wiley

NEWSLETTER

Coverage Litigation Focus: Choice of Law and the Race to the Courthouse

May 2008

Although the Commerce Clause of the United States Constitution gives Congress the power to regulate interstate commerce, the states historically have regulated the business of insurance. The rules and laws applicable to insurance contracts vary from state to state, and courts in different states often construe identical policy language in different ways. As a result, the outcome of a coverage dispute may turn on which state's law governs. That determination, both in federal court and state court, depends on the choice of law principles of the forum state. Such principles, however, also vary from state to state, and, therefore, where the case is heard ultimately may determine whether the insurer will be liable under the contract. For this reason, an insurer may find itself in a race to file suit first in a jurisdiction most likely to apply the substantive law most favorable to its coverage position.

The United States Supreme Court has recognized the inescapability of such procedural maneuvering and noted that because jurisdiction and venue requirements often are easily satisfied, "plaintiffs will select the forum whose choice-of-law rules are most advantageous." *See Piper Aircraft Co. v. Reyno*, 454 U.S. 235, 250 (1981). Insurers' efforts in this regard are bolstered by the fact that courts faced with a later-filed, mirror-image suit often will defer to the first-filed action. *See, e.g., Employers Ins. of Wausau v. News Corp.*, No. 06-4652, 2008 WL 817509, at *3 (2d Cir. Mar. 27, 2008); *U.S. Fire Ins. Co. v. Goodyear Tire & Rubber Co.*, 920 F.2d 487, 488 (8th Cir. 1990). Indeed, provided that there is some connection between the dispute and the jurisdiction, and "special circumstances" do not dictate otherwise, courts traditionally will "honor the plaintiff's choice of forum." *See News Corp.*, 2008 WL 817509, at **3-4 (recognizing that "only a limited number of such circumstances" exist and dismissal of the first-filed action, therefore, "is quite rare").

In many jurisdictions, courts apply the rule that insurance contracts are governed by the law of "the place of contracting"—this is the principle of l*ex loci contractus. See, e.g., Regents of Mercerburg College v. Republic Franklin Ins. Co.*, 458 F.3d 159, 163 (3d Cir. 2006) (Pennsylvania); *Seabulk Offshore, Ltd. v. Am. Home Assur. Co.*, 377 F.3d 408, 419 (4th Cir. 2004) (Virginia); *Fioretti v. Mass. Gen. Life Ins. Co.*, 53 F.3d 1228, 1235 (11th Cir. 1995) (Florida). Among the states that follow this principle, there are different interpretations as to "the place contracting." For example, in some jurisdictions, an insurance contract is "made" in the state where the policy is "issued" or "delivered"—*see, e.g., Park Univ. Enter., Inc. v. Am. Cas. Co. of Reading, Pa.*, 442 F.3d 1239, 1244 (10th Cir. 2006) (Kansas); *CAT Internet Servs., Inc. v. Providence Washington Ins. Co.*, 333 F.3d 138, 141 (3d Cir.

2003) (Pennsylvania)—while in others it is where the contract is "executed" and "the premium is paid." *See, e.g., State Farm Mut. Auto. Ins. v. McNeal*, 491 F. Supp. 2d 814, 820 (S.D. Ind. 2007); *Rouse Co. v. Fed. Ins. Co.*, 991 F. Supp. 460, 462 (D. Md. 1998).

Alternatively, a number of states follow the "most significant relationship" approach, which requires the court to apply the law of the state that has "the most significant contacts with the matter in dispute." *See, e.g., Maryland Cas. Co. v. Continental Cas. Co.*, 332 F.3d 145, 151 (2d Cir. 2003) (New York). In making this determination, the court takes into account the place of contracting, the place of negotiating, the place of performance, the location of the subject matter of the contract and the domicile, place of incorporation and/or place of business of the parties. *See id.* at 151-52; *W.R. Grace & Co. v. Cont'l Cas. Co.*, 896 F.2d 865, 873 (5th Cir. 1990) (Texas); *see also* Restatement (Second) of Conflicts of Law, §§ 6, 188 and 193. Some states also require a "government interest" analysis, by which the court must consider these contacts in the context of which state has the greatest interest in the proper resolution of the dispute. *See, e.g., Costco Wholesale Corp. v. Liberty Mut. Ins. Co.*, 472 F. Supp. 2d 1183, 1198 (S.D. Cal. 2007); *NL Indus., Inc. v. Comm. Union Ins. Co.*, 926 F. Supp. 446, 459-60 (D.N.J. 1996).

The application of these rules, and the determination of which state's law governs, is critical in cases involving a number of recurring issues with respect to which the law between states is distinctly opposite. For example, under California law, an insurer cannot provide coverage for punitive damages, but under the law of nearby Washington, it can be held liable for such amounts. *See PPG Indus., Inc. v. Transamerica Ins. Co.*, 975 P.2d 652, 657 (Cal. 1999) (citing Cal. Ins. Code § 533); *Fluke Corp. v. Hartford Acc. & Indem. Co.*, 7 P.3d 825, 831 (Wash. Ct. App. 2000). In *Fluke*, the coverage action had been brought in Washington, and, applying that jurisdiction's most significant relationship test, the state court determined that the substantive law of Washington, and not California, governed the insured's claim for coverage for $4 million in punitive damages. *See id.* at 832-33. Had the action been filed first in California, applying that state's government interest test, the court likely would have determined that California's expressed public policy against the insurability of punitive damages warranted the application of California law, which would have resulted in a finding for the insurer.

Another situation in which an insurer's liability may turn on choice of law principles involves the question of late notice and whether a showing of prejudice is required to support such a defense to coverage. Under New York law, for example, an insured's failure to provide timely notice of a claim is an absolute bar to coverage, regardless of whether the insurer has been prejudiced by the delay. *See Rekemeyer v. State Farm Mut. Auto. Ins. Co.*, 828 N.E.2d 970, 974 (N.Y. 2005). In contrast, under the law of neighboring Vermont, an insurer cannot deny coverage based on late notice unless it makes a showing of prejudice. *See Hardwick Recycling & Salvage, Inc. v. Acadia Ins. Co.*, 869 A.2d 82, 96 (Vt. 2004). Because the existence of prejudice may be a question for the trier of fact, securing a forum that will apply New York law over Vermont law may mean for the insurer the difference between obtaining an early summary judgment and proceeding with protracted and expensive litigation.

The lesson here is that before bringing a coverage action, an insurer may wish to evaluate which forum's law most favors its position and then determine which of the forums available to it most likely will apply that law to the dispute. Once that determination is made, and the matter is ripe for adjudication, the insurer may consider promptly filing suit in the appropriate jurisdiction.