra* note 3, § 12, cmt. *a* (emphasis added).

26. But, even under that rationale, subsection 12(1) should have provided that insurers are a last recourse; in other words, recourse must first be sought (and fail) against the malpracticing defense counsel. *See, e.g.*, Country Mut. Ins. Co. v. Martinez, No. CV-17-02974, 2019 U.S. Dist. LEXIS 69283, at *39-41 (D. Ariz. Apr. 24, 2019).

27. The Reporters acknowledge this lack of any jurisprudence addressing the issue of insurer liability for selecting an attorney with inadequate malpractice insurance. *See* RLLI, *supra* note 3, § 12, Reporters' Note *b*.

28. Cohen, *supra* note 19, at 134 n. 77.

29. If there were a rampant problem with underinsured attorneys, presumably states would have acted to address this problem and mandated that attorneys have malpractice insurance, perhaps even with certain minimum limits. But with only a handful of exceptions, states have not done this. As of April 2020, only two states require attorneys to have malpractice insurance—Oregon and Idaho. Several other states—California, Nevada, New Jersey, and Washington—have considered it and decided not to require attorneys to carry malpractice insurance. Susan Saab Fortney, *Mandatory Legal Malpractice Insurance: Exposing Lawyers' Blind Spots*, 9 St. Mary's J. Legal Malpractice & Ethics 190, 193-95 (2019). Instead, many states have malpractice disclosure requirements for attorneys under which attorneys must disclose whether they are currently covered by professional liability insurance. *See* State Implementation of ABA Model Court Rule on Insurance Disclosure (Am. Bar Ass'n Mar. 2018), https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/chart_implementation_of_mcrid.pdf; *see also* ABA Model Court Rule on Insurance Disclosure (Am. Bar Ass'n 2005), https://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/aba_model_court_rule_on_insurance_disclosure.pdf. The fact that only two states currently require practicing attorneys to hold malpractice insurance, while many other states require merely a disclosure of whether an attorney has malpractice insurance, demonstrates that the issue of attorneys not carrying enough malpractice insurance has already been considered and addressed by multiple states and determined not to be such a major concern that mandatory attorney malpractice insurance is necessary.

of support for the existence of a problem is at odds with the ALI's own directive that the Reporters cite to relevant "social science evidence and empirical analysis" when "ascertain[ing] the relative desirability of competing rules."[30]

2. Subsection 12(2)

Similarly, Subsection 12(2) seems designed to ensure that an insured can recover fully on any judgment entered against its attorney. In addition, Subsection 12(2) appears to be concerned that an insurer will select an attorney who will serve its own interests rather than those of the insured, and who will put the insurer's interests and directives above those of the insured. But as with Subsection 12(1), there is no indication that this is in fact a problem. Subsection 12(2) assumes that defense counsel's judgment could be overridden by an insurer without consequence, and that insurers "supervise" defense counsel in a way that allows insurers to be held liable for defense counsel's misconduct. Neither of these assumptions are true.

Attorneys whose primary duty of loyalty runs to the insured are prohibited from putting the insurer's interests above the insured's.[31] Moreover, attorneys are bound by rules of professional ethics to exercise their independent professional judgment in service of their clients, and are subject to liability for malpractice if they fail to do so. A third party such as an insurer may direct an attorney's conduct, with some limitations, so long as "the direction does not interfere with the lawyer's independence of professional judgment" and "is reasonable in scope and character."[32] However, substantial insurer control of defense counsel breaches the rules of professional

30. ALI Style Guide, *supra* note 2, at 5.

31. *See infra* notes 33, 42.

32. Restatement, Third, The Law Governing Lawyers § 134(2) (Am. Law Inst. 2000); *see* RLLI, *supra* note 3, § 12, Reporters' Note *d* (acknowledging this section of the *Restatement Governing Lawyers*); *see also* Model Rules of Prof'l Conduct, r. 1.8(f) (Am. Bar. Ass'n 2020) [hereinafter Model Rules] ("A lawyer shall not accept compensation for representing a client from one other than the client unless: (1) the client gives informed consent; (2) there is no interference with the lawyer's independence of professional judgment or with the client-lawyer relationship; and (3) information relating to representation of a client is protected as required by Rule 16."); Model Rules, *supra*, r. 5.4(c) ("A lawyer shall not permit a person who recommends, employs, or pays the lawyer to render legal services for another to direct or regulate the lawyer's professional judgment in rendering such legal services."); Model Rules, *supra*, r. 1.7, cmt. 13 (when a lawyer is paid by someone other than the client, the arrangement "cannot compromise the lawyer's duty of loyalty or independent judgment to the client"). Directions are "reasonable in scope and character" if they "reflect obligations borne by the person directing the lawyer," and if, for example, "the third party will pay any judgment rendered against the client and makes a decision that defense costs beyond those designated by the third party would not significantly change the likely outcome." Restatement, Third, The Law Governing Lawyers, *supra*, § 134, cmt. *d*. Elsewhere in the RLLI, the Reporters acknowledge that "[r]ules governing lawyers' professional obligations are outside the scope of this Restatement," and look to the *Restatement Governing Lawyers* for guidance on such obligations. *See* RLLI, *supra* note 3, §11, cmt. *d*.

conduct for attorneys, and could not even occur very effectively in light of defense counsel's limited ability under those same rules and other portions of the *RLLI* to share information with the insurer.[33]

Moreover, as noted above with respect to Subsection 12(1), aggrieved insureds already may file a grievance with the state bar association or bring a malpractice action against defense counsel for alleged misconduct. Defense counsel retained by an insurer to represent an insured cannot, as a practical or ethical matter, cede control of the conduct of the representation to the insurer. Although Subsection 12(2) speaks to a situation in which defense counsel has followed directives of an insurer against the dictates of counsel's professional judgment, that act of defense counsel allowing her personal judgment to be overridden by the insurer, in and of itself, could be deemed a violation of the rules of professional conduct or attorney malpractice. Subsection 12(2) is thus not needed to provide an insured with essentially duplicative redress for defense counsel's misconduct.

IV. SECTION 12 CREATES A NEW TORT CLAIM FOR CONDUCT ALREADY REDRESSED BY A BREACH OF CONTRACT CLAIM

The consequences of Section 12's invention are dramatic. While purporting to provide a "clear formulation[] of common law . . . as it presently stands or might appropriately be stated by a court,"[34] Section 12 actually introduces a new tort claim. Although the lack of support from pre-existing case law or a compelling policy justification for Section 12 are troubling, perhaps the most significant problem with Section 12 is its attempt to punish—in tort—conduct that is already redressed in contract through the duty to defend. This new cause of action is unnecessary—because it is entirely duplicative of the contractual claim for breach of the duty to defend—and problematic—because it fundamentally changes the damages model that has consistently applied to the insurer-insured relationship.

33. *See*, *e.g.*, Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134, cmt. *f*; *see also*, *e.g.*, RLLI, *supra* note 3, §11 ("Confidentiality," limiting insurer's access to information covered by privilege or "defense lawyer's duty of confidentiality under the rules of professional conduct"), § 14 ("Duty to Defend: Basic Obligations," requiring defense counsel to keep certain relevant information from insurers). Defense counsel's fiduciary duties to the insured do not necessarily run to the insurer, and prevent the insurer from having all of the information that guides defense counsel's professional judgment in handling the case. Defense counsel may not share with the insurer adverse, confidential information without the insured's explicit informed consent where the insurer is defending under a reservation of rights, or there is some question as to whether a claim against the insured is within the policy coverage. Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134, cmt. *f*.

34. *See* ALI Style Guide, *supra* note 2, at 3.

A. *An Insurer's Conduct with Respect to Defense Counsel Is Embedded in Its Contractual Duty to Defend*

The insurer-insured relationship is a contractual one arising out of the insurance policy.[35] In a general liability policy, assuming coverage exists, two principal duties owed by an insurer to an insured are the duty to defend, and the duty to indemnify. Section 12 bears upon the duty to defend. In fulfilling its duty to defend, the insurer may play a role in defense strategy, attorney selection, and settlement. In many circumstances, the insurer has a contractual right or obligation to select defense counsel for the insured. Because of the possibility that the insurer will indemnify the insured for damages within the limits of the insured's policy, the insurer has a keen interest in selecting competent defense counsel who will resolve the underlying litigation favorably for the insured, and, relatedly, for the insurer in limiting the insured's liability.

In discharging its duty to defend, the insurer either creates or joins two new relationships: The insured-defense counsel relationship, and the insurer-defense counsel relationship. The insured-defense counsel relationship is an attorney-client relationship, and may also be contractual.[36] Under professional conduct rules, lawyers owe unique duties to their clients, which include an obligation to provide competent representation, including possessing "the legal knowledge, skill, thoroughness and preparation reasonably necessary for the representation"; to act promptly in representing a client; to consult with the client regarding the objectives of the representation and the means by which to accomplish those objectives; to enable the client to make informed decisions regarding the representation; to "abide by a client's decision whether to settle a matter"; and to maintain the confidentiality of information provided by a client and communications with a client, and to protect this information from disclosure.[37] Among the most significant of an attorney's duties to her clients is the obligation to exercise her own independent professional judgment in the representation.[38] Defense counsel cannot abrogate these ethical obligations.

In fulfilling its duty to defend, the insurer also necessarily creates its own relationship with defense counsel. This relationship is generally contractual, but benefits from some aspects of the attorney-client relationship

35. *See* 1 New Appleman on Insurance Law Library Edition § 3.01 (2020) [hereinafter Appleman on Insurance]; *see, e.g.*, Bank of the West v. Superior Court, 833 P.2d 545, 551–52 (Cal. 1992).

36. *See, e.g.*, Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134, cmt. *f* (an insurer may designate a lawyer to represent the insured, and, in such situations, it is "clear" that the lawyer designated to defend the insured "has a client-lawyer relationship with the insured").

37. Model Rules, *supra* note 32, pmbl., rr. 1.1, 1.3, 1.2 (a), 1.4 (a), 1.6 (a).

38. Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134 (2), 134 cmt. *f*; *see also* Model Rules, *supra* note 32, rr. 1.8(f), 1.7 cmt. 3, r. 5.4 (c).

between the insured and defense counsel.[39] Nonetheless, many courts have recognized the need for close communication between the insurer, defense counsel, and the insured, and absent a conflict, permitted the exchange of privileged information and communications with the insurer.[40] Moreover, while as noted above, an insurer may pay for defense counsel's work and provide some direction, that direction may "not interfere with the lawyer's independence of professional judgment."[41] It is equally well-settled that the primary duty of loyalty of defense counsel flows to the insured.[42]

B. *Section 12 Impermissibly Creates a Tort Cause of Action Arising out of the Insurer's Existing Contractual Obligations*

Because the selection and supervision of defense counsel flows from the insurer's contractual duty to defend, the tort cause of action contemplated by Section 12 of the *RLLI* is redundant to a breach of contract claim against an insurer for a breach of the insurer's duty to defend. Section 12 thus imposes tort liability for conduct that is already accounted for by the parties through their contractual relationship, and for which both a legal cause of action and a damages framework already exists.

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39. *See* Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134, cmt. *d* (acknowledging that insureds have typically "contractually conferred the power of direction" of counsel to the insurer).

40. *See* Appleman on Insurance, *supra* note 35 § 16.04; Restatement, Third, The Law Governing Lawyers, *supra* note 32, §134, cmt. *f*; *id.*, Reporters' Note *f*; *see also* Paradigm Ins. Co. v. Langerman Law Offices, P.A., 24 P.3d 593, 596, 599 (Ariz. 2001) (stating that defense counsel "does not *automatically* represent the insurer," and recognizing but not holding that there could be circumstances in which defense counsel has an attorney-client relationship with the insurer, such as in the absence of a conflict of interest); *see also*, *e.g.*, Pine Island Farmers Coop v. Erstad & Riemer, P.A., 649 N.W.2d 444, 449 (Minn. 2002); Leaphart v. Nat'l Union Fire Ins. Co., No. DA 15-0583, 2017 Mont. Dist. LEXIS 16, at *7–8 (Mont. Dist. Ct. July 28, 2017) (citing *In re* the Rules of Professional Conduct, 2 P.3d 806 (Mont. 2000)); Spratley v. State Farm Mut. Auto. Ins. Co., 78 P.3d 603, 607 (Utah 2003); Gen. Sec. Ins. Co. v. Jordan, Cyone & Savits, LLP, 357 F Supp. 2d 951 (E.D. Va. 2005); Gulf Ins. Co. v. Berger, Kahn, Shafton, Moss, Figler, Simon & Gladstone, 93 Cal. Rptr. 2d 534, 541–43 (Ct. App. 2000).

41. Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134 (2); *see id.*, cmt. *f*; Model Rules, *supra* note 32, r. 1.8 (f).

42. *See* Model Rules, *supra* note 32, r. 1.7, cmt. 13; Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134 (2) (a); Atlanta Int'l Ins. Co. v. Bell, 475 N.W.2d 294, 297 (Mich. 1991) (recognizing that "courts have consistently held that the defense attorney's primary duty of loyalty lies with the insured, and not the insurer"); Peterson v. St. Paul Fire & Marine Ins. Co., 239 P.3d 904, 918 (Mont. 2010) (citing *In re* Rules of Prof'l Conduct, 2 P.3d 806, 814 (Mont. 2000) (defense counsel owes "a duty of undivided loyalty to the insured," must consult with insurer and is accountable for his or her work); Feliberty v. Damon, 72 N.E.2d 112, 265 (N.Y. App. 1988) ("The paramount interest independent counsel represents is that of the insured, not the insurer."); *see also*, *e.g.*, First Am. Carriers, Inc. v. Kroger Co., 787 S.W.2d 669, 671 (Ark. 1990); Higgins v. Karp, 687 A.2d 539, 543 (Conn. 1997); Niedzwiadek v. Laliberte, No. C.A. PC 98-2880, 2001 R.I. Super. LEXIS 147, at *2 (Nov. 20, 2001) (citing Casco Indem. Co. v. O'Connor, 755 A.2d 779 (R.I. 2000)); State Farm Mut. Auto. Ins. Co. v. Traver, 980 S.W.2d 625, 628 (Tex. 1998).

If an insured believes that an insurer has breached its duty to defend, the insured has recourse in the form of a breach of contract claim.[43] To the extent a claim against an insurer rises to the level of asserting bad faith, there is a contractual remedy for that as well. Despite these existing contractual obligations, Section 12 imposes the identical duty in tort.[44] As drafted, any liability under Section 12 necessarily arises out of the same actions that would give rise to an insured's claim for breach of the duty to defend by the insurer. There is no additional duty imposed by Section 12 that could not be captured in a breach of contract claim; in other words, there is no conduct that would be actionable under Section 12 but not as a breach of contract, or vice versa.

As a general matter, a duty in tort must exist independently from any contractual duty.[45] As the California Supreme Court explained in *Applied Equipment Corp. v. Litton Saudi Arabia Ltd.*, "[c]onduct amounting to a breach of contract becomes tortious only when it also violates an independent duty arising from principles of tort law."[46] A breach of contract alone

43. Appleman on Insurance, *supra* note 35, § 7.06 ("Breach of contract claims by the policyholder may cover the full spectrum of obligations under the policy, but often involve breach of the duty to defend, breach of the duty to settle, and breach of the duty to indemnify."); *see* Signal Prods. v. Am. Zurich Ins. Co., Case No. 4:14 CV 1112 CDP, 2014 U.S. Dist. LEXIS 203534, at *45-46 (C.D. Cal. Aug. 4, 2014) (insured argued insurer breached its duty to defend by (1) accepting defense of insured's claim too late; (2) "adopting unreasonable coverage positions"; (3) refusing to pay certain of defense counsel's fees; and (4) "agreeing to pay only a portion of the fees owed, and conditioning the partial payment on insured consenting to reduce the fees under various billing guidelines"); Fireman's Fund Ins. Co. v. CTIA, 480 F. Supp. 2d 7, 16 (D.D.C. 2007) (striking insured's tort claim for bad-faith breach of contract claim but keeping insured's breach of contract claim against insurer); Ingersoll-Rand Equip. Corp. v. Transp. Ins. Co., 963 F. Supp. 452, 455 (M.D. Pa. 1997) (observing that insured may bring a claim for breach of an insurer's contractual duty to exercise due care in defending the claim if the insured believes that the insurer exercised "an abnormal degree of control over the litigation"); *see also* R.C. Wegman Constr. Co. v. Admiral Ins. Co., 629 F.3d 724, 728 (7th Cir. 2011); Merritt v. Rsrv. Ins. Co., 110 Cal. Rptr. 511, 527 (Ct. App. 1973); Aetna Cas. & Sur. Co., 631 So. 2d at 306.

44. The notes to Section 12 acknowledge that tort liability under the section will mirror contract liability in most circumstances and that "there are no judicial decisions that have held an insurer liable in tort for negligent selection of counsel." RLLI, *supra* note 3, § 12 Reporters' Note *b*.

45. *See*, *e.g.*, 8 McNamara, New Hampshire Practice: Personal Injury—Tort and Insurance Practice § 4.43 (4th ed. 2019) ("Only if the facts constituting the breach of the contract also constitute a breach of the duty owed by the defendant to the plaintiff independent of the contract will a separate claim for the tort lie."); *see also*, *e.g.*, Colorado Construction Law § 8.4.11 (2013) ("In Colorado, then, the application of the economic loss rule is determined by a comparison of the contractual duty and duty in tort alleged to have been breached. Where those duties overlap and where there is no special independent duty of care in tort, the economic loss rule applies."); 2 Products Liability § 13.07 (1) (a) (2020) ("In the overwhelming majority of jurisdictions, the economic loss rule prevents plaintiffs from recovering for economic losses in tort.").

46. Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 869 P.2d 454, 460 (Cal. 1994); *see also* Travelers Indem. Co. v. Royal Oak Enters., 429 F. Supp. 1265, 1273 (M.D. Fl. 2004) (holding insured's tort counts "[were] barred by Florida's economic loss rule, which states that a party

cannot give rise to an independent tort action absent *additional* tortious conduct.[47] A separate tort cause of action, thus, must arise from acts that are *separate* from those that gave rise to the breach of contract claim.

Under Section 12, tort liability would necessarily arise out of the insurer's breach of its existing contractual duty to defend, and not an independent duty arising out of tort law.[48] The Reporters' notes acknowledge that "the scope of liability under the rule stated in [section 12] will mirror liability under a breach-of-contract theory," and posit without explanation that the additional tort theory will "*reinforce*[] the importance of the duty to-defend by creating an added incentive to select competent and qualified counsel."[49] Not even the Reporters have identified what separate conduct an insurer will have to engage in to be liable for both breach of contract and for a related tort under Section 12, where Section 12 was purportedly designed to "reinforce" the existing contractual duty to defend.

There is also nothing inherent in the tripartite relationship created by the duty to defend—the relationship among the insurer, the insured, and defense counsel[50]—that warrants additional tort duties. None of these relationships are agency relationships that would give rise to tort claims under a typical agency analysis. The insurer-insured relationship is purely a contractual one. Because general agency laws do not apply to lawyers, over whom employers and principals do not have the control required for liability,[51] neither the defense counsel-insured relationship (as an

may not pursue a claim in tort solely for economic losses unless the party breaching the contract has committed a tort which is distinguishable from or independent of the breach of contract."); Elrich v. Menezes, 981 P.2d 978, 982 (Cal. 1999) (stating that the "distinction between tort and contract is well grounded in common law" and while "contract actions are created to enforce the intentions of the parties to the agreement, tort law is designed to vindicate 'social policy'").

47. *See* Elec. Sec. Sys. v. S. Bell Tel. & Tel. Co., 482 So. 2d 518, 519 (Fla. 3d Dist. Ct. App. 1986); *see also Fireman's Fund*, 480 F. Supp. 2d at 15 (refusing to recognize insured's tort claim of "bad faith breach of contract against insurer and explaining that a plaintiff cannot recover punitive damages for a contract cause of action unless "the breach of contract merges with an independent, recognized tort, such as IIED or fraud").

48. *See Travelers Indem*., 429 F. Supp. 2d at 1273 ("If the insurer acts negligently in carrying out its duty to defend, its conduct constitutes a breach of contract, entitling the insured to recover all damages naturally flowing from the breach."). The court also held that insured's tort claims against insurer were barred under Florida's economic loss rule. *See id.*

49. *See* RLLI, *supra* note 3, §12, Reporters' Note *b* (emphasis added).

50. *See generally, e.g.*, Robert E. O'Malley, *Symposium: Marine Insurance: Ethics Principles for the Insurer, the Insured, and Defense Counsel: The Eternal Triangle Reformed*, 66 Tul. L. Rev. 511 (1991); Geoffrey C. Hazard, Jr., *Triangular Lawyer Relationships: An Exploratory Analysis*, 1 Geo. J. Legal Ethics 15 (1987).

51. This principle is well-established by the *Restatement, Third, Law Governing Lawyers*, the rules of professional conduct governing lawyers, and the body of ethical and legal opinions that apply to the practice of law. *See* Restatement, Third, The Law Governing Lawyers, *supra* note 32, § 134, cmt. *f* (an insurer may designate a lawyer to represent the insured, and, in such situations, it is "clear" that the lawyer designated to defend the insured "has a client-lawyer relationship with the insured"); Model Rules, *supra* note 32, rr. pmbl, 1.8 (f).

attorney-client relationship that imposes independent ethical and legal obligations)[52] nor the insurer-defense counsel relationship fit the contours of an agency relationship.[53] Indeed, the Reporters' notes to Section 12 acknowledge that agency principles do not apply: "Because defense counsel are not generally agents of the insurer, vicarious, apparent-authority, and negligent-supervision liability claims would not make sense."[54] Section 12's imposition of direct tort liability for conduct that is already fully redressed by contract law is thus at odds with the well-established distinction between tort and contract claims.[55]

V. BY PENALIZING AN INSURER'S CONDUCT IN SELECTING AND OVERSEEING DEFENSE COUNSEL IN TORT AND IN CONTRACT, SECTION 12 IMPOSES GREATER DAMAGES AGAINST INSURERS WITHOUT CAUSE

Creating a separate cause of action in tort law for conduct that already is captured within a breach of contract claim is problematic because it fundamentally changes the damages analysis, and alters the universe of available damages to an insured plaintiff without requiring any additional breach of duty by the insurer. Through an action for breach of the duty to defend, an insured can recover for those losses that are reasonably foreseeable at the time of contract. Yet despite acknowledging this available contractual recovery, Section 12 effectively allows insured plaintiffs to contravene the traditional principles of contract law—including the important limitations of contract damages—to attempt to recover tort damages, which may extend to all losses that are proximately caused by one party's conduct.[56]

52. *See*, *e.g.*, 4 Bender's New York Evidence § 160.02 [2] [b] (b) (2020).

53. This relationship also cannot be characterized as an agent/sub-agent relationship, with the principal being the insured. First no agency relationship exists between either defense counsel and the insured or the insurer and the insured. Second, while defense counsel selected by an insurer to represent an insured receives some limited information from the insurer, he or she gathers much more information from her own investigation or the insured, who is the target of the plaintiff's claim and has personal knowledge of the merits and defenses to the plaintiff's allegations regarding the insured's alleged wrongdoing. Moreover, defense counsel owes duties to the insured stemming from the attorney-client relationship (*e.g.*, to keep privileged communications confidential) that do not necessarily run to the insurer, and therefore prevent the insurer from having all of the information that guides defense counsel's professional judgment in handling the case.

54. *See* RLLI, *supra* note 3, § 12, Reporters' Note *d* ("Lawyers hired by insurers to represent insureds are not understood to be agents of the insurers.").

55. The Reporters concede that section 12 of the *Restatement* rejects vicarious liability. *See* RLLI, *supra* note 3, cmt. *e* ("This Section declines to follow the vicarious-liability rule. . . .").

56. *See id.* §12, Reporters' Note *b* (noting that "an insured may seek damages from the insurer under a breach-of-contract theory based on the insurer's selection of incompetent or unqualified counsel to defend its insured"). "In addition to the availability of contractual remedies, [Section 12] states that an insured may seek remedies in tort based on an insurer's negligent selection of counsel." *See id.*; *see also* RLLI, *supra* note 3, § 12 cmt. *b*. ("Under the

This is in direct contravention to the distinct purposes of tort and contract remedies, and the long-recognized ban on double-dipping remedies for the same conduct, as expressed by the economic loss rule.

A. *Contract Remedies and Tort Remedies Serve Different Purposes and Result in Different Damages Models*

Contract damages and tort damages derive from different models of risk allocation and responsibility for harm. Parties owe contractual duties only to one another, while in tort, all individuals owe a duty to all foreseeable plaintiffs.[57] The scope of damages is also different. Contract damages are foreseeable at the time of the parties' creation of the contract, whereas a party may be liable in tort for all damages that are proximately caused by the alleged tortious conduct.[58]

In contract, plaintiffs typically may recover only those damages that naturally flow from the breach or were foreseeable, and cannot recover for other economic losses or punitive damages.[59] These limitations for contract damages exist "to encourage contractual relations and commercial activity" as parties are expected to allocate their rights, duties, and relative risk prior to the formation of their commercial relationship.[60] Contract damages thus "seek to approximate the agreed-upon performance" and 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."[61] The contract-based remedies available to an insured under a theory of breach of duty to defend are those damages that would typically flow from the breach.[62] These include contract damages,[63] defense costs,[64] interest, and in some jurisdictions, attorney's fees for breach of the duty to defend. [65]

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rule stated in this Section, an insured may . . . seek recovery in tort for harms caused by that malpractice from the liability insurer in two limited sets of circumstances.").

57. *See*, *e.g.*, Palsgraf v. Long Island R. Co., 162 N.E. 99, 101 (N.Y. 1928).

58. Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 869 P.2d 454, 460 (Cal. 1994).

59. 11 Corbin on Contracts § 59.2 (2019).

60. *Applied Equip. Corp.*, 869 P.2d at 460.

61. *Id.*

62. Courts already recognize the fact that insureds may already recover for an insurer's failure to provide adequate defense under a contract theory. *See* Travelers Indem. Co. v. Royal Oak Enters., 429 F. Supp. 1265, 1273 (M.D. Fl. 2004) ("If the insurer acts negligently in carrying out its duty to defend, its conduct constitutes a breach of contract, entitling the insured to recover all damages naturally flowing from the breach.").

63. *See* Mont. Petroleum Tank Release Comp. Bd. v. Crumleys, Inc., 174 P.3d 948, 960–61 (Mont. 2008) (explaining a party may recover proximate and consequential damages for breach of contract).

64. *See* Greer v. Nw. Nat'l Ins. Co., 743 P.2d 1244, 1250 (Wash. 1987).

65. *See* Hogan v. Midland Nat'l Ins. Co., 476 P.2d 825, 831 (Cal. 1970); Appleman on Insurance, *supra* note 35, §§ 1.04[6], 7.06.

Tort damages, on the other hand, compensate the victim for the injury he or she has suffered, and the measure of damages will therefore often account for the "detriment proximately caused . . . whether it could have been anticipated or not."[66] Tort damages are designed to serve three purposes: (1) make the plaintiff whole; (2) deter the defendant's conduct; and (3) punish the defendant for acting in a way that is inconsistent with societal standards.[67] A tort claim permits the recovery of non-contract damages, including compensatory damages, damages for emotional distress, punitive damages, and attorney's fees.[68] Punitive damages in particular—damages intended solely to punish the party found to be at fault—represent a substantial risk accompanying tort claims that are not permitted for breach of contract claims, whose damages are generally limited to returning the aggrieved party to the position it would have been in but for the breach.

B. *Enhanced Tort Damages Are Not Available for a Breach of Contract*

As discussed above, a plaintiff may only recover damages in tort and in contract when the defendant committed both a tort and a breach of contract separately. Invoking tort law to penalize what is effectively a breach of contract is a common tactic to obtain greater damages than would be permitted in a straightforward contract action—and it is a commonly rejected one. In many jurisdictions, the economic loss rule prohibits plaintiffs from recovering purely economic losses in a tort action.[69] The rule

66. Appleman on Insurance, *supra* note 35, § 1.04 [6].

67. *See* Corbin on Contracts, *supra* note 59, § 59.2 ("Breaches of contract, in general, do not cause as much resentment or other mental and physical discomfort as do torts and crimes. Therefore, the remedies to prevent them and to prevent disorder and breach of the peace by satisfying the injured parties are not so severe upon the wrongdoer. Pecuniary compensation given to the injured party has been found to be sufficient, without the necessity for satisfying the party's feelings and allaying community resentment by fines or physical punishment."); *see also* Restatement of the Law, Second of Torts, § 901 (Am. Law Inst. 1979) (explaining purposes to bring tort actions are "(a) to give compensation, indemnity or restitution from harms; (b) to determine rights; (c) to punish wrongdoers and deter wrongful conduct; and (d) to vindicate parties and deter retaliation or violent and unlawful self-help").

68. *See* Brit UW Ltd. v. City of San Diego, No. 14cv2195 JM (WVG), 2015 U.S. Dist. LEXIS 94988, at *12 (S.D. Cal. July 21, 2015); Restatement of the Law, Second of Torts, *supra* note 74, § 901.

69. *See* Phoenix Packaging Operations, LC v. M&O Agencies, Inc., No. 7:15cv569, 2016 U.S. Dist. LEXIS 72945, at *15 (W.D. Va. June 3, 2016) (holding that professional negligence claim was breach of contract claim disguised as tort action, and parties could only recover economic damages "where the parties are in contractual privity and their relationship gives rise to duties not imposed by the explicit terms of the contract but by common law"); Filak v. George, 594 S.E.2d 610, 613 (Va. 2004) ("[W]hen a plaintiff alleges and proves nothing more than disappointed economic expectations assumed only by agreement, the law of contracts, not the law of torts, provides the remedy for such economic losses."); *see also* 2 Products Liability § 13.07 (1) (a) (2020) ("In the overwhelming majority of jurisdictions, the economic loss rule prevents plaintiffs from recovering for economic losses in tort."); William K. Jones, *Product Defects Causing Commercial Loss: The Ascendancy of Contract over Tort*, 44 U. Miami L. Rev. 731, 799 (1990) (listing jurisdictions that have adopted the economic loss rule in commercial sales transactions).

exists to prevent a contracting party from using tort claims to obtain damages she cannot obtain through contract claims—that is, from recovering damages beyond contract damages for a pure breach of contract.[70] On its face and in its accompanying comments and notes, Section 12 offers no basis upon which a plaintiff should be entitled to recover in tort, under the cause of action articulated in Section 12, for damages in excess of what she could recover for the same insurer conduct in a breach of contract action. In fact, not only does Section 12 offer no foundation for extending tort liability to a breach of contract claim in contravention of the economic loss rule, but the Reporters' notes to Section 12 explicitly acknowledge the existence of the economic loss rule, and its application to situations in which parties attempt to obtain additional damages for a purely contractual harm.[71] Instead of articulating why the economic loss rule is no bar to tort recovery under Section 12 when a breach of contract claim would suffice, the Reporters' notes suggest that we simply ignore the economic loss rule when considering the application of Section 12.[72] This is illogical; the economic loss rule exists to prevent double-dipping in contract and tort for claims that sound solely in contract. Where adequate remedies are available in contract for a breach of the duty to defend, tort remedies are unnecessary, and would impose the type of punitive sanction for a breach of contract that the economic loss rule prohibits. Absent any separate, tortious conduct, the appropriate remedy for the type of conduct addressed by Section 12 is a contractual one, and not one sounding in tort.[73]

VI. THE DECISIONS CITING SECTION 12 HAVE FRAMED SECTION 12 AS ARTICULATING POTENTIAL BREACHES OF THE DUTY TO DEFEND, AND HAVE NOT EXPLICITLY RECOGNIZED THE AVAILABILITY OF TORT DAMAGES

At the time of this writing, only three cases have discussed Section 12: *Country Mutual Ins. Co. v. Martinez*, a decision of the U.S. District Court for the District of Arizona, *Sapienza v. Liberty Mutual Fire Insurance Co.*, a decision of the U.S. District Court for the District of South Dakota,

70. *See* Chi. Title Ins. Co. v. Commonwealth Forest Invs., Inc., 494 F. Supp. 2d 1332, 1337 (M.D. Fla 2007) (explaining that Florida's economic loss rule bars "tort actions when the parties are in contractual privity and one party seeks to recover damages in tort for matters arising from the contract [because] the economic loss rule protects . . . contractual expectations").

71. RLLI, *supra* note 3, § 12, Reporters' Note *d*.

72. *Id.* The Reporters' Notes acknowledge "the general rule . . . disfavoring tort law remedies for purely economic harms, particularly where those harms arise from contractual relationships" and then ask readers to "set[] [it] aside." *Id.*

73. Indeed, the Reporters' Notes acknowledge that "[i]n many if not most cases, the scope of liability under the rule stated in this Section will mirror liability under breach-of-contract theory" and that it is only in some "cases on the margins," which the Notes do not further identify or define, where a tort remedy would purportedly better serve the insured. *Id.*

and *Progressive Northwestern Insurance Co. v. Gant*, a decision of the U.S. Court of Appeals for the Tenth Circuit applying Kansas law. All three cases confirm that an insured may bring a breach of contract claim against an insurer for breach of the duty to defend. *Martinez* stated that any claims regarding the selection or conduct of defense counsel are claims that would arise under the duty to defend, if they are permitted at all. *Gant* further explained that a claim of negligent hiring of defense counsel, the subject of Subsection 12(1), should be understood as a contract claim, and not a freestanding tort claim. Both *Martinez* and *Gant* confirm that courts should look to applicable case law first and then turn to the *RLLI* only to the extent it comports with existing common law.

With respect to Subsection 12(2), *Martinez* declined to address the concept, noting only that it could constitute a breach of the contractual duty to defend, and although both *Sapienza* and *Gant* adopted the concept articulated in Subsection 12(2), they did so on a very limited basis. In *Sapienza*, the court utilized Subsection 12(2) to analyze whether the plaintiffs had stated a claim for a breach of the duty to defend, and ultimately concluded that their claim barely passed muster. In *Gant*, the court adopted Subsection 12(2) but concluded that the standard had not been satisfied. In neither case did the court discuss whether Subsection 12(2) provides tort remedies beyond those available in a breach of contract/breach of the duty to defend claim. Accordingly, there is to date no case law supporting Subsection 12's imposition of tort liability for conduct that can be redressed through a breach of the duty to defend claim.

A. Country Mutual Insurance Co. v. Martinez

The *Martinez* case arose out of a lawsuit brought by the father of two children who were seriously injured in an automobile accident during which the mother of the children, his ex-wife, was driving.[74] The father sued a number of parties, including the mother, who was insured by Country Mutual Insurance Company. Country Mutual agreed to defend the mother without any reservation of rights and retained an attorney to defend her.[75] During the litigation, the mother's attorney took a less active role because he believed, based on conversations he had with the father's counsel, that the father's strategy was to shift all fault to the other defendants and away from the mother.[76] The mother's attorney did not retain any experts, instead relying upon the experts retained by the father. The defense attorney for the mother also declined to pursue any separate summary judgment motions

74. Country Mut. Ins. Co. v. Martinez, No. CV-17-02974, 2019 U.S. Dist. LEXIS 69283 (D. Ariz. Apr. 24, 2019).
75. *Id.* at *7.
76. *Id.* at *7–8.

or join in a summary judgment motion filed by the father. Over time, the father's counsel "became frustrated with [the mother's attorney's] allegedly insignificant efforts at defending [the mother]."[77] The parties engaged in settlement conversations, leaving the mother as the only remaining defendant.[78] The last settlement offer authorized by Country Mutual was for up to $100,000 beyond the policy limits.[79] A year later, the mother settled, and assigned all of her claims against Country Mutual to the father as guardian ad litem for the children; the father agreed not to execute the $30 million settlement against the mother.[80] At the time of the settlement, the mother believed that the defense provided to her by Country Mutual was inadequate.[81]

Country Mutual filed a declaratory judgment action against the children and their father on the basis that the mother had "breached implied and express terms" of the insurance policy and forfeited coverage.[82] The father asserted a counterclaim alleging that Country Mutual breached the insurance policy, including its duty of equal consideration, its duty to defend, and its duty to indemnify, and that, by committing an anticipatory breach, the insurer permitted the mother to enter into the settlement agreement.[83]

The U.S. District Court for the District of Arizona granted Country Mutual's motion for summary judgment, concluding that Country Mutual did not breach any of its duties to the mother such that she could enter into the settlement agreement.[84] With respect to the duty to defend, the district court concluded that so long as the insurer retained an attorney to provide a defense to the insured, which Country Mutual did, it fulfilled its duty to defend. The court differentiated "between an insurer taking no action to defend its insured and an insurer retaining counsel to defend the insured."[85] "In the latter circumstances, an insurer has discharged its duty to defend and any failures must be attributed to counsel, not the insurer."[86] Relying on an Arizona Court of Appeals decision, the district court explained that:

> [A]n insurer cannot be found to have breached its duty to defend based on the failures of counsel. In general, once an insurer hires competent counsel and allows that counsel to perform as he deems appropriate, an insurer has

77. *Id.* at *10–11.
78. *Id.* at *15–16.
79. *Id.* at *5, *17.
80. *Id.* at *17; *id.* at *3–4.
81. *Id.* at *3–4.
82. *Id.* at *3–4, *18.
83. *Id.* at *18.
84. *Id.* at *19. In so doing, the district court concluded that Country Mutual did not breach any of the three duties it owed to the mother: "the duty to treat settlement proposals with equal consideration, the duty to defend, and the duty to indemnify." *Id.*
85. *Id.* at *39.
86. *Id.* (citing Lloyd v. State Farm Mut. Auto. Ins. Co., 860 P.2d 1300, 1305 (Ariz. Ct. App. 1992)).

> discharged its duty to defend and cannot be liable for counsel's failures. Such failures must be attributed to counsel, not the insurer. There may, of course, be exceptions to this general rule. For example, if an insurer were to retain unqualified counsel or specifically direct counsel to take inappropriate action, a court might find an insurer breached the duty to defend despite having formally hired counsel to defend the insured. Those exceptions, however, do not change the general rule that the duty to defend is discharged by hiring counsel.[87]

In recognizing this potential exception, the district court cited to a draft of Section 12 of the *RLLI*.[88] But because the court concluded that the exception did not apply, and that the experienced attorney exercised his independent judgment in making strategic defense decisions, it concluded that Country Mutual did not breach its duty to defend, and the court did not further discuss the potential application of Section 12 of the *RLLI*.[89] *Martinez* is instructive because it explicitly classifies any of the conduct identified in Section 12 as a potential breach of the duty to defend, and not as extracontractual conduct subject to tort liability.[90]

B. Sapienza v. Liberty Mutual Fire Insurance Co.

The *Sapienza* case arose out of a lawsuit brought against the insureds, the Sapienzas, by their neighbors, who alleged that the Sapienzas violated height and setback regulations in their renovations of a home in a historic district.[91] The Sapienzas retained defense counsel and answered the complaint, and it was not until two months later that they notified Liberty, with whom the Sapienzas had a homeowner's policy and an excess policy, of the lawsuit.[92] Liberty agreed to defend the Sapienzas in the lawsuit under a reservation of rights because it appeared that there could be a property damage claim.[93] Defense counsel retained by the Sapienzas continued to represent them, with Liberty paying his attorney's fees.[94] In the underlying lawsuit, the state court ultimately entered a mandatory injunction requiring the Sapienzas to bring their house into compliance with applicable regulations or rebuild it, and did not award any monetary damages.[95] Based

87. *Id.* at *41 (footnotes and citations omitted).
88. *Id.* at *41 n.15.
89. *Id.* at *41–42.
90. In so doing, the *Martinez* court also demonstrated that the Reporters' reliance on *Lloyd v. State Farm Mut. Auto. Ins. Co*., 860 P.2d 1300, 1305 (Ariz. Ct. App. 1992), as support for Section 12 stating a tort cause of action is misplaced, as the *Martinez* court interpreted *Lloyd* as recognizing a variation of the contractual duty to defend and nothing more. *See Martinez*, 2019 U.S. Dist. LEXIS 69283, at *39–41.
91. Sapienza v. Liberty Mut. Fire Ins. Co., 389 F. Supp. 3d 648, 650 (D.S.D. 2019).
92. *Id.* at 650–51.
93. *Id.*
94. *Id.*
95. *Id.* at 651–52.

on this order, Liberty informed the Sapienzas that it would continue to provide a defense for the lawsuit, but that it would not provide indemnification for the injunctive relief ordered by the state court judge, because such relief and the costs of complying with it did not constitute "damages" under the policies.[96]

The state court judge's ruling in the underlying lawsuit was affirmed by the South Dakota Supreme Court with respect to the injunctive relief and was remanded for further consideration based on the court's conclusion that "[p]ecuniary compensation would not provide adequate relief" for the harm caused to the neighbors and the historic district.[97] The state court judge, on remand, gave the Sapienzas six weeks to submit plans for compliance to the board; the Sapienzas submission was rejected by the board, and they were precluded from submitting any future plans.[98] The Sapienzas' defense counsel did not attend the board meeting.[99] Thereafter, the state judge issued a writ of execution giving the Sapienzas thirty days to demolish their home, with which they complied and incurred greater than $60,000 in so doing.[100]

After incurring these expenses, the Sapienzas filed suit against Liberty, alleging that it breached its duty to defend, breached its duty to indemnify the Sapienzas, provided them with an inadequate defense and acted in bad faith in failing to defend.[101] Liberty moved to dismiss the complaint.[102] The court granted the motion to dismiss as to the Sapienzas' bad faith claims, and gave the Sapienzas two weeks to amend their complaint to survive the motion to dismiss as to the breach of the duty to defend claims.[103]

In its opinion on the motion to dismiss, the court observed that there are no South Dakota cases "addressing an insurer's liability for an inadequate defense."[104] In the absence of such precedent, the court *sua sponte* looked to "a draft of the Restatement addressing this issue" and cited to Subsection 12(2) of the *RLLI* as support that a claim could be brought against Liberty for an "inadequate" or "improper defense," if "the insurer itself . . . engaged

96. *Id.* The court certified a question to the Supreme Court of South Dakota as to whether the costs incurred by the Sapienzas to comply with the injunction constitute "damages" under the insurance policies. *Id.* at 663. The court explained that "[t]he answer to this question will be determinative of the Sapienzas' claim that Liberty Mutual breached the insurance contract by refusing to indemnify them for these costs." *Id.* at 659. That question is still pending before the South Dakota Supreme Court at the time of this writing.

97. *Id.* at 652.

98. *Id.*

99. *Id.*

100. *Id.*

101. *Id.*

102. *Id.* at 650.

103. *Id.* at 663.

104. *Id.* at 653.

in some misconduct."[105] The court predicted that, in the absence of South Dakota precedent, the Supreme Court of South Dakota "would adopt the Restatement's position on insurer liability for an improper defense" because that court has previously found *Restatements* "persuasive in many instances," and because "the draft Restatement follows the well-reasoned majority rule."[106]

In applying Subsection 12(2) to the Sapienzas' allegations, the court concluded that the Sapienzas had not stated a claim for breach of the duty to defend based on the provision of an inadequate defense, because the Sapienzas did not allege that Liberty overrode defense counsel's professional judgment.[107] Despite this conclusion, the court gave the Sapienzas two weeks to seek leave to amend their complaint "if indeed there is a basis under the facts for a claim for breach of the duty to defend."[108] The court reasoned that immediate dismissal was not appropriate, because "the Sapienzas may not have contemplated in the absence of settled South Dakota precedent application of the most recent draft of § 12 of the *Restatement* to dismiss their breach of the duty to defend claim."[109]

The Sapienzas accordingly sought leave to amend their complaint to allege that Liberty had breached its duty to defend by failing to provide them with an adequate defense.[110] In granting the Sapienzas leave to amend, the court again acknowledged that "there is no South Dakota precedent on an insurer's liability for providing an inadequate defense," and therefore that it must "predict how the Supreme Court of South Dakota would treat the Sapienzas' claims."[111] The court reasoned that, since the South Dakota

105. *Id.* (citing Restatement of the Law, Liability Insurance § 12 (Am. Law Inst., Revised Proposed Final Draft No. 2, Sept. 7, 2018)).

106. *Id.*

107. *Id.* at 655. The Sapienzas alleged that Liberty issued "instructions to defense counsel" and refused "to pay for certain activities," but did not allege what those instructions were or for what Liberty Mutual refused to pay, or that "Liberty Mutual's instructions and refusal to pay overrode defense counsel's independent professional judgment or caused the Sapienzas harm." *Id.* The court similarly concluded that the Sapienzas' allegation that Liberty "controlled the defense by . . . failing to retain an independent expert architect or contractor" did not state a claim under Subsection 12(2) because the Sapienzas did not allege "that defense counsel wanted to hire an expert or that Liberty Mutual overrode defense counsel's professional judgment that an expert was necessary" or that "the failure to hire an expert hurt the Sapienzas' defense." *Id.* Finally, the court concluded that the Sapienzas' allegation that Liberty breached its duty to defend because defense counsel "did not attend" the Board's hearing on the Sapienzas' new application also did not allege a breach under Subsection 12(2), because the Sapienzas did not allege "that Liberty Mutual engaged in any wrongdoing" or "that Liberty Mutual was so closely involved in the Sapienzas' defense that it could be liable for failing to require or direct counsel to attend the Board hearing." *Id.* at 655, 656.

108. *Id.* at 656.

109. *Id.*

110. Sapienza v. Liberty Mut. Fire Ins. Co., No. 3:18-CV-03015-RAL, 2019 U.S. Dist. LEXIS 179017, at *2 (D.S.D. Oct. 16, 2019).

111. *Id.* at *10.

Supreme Court has found the *Restatements* persuasive in the past, it would likely follow the *RLLI* with respect to "insurer liability for an improper defense."[112] The court thus adopted Section 12 of the *RLLI* as the putative law of South Dakota on this issue.[113]

The court rejected Liberty's challenge to this approach based on the court's view that "[t]here are cases supporting the Restatement's position that insurer's [sic] can be liable for overriding defense counsel's independent professional judgment" and therefore "the American Law Institute did not fashion § 12(2) out of whole cloth as Liberty Mutual contends."[114] The court also rejected the suggestion that "the Supreme Court of South Dakota would protect an insurer from liability in the rare instance when the insurer is able to override counsel's independent professional judgment and thereby harm the insured."[115]

Analyzing the Sapienzas' proposed amended allegations, the court concluded that the Sapienzas stated "a thin but plausible claim for breach of the duty to defend" under Subsection 12(2), even though they did not allege that "it was defense counsel's independent professional judgment that these services were necessary and that Liberty Mutual overrode this judgment."[116] The court concluded that the amended complaint did "not provide much of a factual basis for [the plaintiffs'] 'belief' that Liberty Mutual engaged in the alleged misconduct, but it [went] beyond pure speculation," and therefore the amendments to the Sapienzas' claim for breach of the duty to defend were not futile.[117]

Sapienza offers two important takeaways. First, although the court stated that several cases "support[] the Restatement's position that insurer's [sic] can be liable for overriding defense counsel's independent professional judgment," the cases it cited show that there is in fact no support for Subsection 12(2).[118] Second, the court explicitly framed the plaintiffs' claims

112. *Id.*

113. *Id.* at *10–12.

114. *Id.* at *14.

115. *Id.* at *15.

116. *Id.* at *16. The court found that the Sapienzas alleged "that Liberty Mutual directed defense counsel not to contact experts in the field of historic districts and regulations, not to present expert testimony before the state court, not to respond to the written arguments that the McDowells submitted to the Board, and not to attend the Board hearing on the Sapienzas' proposed renovations to their home." *Id.* at *15. They further alleged that Liberty Mutual "took steps to overrule [defense counsel's] professional judgment" by telling him that he would not be paid for the tasks described above. *Id.*

117. *Id.* at *17. With respect to the bad faith claim, the court applied South Dakota's first-party bad faith test and concluded that the Sapienzas' bad faith claim would rise and fall with the amended claim for breach of the duty to defend. *Id.* at *17–18. The court accordingly reserved ruling on whether the Sapienzas could state a claim for bad faith. *Id.*

118. *Id.* at *13. While acknowledging that "§ 12 rejected the rule applied by a minority of states that insurers are vicariously liable for all malpractice by defense counsel they hire," *id.* at *11, four of the six cases the court cited as supporting the RLLI's position are actually

to which it applied Subsection 12(2) as asserting a breach of the duty to defend, and not as asserting a separate tort claim.[119] In fact, the court dismissed the plaintiffs' bad faith claims, leaving no tort remedies available.[120] Thus, even under *Sapienza*, the court's reliance on Subsection 12(2) is nonetheless grounded in stating a variety of a contractual breach of the duty to defend claim, not a separate tort claim.

C. Progressive Northwestern Insurance Co. v. Gant

This case arose out of a wrongful death action filed in Kansas state court by the surviving spouse of a woman who was killed in a vehicular accident against the young man driving the car that killed her, his parents, and their family business.[121] The individual defendants held a Progressive automobile-liability policy with a liability limit of $250,000; the business had an automobile-liability policy with Bitco with a policy limit of $1 million.[122] Shortly before trial, two important events occurred. First, the defendants assigned to the plaintiff, Gant, their rights to the policy limits under the Progressive and Bitco policies, and any claims that the defendants had against Progressive for breach of contract, negligence, or bad faith, and Gant agreed not to execute any judgment against the individual defendants.[123] Second, Progressive moved to intervene so that it could move to compel the withdrawal of defense counsel it had selected from representing the insureds.[124] Progressive was concerned with defense

vicarious liability cases from minority jurisdictions. *See id.* at *13–14 (citing Progressive Nw. Ins. Co. v. Gant, No. 18-3226, 2016 WL 4430669 (D. Kan. Aug. 22, 2016)); *see also* Gibson v. Casto, 504 S.E.2d 705, 708 (Ga. Ct. App. 1998); Hackman v. W. Agric. Ins. Co., 275 P.3d 73 (Table) (Kan. Ct. App. Apr. 27, 2012); Trau-Med of Am., Inc. v. Allstate Ins. Co., 71 S.W.3d 691, 697 (Tenn. 2002). The remaining two cases the court cited, while somewhat consistent with the RLLI in blurring the lines between breaching the duty to defend and creating a new cause of action, did not uphold claims against the insurer like those levied in *Sapienza*. *See* Mentor Chiropractic Ctr., Inc. v. State Farm Fire & Cas. Co., 744 N.E.2d 207, 211, 211 n.3 (Ohio Ct. App. 2000) (rejecting vicarious liability concept, noting in a footnote that "if there is evidence to show that an insurance company interfered with the strategy of the counsel it retained, then under a given fact scenario, such counsel might not be found to be an independent contractor," and affirming the lower court's grant of summary judgment for the insurer, because there was no evidence that the attorney committed any malpractice or was not competent, and no evidence that the insurer acted in bad faith); Ingersoll-Rand Equip. Corp., 963 F. Supp. at 455 (dismissing the plaintiff's claims against its liability insurer and defense counsel selected by insurer because if the plaintiff wished to pursue a remedy for any harm suffered as a result of legal malpractice, it could pursue a negligence claim against the attorney or a breach of the insurer's contractual duty to exercise due care in defending the claim, but it had not done so).

119. Sapienza v. Liberty Mut. Fire Ins. Co., 389 F. Supp. 3d 648, 650, 653, 656 (D.S.D. 2019).

120. *Id.* at 662, 663.

121. Progressive Nw. Ins. Co. v. Gant, 957 F.3d 1144, 1148 (10th Cir. 2020).

122. *Id.* at 1147.

123. *Id.*

124. *Id.* at 1149.

counsel's "handling of the [insureds'] defense, including the imposition of sanctions that resulted in the deemed admission of hundreds of requests for admission and a finding that [the insureds' company] was the alter ego of [the insureds]."[125] Defense counsel withdrew before the court ruled on the motion.[126]

Following a bench trial, the judge found that the insured who drove the car was liable for the death of the plaintiff's wife, his parents (also insureds) were liable for negligently entrusting the vehicle to their son, and their family business was liable under the doctrine of respondeat superior.[127] The judge awarded Gant $6.7 million in damages.[128] Thereafter, Progressive filed a declaratory judgment action in federal district court seeking a declaration that Progressive had fulfilled its duties to its insureds under the policy and was not liable beyond the policy's $250,000 liability limit.[129] Gant counterclaimed, asserting that, among other things, Progressive was negligent in hiring defense counsel to defend the suit, and was vicariously liable for defense counsel's conduct.[130]

The district court granted summary judgment for Progressive on its claim and Gant's counterclaim.[131] The Tenth Circuit affirmed the district court's ruling, including that Progressive was not negligent in hiring McMaster and any alleged negligence was not harmful to Gant, and that Progressive was not vicariously liable for McMaster's conduct because it did not impose on his independent judgment as an attorney.[132]

Gant argued on appeal that Progressive's decision to hire defense counsel to represent its insureds "was negligent because (1) [defense counsel] had mishandled settlement discussions in the past and (2) allowing [defense counsel] to represent all [the defendants] created potential conflicts of interest."[133] The Tenth Circuit reasoned that this negligent hiring claim was properly assignable by the insureds to Gant because it "is part of Gant's breach-of-contract claim asserting bad faith and negligence—not a separate tort claim as Progressive contends."[134] Relying on *Hackman v. Western Agricultural Insurance Co.*, the court observed that Progressive "was contractually obligated to provide [the insureds] with competent counsel to

125. *Id.*
126. *Id.*
127. *Id.*
128. *Id.* at 1147.
129. *Id.* at 1147, 1149.
130. *Id.* at 1147.
131. *Id.*; *see* Progressive Nw. Ins. Co. v. Gant, No. 15-9267-JAR-KGG, 2018 U.S. Dist. LEXIS 163624, at *3 (D. Kan. Sept. 25, 2018), *aff'd*, 957 F.3d 1144 (10th Cir. 2020).
132. *Gant*, 957 F.3d at 1147. The Tenth Circuit noted that, under Kansas law, insurance contracts contain an implied term that an insurer providing a defense owes a duty to act in good faith and without negligence to the insured. *Id.* at 1150.
133. *Id.* at 1151.
134. *Id.* at 1151 n.2.

defend the claim."[135] The Tenth Circuit also looked to Subsection 12(1) of the *RLLI* as affirming that an insurer can be liable for breaching the duty to provide competent counsel.[136] However, the court did not discuss what damages would be available for a breach. Presumably if it did, it would limit the damages to those available for a breach of the duty to defend, based on its observation that Gant's negligent hiring claim was part of his breach of contract claim.

Ultimately, the court concluded that there was insufficient evidence "to support a finding that Progressive was unreasonable in thinking that [defense counsel] would provide competent representation of the [insureds]."[137] In addition, the Tenth Circuit concluded that Gant had not demonstrated causation or harm as required by Subsection 12(1) of the *RLLI* and Kansas law.[138] Gant had not established a causal link between "the types of deficiencies of [defense counsel] alleged in the past (unresponsiveness in settlement discussions)" and defense counsel's alleged failures in this representation, and had not presented any evidence that Progressive was aware of these particular deficiencies in defense counsel's skill set.[139] Moreover, "there was no apparent harm from the deficiencies in [defense counsel's] performance," none of which related to the misconduct defense counsel was alleged to have engaged in on previous representations, and which ultimately led to Progressive asking defense counsel to withdraw from the case.[140]

Gant also argued that Progressive was negligent in hiring defense counsel to represent all of the defendants because there were potential conflicts of interest among the individual defendants (specifically the son who was involved in the accident, compared to his parents) and between the individual defendants and the defendant business.[141] The court rejected this argument because one of the family members testified that they did not want to place blame on one another and took a unified position, and

135. *Id.* at 1152 (citing Hackman v. W. Agric. Ins. Co., 275 P.3d 73 (Kan. Ct. App. 2012)).

136. *Id.*

137. *Id.* at 1153. Gant submitted statements from three attorneys who alleged that they had informed Progressive of certain misconduct by defense counsel, mainly around not scheduling or appearing for settlement hearings. *Id.* at 1152. The Tenth Circuit reasoned that these allegations were insufficient to create a genuine issue of material fact as to whether Progressive was negligent in hiring this defense counsel, because "in the highly competitive world of personal-injury litigation, complaints of allegedly unreasonable conduct of opposing counsel are hardly uncommon," and defense counsel had substantial experience, especially with jury trials, in suits involving serious bodily injury. *Id.* Moreover, defense counsel's law license had never been suspended or revoked. *Id.*

138. *Id.* at 1153. The Tenth Circuit quoted Subsection 12(1) for the proposition that "harm caused by any subsequent negligent act or omission of the selected counsel that is *within the scope of the risk that made the selection of counsel unreasonable*." *Id.* (emphasis added by court).

139. *Id.*

140. *Id.*

141. *Id.*

because defense counsel had obtained a conflict waiver signed by all of the defendants after consultation with their personal attorney.[142]

Finally, the Tenth Circuit rejected Gant's argument that Progressive was vicariously liable for defense counsel's negligent misrepresentation.[143] The court emphasized that attorneys have an "ethical obligation . . . to exercise independent judgment," as acknowledged by the Restatement (Third) of the Law Governing Lawyers § 134, and for this reason, courts have largely rejected the concept of "an insurer's general vicarious liability for negligent representation by the insured's attorney."[144] Instead, the court speculated that the Kansas Supreme Court would likely adopt the standard articulated in Subsection 12(2) of the *RLLI* that an insurer may be subject to liability for harm caused by defense counsel's negligence if "the insurer directs the conduct of the counsel with respect to the negligent act or omission *in a manner that overrides the duty of the counsel to exercise independent professional judgment.*"[145] This speculation was supported by a decision of the Kansas Court of Appeals stating that vicarious liability would be permitted only "if, at the time in question, the attorney's acts or omissions were directed, commanded, or knowingly authorized by the insurer."[146] In this case, the court concluded that Progressive had not acted in the way contemplated by Subsection 12(2) because there was no evidence that it intruded on defense counsel's professional judgment.[147] In particular, the court rejected Gant's argument that Progressive's Defense Counsel Guidelines, "which require defense counsel to obtain prior approval from Progressive for certain tasks, including engaging in over one hour of legal research and filing motions," demonstrated Progressive's "control" over defense counsel, and emphasized that the actual exercise of control, not the assertion of the right to do so, is determinative of whether an insurer overrides the professional judgment of defense counsel.[148]

Although *Gant* purported to adopt Subsection 12(1) and Subsection 12(2), the court concluded that neither standard had been satisfied. Moreover, the Tenth Circuit explicitly considered the Subsection 12(1) claim to be a part of Gant's breach of contract claim, and not to state a separate tort claim. Accordingly, like *Sapienza*, *Gant* supports the framework advanced by this article that Section 12 should be interpreted as doing nothing more than articulating conduct that could potentially be considered a breach

142. *Id.* at 1153–54.
143. *Id.* at 1154.
144. *Id.* at 1155.
145. *Id.* (quoting RLLI, *supra* note 3, § 12(2) (emphasis added by court)).
146. *Id.* (quoting Hackman v. W. Agric. Ins. Co., No. 104-786, 2012 Kan. App. Unpub. LEXIS 311, at *16 (Apr. 27, 2012)).
147. *Id.*
148. *Id.* at 1156.

of an insurer's existing contractual duty to defend. In addition, *Martinez*, *Sapienza*, and *Gant* illustrate the futility of asking a court to adjudicate a legal malpractice claim within an insurance coverage dispute regarding the duty to defend. If an attorney has acted negligently in her representation of her client, that conduct deserves direct adjudication in a separate legal malpractice lawsuit between the insured plaintiff and defense counsel. Section 12 should not be used as a shortcut to determining that predicate liability.[149]

VII. CONCLUSION

If the insurer breached its duty to defend, a remedy in contract is already available, and double-dipping into tort damages for identical conduct is not permitted. And if the insurer did not breach its duty to defend, and has otherwise faithfully performed its obligations, imposing liability on the insurer for the misconduct of defense counsel would run far afoul of well-established principles of contract law and impose agency liability in a relationship that is purely a contractual one.

Given the lack of support or justification for the rules announced in Section 12, and the existence of a well-established and adequate remedy under contract law, Section 12 should not be adopted as establishing a tort cause of action for insureds against their insurers. Instead, courts should hold insurers and insureds to the terms of their contractual relationship. Like the courts in *Martinez*, *Sapienza*, and *Gant*, courts considering relying on Section 12 in future cases should limit the scope of both parts of Section 12 to breach of contract claims, and should be wary of adjudicating attorney malpractice as a threshold question to determining an insurer's contractual liability. Further, courts should be wary of efforts to utilize Section 12 to obtain tort damages for a breach of an insurer's duty to defend when recourse to the insured already exists under the well-developed body of law regarding an insurer's breach of the duty to defend.

149. Although neither *Sapienza* nor *Gant* reached the point of addressing what damages would be available under Subsection 12(1) or Subsection 12(2), by entertaining the application of Section 12 in a case in which a judgment in excess of the policy limits was at issue, *Gant* implied that tort damages could be available for the conduct identified in Section 12. But even the Reporters' Notes to Section 12 show that tort damages for an insurer's conduct in selecting and overseeing defense counsel are not appropriate because such conduct is already actionable in contract. Where there is already a contractual remedy for the same conduct, extending tort liability would violate the principle embodied in the economic loss rule.