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Lawyer Insights

Navigating High Court's Options In Insurer Choice Of Law

By Lara Cassidy and Adriana Perez
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Insurance coverage cases are few and far between in the U.S. Supreme Court. Thus, the high court's recent agreement to hear Great Lakes Insurance SE v. Raiders Retreat Realty Co. LLC. has sparked wide interest. The Supreme Court accepted certiorari in Great Lakes to consider the circumstances under which a choice-of-law provision in a maritime insurance policy might be "rendered unenforceable if enforcement is contrary to the 'strong public policy' of the state whose law is displaced."

Although the question presented is couched in terms of federal admiralty law in Great Lakes, the underlying issue pops up frequently in nonadmiralty cases, too: whether the choice-of-law provision in an insurance policy strictly governs a policyholder's extracontractual bad faith causes of action.

In Great Lakes, the Supreme Court will be called upon to decide whether a yacht owner may pursue extracontractual bad faith claims against its insurer under Pennsylvania law in a Pennsylvania court, even though the choice-of-law provision in its maritime insurance policy favors federal admiralty law and New York state law, in that order.

How the Supreme Court addresses the choice-of-law issue could have significant ramifications not only for maritime insurance cases going forward, but also for other insurance coverage disputes over the enforceability of choice-of-law provisions in the bad faith context. While the issue lends itself to multiple lines of analysis, we discuss four alternatives below.

Background

A brief review of the case is helpful to understand what is at stake. After its yacht ran aground in June 2019, owner Raiders Retreat sought insurance coverage from Great Lakes Insurance for $300,000 in damages.

Great Lakes denied coverage on the unrelated basis that the yacht's fire suppression system was out of date. Great Lakes subsequently filed a declaratory judgment action in the U.S. District Court for the Eastern District of Pennsylvania in September 2019, claiming that the expired fire extinguishers breached a policy warranty and voided the policy.

Raiders pleaded extracontractual counterclaims in the Pennsylvania action under Pennsylvania law: breach of fiduciary duty, bad faith failure to pay claims and violation of Pennsylvania state consumer fraud statutes.

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The issue before the Supreme Court is whether Raiders may pursue its extracontractual causes of action under Pennsylvania law in light of the choice-of-law provision in the insurance policy stating that disputes under the policy are subject to New York state law. That provision states that

> any dispute arising hereunder shall be adjudicated according to well established, entrenched principles and precedents of substantive United States Federal Admiralty law and practice[,] but where no such well-established, entrenched precedent exists, this insuring agreement is subject to the substantive laws of the State of New York.

Great Lakes moved to dismiss the extracontractual claims, arguing that the choice-of-law provision mandated applying New York law, and New York law does not recognize bad faith claims in the same way Pennsylvania law does. Raiders opposed the motion, arguing that the forum state Pennsylvania has a strong public policy of holding insurers liable for their bad faith conduct, rendering a New York choice of law unenforceable.

The district court and the U.S. Court of Appeals for the Third Circuit seesawed on the issue. The district court agreed with the insurer that New York law applied without exception and dismissed the yacht owner's extracontractual claims.

On appeal, however, the Third Circuit in 2022 sided with the yacht owner that the choice-of-law provision would have to give way if the forum state of Pennsylvania "has a strong public policy that would be thwarted by applying New York law." The Third Circuit then remanded the case to the district court for a determination of Pennsylvania's interest in the yacht owner's bad faith claims.

The insurer filed a petition for a writ for certiorari to the Supreme Court before the case was remanded to the district court, and the high court accepted. In its petition, the insurer asked the Supreme Court to uphold consistent enforcement of maritime choice-of-law provisions to fend off disgruntled insureds and to prevent encroaching state law from undermining the laws selected by the insurers and replacing them with more favorable state law.

This plain language shows that the insurer has little interest in the esoteric question of what standards apply to choice-of-law determinations under admiralty law. It wants to insulate itself from bad faith causes of action by incorporating into its policies choice-of-law provisions pointing to the law of states that do not recognize those causes of action.

Analysis

This case presents the Supreme Court the opportunity to consider the extent to which insurers may rely on choice-of-law provisions to thwart the application of state-specific insurance law designed to hold insurers accountable. As such, the case is significant not only for maritime cases going forward, but also for other insurance disputes over choice-of-law provisions.

Indeed, the fact that this case has progressed to the Supreme Court on an insurance claim worth only $300,000 suggests that the insurance industry already has pinpointed this case as having a great potential impact, and policyholder counsel would be well advised to do the same.

To be sure, the Supreme Court could simply adopt a flat rule that federal maritime law upholds choice-of-

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law provisions in insurance policies as to both contractual and extracontractual claims, irrespective of any potential conflicts with forum state law, but we do not think that result is likely here.

The Supreme Court already rejected the insurer's request to frame the question presented as "the standard for judging the enforcement of a choice-of-law clause in a maritime contract," which would have set the stage for that easy out. Instead, the court agreed to weigh in on the thornier question of the interplay between a maritime choice-of-law provision and the public policy of the forum state.

The Supreme Court also could use this case to reset the standards in long-standing precedential cases Wilburn Boat Co. v. Fireman's Fund Insurance Co. from 1955 and The Bremen v. Zapata Off-Shore Co. from 1972, both of which curb the application of contractual provisions in the admiralty context to ensure just results.

The gist of the insurer's argument is that this precedent has devolved admiralty law into chaos, as evidenced by the Third Circuit's willingness to take into account the public policy of the forum state in the same way as a court might do in a nonadmiralty choice-of-law dispute.

More to the point, the insurer asks the Supreme Court to confirm that forum state public policy is not material to the admiralty choice-of-law analysis at all. In sum, the insurer argues that considering forum state law "represents a mortal threat" to the insurer's painstaking efforts to ensure that insurer-friendly law governs its maritime policies.

Alternatively, the Supreme Court could leave the existing precedent in place, but confirm the extent to which forum state law constitutes a factor meriting consideration.

In this regard, the Third Circuit decision focused extensively on the exception set forth in Bremen, which questions whether a "compelling and countervailing reason" renders enforcement unreasonable. The Third Circuit remanded the case for a determination of whether Pennsylvania has a strong enough interest in the pending dispute to constitute a compelling and countervailing reason.

The Supreme Court recently has deferred to state law and decentralized decision-making in multiple contexts, so it easily could follow the same approach here and confirm that forum state law is a valid consideration. This holding, even if couched in the maritime law framework in Great Lakes, no doubt would embolden policyholders to challenge the application of choice-of-law provisions that conflict with other forum state law in a wide variety of insurance disputes.

Finally, the court could skirt the challenging precedent altogether and focus on whether the choice-of-law provision at issue unambiguously extends to extracontractual claims, such as bad faith or violation of state consumer-protection acts.

Notably, the Third Circuit alluded to the possibility that the policyholder's extracontractual claims might be beyond the scope of the choice-of-law provision as an "intriguing argument," but declined to reach the issue because Raiders had not raised it in the federal district court.

While the Supreme Court also is constrained by the underlying record, it certainly could offer some insight on this issue should it choose to do so.

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Conclusion

Insurance coverage law is highly dependent on state law, and the application of one state's laws over another's can determine the outcome of a dispute. This is particularly true with respect to bad faith liability laws and standards, which vary greatly from state to state.

With this in mind, prudent policyholders will watch the Great Lakes case closely, as it may validate efforts to hold insurers responsible for bad faith conduct notwithstanding the insurers' efforts to contract away that liability by imposing insurer-friendly choice-of-law provisions in their policies.

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