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## **Choice of Law: How It Impacts Coverage and Surrounding Litigation**

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## *Choice of Law – How It Impacts Coverage and Surrounding Litigation*

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When determining insurance coverage, an insurer's duties, extracontractual remedies, and defenses, which state's law applies may be crucial. Choice of law will matter when Texas law provides a bad answer or no answer.

As will be discussed, several factors affect the choice of law, and some of those factors are subject to being influenced in the underlying litigation.

In deciding choice of law issues, it matters which insurance policy, which insurer, which insured, and which issues you are focusing on. For example, Texas law is more likely to apply to a policy with an insurer whose insured has its principal place of business in Texas. New York law is more likely to apply to coverage for an entity that has its principal place of business in New York, particularly when the insurer has offices in New York.

### **1. Is there a difference in the laws?**

When the laws of more than one state may apply, the first question is whether the laws are different. If they are the same, or would lead to the same result, there is no reason to determine which applies.

Texas courts initially determine whether there is a conflict between Texas law and the other potentially applicable law. If there is no difference – the result would be the same under either – there is no need for a court to resolve the choice of law question. *Bailey v. Shell W. E&P, Inc.*, 609 F.3d 710, 722-23 (5th Cir. 2010); *SAVA gumarska in kemijska industrija d.d. v. Advanced Polymer Sciences, Inc.*, 128 S.W.3d 304, 314 (Tex. App.–Dallas 2004, no pet.) (“[W]e should first determine if the laws are in conflict. If the result would be the same under the laws of either jurisdiction, there is no need to resolve the choice of law question.”); *Vandeventer v. All Am. Life & Cas. Co.*, 101 S.W.3d 703, 711-12 (Tex. App.–Fort Worth 2003, no pet.) (“In the absence of a true conflict, we need not undertake a choice-of-law analysis.”).

### **2. Is the difference good for your side?**

Courts don't care about this, but you do. If there is a difference in the potentially-applicable laws and Texas law is better for you, it makes no sense to raise a choice-of-law question if your opponent doesn't.

Sometimes answering this question requires balancing different factors. For example, Colorado legal standards for holding a liability insurer liable for failing to settle are easier, but Texas law allows attorney's fees.

### **3. Which law applies to decide which law applies?**

The next question is – what legal framework applies to decide which laws apply?

Of course, a forum state court would apply its own rules to make this determination.

“Federal courts apply the forum state’s conflicts-of-law rules to determine what law governs state-law claims.” *Bailey v. Shell W. E&P, Inc.*, 609 F.3d 710, 722 (5th Cir. 2010) (citing *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 496 (1941)).

Because of this rule, it may make a difference where the suit is filed. If the choice-of-law rules are different, you need to analyze which is better for your side and file suit there, if possible.

Even if both jurisdictions have the same choice-of-law rules, it makes sense, when possible, to file suit in the forum whose laws you want to apply. A court might be more inclined to apply its own law, if only because the law is more familiar.

### **4. Who decides?**

Which state’s law governs an issue is a question of law for the court to decide. *Torrington Co. v. Stutzman*, 46 S.W.3d 829, 848-49 (Tex. 2000); *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984). “But determining the state contacts to be considered by the court in making this legal determination involves a factual inquiry.” *Hughes Wood Products, Inc. v. Wagner*, 18 S.W.3d 202, 204 (Tex. 2000).

### **5. Is there a choice of law provision in the contract?**

“In Texas, contractual choice-of-law provisions are ordinarily enforced if the chosen forum has a substantial relationship to the parties and the transaction.” *Access Telecom, Inc. v. MCI Telecomm. Corp.*, 197 F.3d 694, 705 (5th Cir. 1999) (citing *De Santis v. Wackenhut*, 793 S.W.2d 670, 677-78 (Tex.1990)).

“However, a choice-of-law provision will not be applied if another jurisdiction has a more significant relationship with the parties and their transaction than the state they choose, that jurisdiction has a materially greater interest than the chosen state, and the jurisdiction’s fundamental policy would be contravened by the application of the law of the chosen state.” *Access Telecom, Inc. v. MCI Telecomm. Corp.*, 197 F.3d at 705.

Courts rely on *Restatement (Second) of Conflict of Laws* § 187 to decide whether other considerations trump the parties’ choice of law. *DeSantis v. Wackenhut Corp.*, 793 S.W.2d 670, 677-78 (Tex. 1990). Section 187 states:

## **§ 187 Law of the State Chosen by the Parties**

(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.

(2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either

(a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or

(b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties.

(3) In the absence of a contrary indication of intention, the reference is to the local law of the state of the chosen law.

*Restatement (Second) of Conflict of Laws* § 187 (1971). Thus, the parties' choice will control unless the state has no substantial relationship, or applying the law will be contrary to the interest of another state with a greater interest.

In *DeSantis v. Wackenhut Corp.*, the court overrode the parties' choice-of-law provision, because the court found that Texas had a more significant relationship with the parties and transaction, Texas had a materially greater interest than the other state in the issue of the enforceability of the agreement, and the law governing enforceability of the agreement was a fundamental policy of Texas, and applying the other state's law would be contrary to that policy. 793 S.W.2d at 678-79.

If the parties' choice-of-law provision does not apply, a court will apply the law of the state with the most significant relationship. *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984); *DeSantis v. Wackenhut Corp.*, 793 S.W.2d at 678. More is said about the "most significant relationship" test below.

### **6. Does a statute govern?**

When a contract does not contain an express choice of law provision, a court must determine whether a relevant statute directs the court to apply the laws of a particular state.

*Reddy Ice Corp. v. Travelers Lloyds Ins. Co.*, 145 S.W.3d 337, 340 (Tex. App.–Houston [14th Dist.] 2004, pet. denied).

If the suit involves an insurance contract payable to a Texan by an insurer doing business in Texas, you must consider article 21.42 of the Texas Insurance Code. That statute provides:

**Art. 21.42. Texas Laws Govern Policies**

Any contract of insurance payable to any citizen or inhabitant of this state by any insurance company or corporation doing business within this state shall be held to be a contract made and entered into under and by virtue of the laws of this state relating to insurance, and governed thereby, notwithstanding such policy or contract of insurance may provide that the contract was executed and the premiums and policy (in case it becomes a demand) should be payable without this State, or at the home office of the company or corporation issuing the same.

Tex. Ins. Code Ann. art. 21.42. As the heading and text make clear, if the statute applies, Texas law governs the policy.

For the statute to apply, courts have identified three requirements:

- (1) the insurance proceeds are payable to a citizen or inhabitant of Texas;
- (2) the policy is issued by an insurer doing business in Texas; and
- (3) the policy must be issued in the course of the insurance company's Texas business.

*Reddy Ice*, 145 S.W.3d at 341.

Courts construe article 21.42 narrowly to avoid giving it extraterritorial effect. *Reddy Ice*, 145 S.W.3d at 341. So, for example, Kansas law applied to a policy issued and paid for in Kansas and insuring property there, even though the insured was a Texan. *Austin Bldg. Co. v. Natl. Union Fire Ins. Co.*, 432 S.W.2d 697, 700-01 (Tex. 1968).

Also, the statute applies only when the Texas citizen is the insured that is subject to the suit. The fact that other insureds might be Texas residents does not suffice. *Reddy Ice*, 145 S.W.3d at 341 & n. 6. For example, in *Scottsdale Ins. Co. v. Nat'l Emerg. Svc's, Inc.*, 175 S.W.3d 284, 292-93 (Tex. App.–Houston [1st Dist.] 2004, pet. denied), the statute did not apply where the insured entity was foreign, even though it had Texas affiliates, some of whom might receive part of the proceeds.

To the extent the statute does not apply, a court will consider which state has the most significant relationship. That is discussed below.

## 7. The “most significant relationship test” – What is the issue?

If the choice of law isn't decided by a contract provision or by statute, courts apply the “most significant relationship” test. *Hughes Wood Products, Inc. v. Wagner*, 18 S.W.3d 202, 205 (Tex. 2000); *Restatement (Second) of Conflict of Laws* §§ 6, 145, 188 (1971).

When deciding which state has the most significant relationship, it is important to focus on precisely what the issue is. The substantive issues determine which factors a court considers in determining the most significant relationship. *See, e.g., W.R. Grace & Co. v. Cont'l Cas. Co.*, 896 F.2d 865, 873 (5th Cir. 1990).

In applying this test, it is wrong simply to decide which state has the most significant relationship to the case. Instead, “the Restatement requires the court to consider which state’s law has the most significant relationship *to the particular substantive issue to be resolved.*” *Hughes*, 18 S.W.3d at 205 (emphasis in original).

It is the quality, not quantity, of the contacts that counts. The supreme court has explained the process to be used, as follows:

In applying § 6 to this case, we must first identify the state contacts that should be considered. Once these contacts are established, the question of which state’s law will apply is one of law. ... Moreover, the number of contacts with a particular state is not determinative. Some contacts are more important than others because they implicate state policies underlying the particular substantive issue. Consequently, selection of the applicable law depends on the qualitative nature of the particular contacts.

*Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 421 (Tex. 1984).

Because a court must consider the contacts and policies as they relate to particular substantive issues, it is possible that the law of one state will apply to some issues, while the law of another state applies to others. *See Scottsdale Ins. Co. v. Natl. Emerg. Serv., Inc.*, 175 S.W.3d 284, 292 (Tex. App.–Houston [1st Dist.] 2004, pet. denied) (“Texas law may apply to some claims, but not other claims.”); *SnyderGen. Corp. v. Great Am. Ins. Co.*, 928 F. Supp. 674, 678 (N.D.Tex.1996).

If the issue is construing the insurance contract, one state may have more significant contacts with that issue. If the issue is the insurer’s claims-handling, another state may have more significant contacts.

Several provisions of the *Restatement (Second) of Conflict of Laws* may come into play in insurance cases when determining which state has the most significant relationship. Section 6 has general principles; section 145 has the principles for torts; and section 188 has principles for contracts. In addition, section 192 applies to life insurance, and section 193 relates to fire, surety, and casualty insurance. Courts discuss the general principles in section 6, but the other sections usually decide the outcome.

Section 6 provides:

## **§ 6. Choice-Of-Law Principles**

(1) A court, subject to constitutional restrictions, will follow a statutory directive of its own state on choice of law.

(2) When there is no such directive, the factors relevant to the choice of the applicable rule of law include

- (a) the needs of the interstate and international systems,
- (b) the relevant policies of the forum,
- (c) the relevant policies of other interested states and the relative interests of those states in the determination of the particular issue,
- (d) the protection of justified expectations,
- (e) the basic policies underlying the particular field of law,
- (f) certainty, predictability and uniformity of result, and
- (g) ease in the determination and application of the law to be applied.

*Restatement* § 6. In turn, section 145 regarding torts provides:

### **§ 145. The General Principle**

(1) The rights and liabilities of the parties with respect to an issue in tort are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the occurrence and the parties under the principles stated in § 6.

(2) Contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place where the injury occurred,
- (b) the place where the conduct causing the injury occurred,
- (c) the domicile, residence, nationality, place of incorporation and place of business of the parties, and
- (d) the place where the relationship, if any, between the parties is centered.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

*Restatement* § 145. Finally, for contract claims, section 188 provides:

**§ 188. Law Governing in Absence of Effective Choice by the Parties**

(1) The rights and duties of the parties with respect to an issue in contract are determined by the local law of the state which, with respect to that issue, has the most significant relationship to the transaction and the parties under the principles stated in § 6.

(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:

- (a) the place of contracting,
- (b) the place of negotiation of the contract,
- (c) the place of performance,
- (d) the location of the subject matter of the contract, and
- (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

These contacts are to be evaluated according to their relative importance with respect to the particular issue.

(3) If the place of negotiating the contract and the place of performance are in the same state, the local law of this state will usually be applied, except as otherwise provided in §§ 189–199 and 203.

**8. How do the rules apply?**

Applying these factors, courts have held that if the issue is the duty to defend or indemnify, and the issues require construction and application of the insurance policies, the relevant inquiry is what state has contacts with the insurance dispute, not with the underlying suit. *St. Paul Mercury Ins. Co. v. Lexington Ins. Co.*, 78 F.3d 202, 205 (5th Cir. 1996); *Reddy Ice*, 45 S.W.3d at 345. The court in *Reddy Ice* went further and said that for a nationwide liability policy, the place of the contract, negotiations, and domicile are the primary factors. 145 S.W.3d at 346.

For example, in a case where Louisiana had the most contacts with the underlying tort suit, but Texas had more contacts with the insurance dispute, Texas had the most significant relationship and Texas law applied to the insurance issues. *St. Paul*, 78 F.3d at 205. Conversely, even if Texas has the most significant relationship to the issues in the underlying tort case, another state may have the most significant relationship to the insurance dispute.

A key case that supports the argument for applying another state's law to policies, even though the tort suit is in Texas, is *W.R. Grace & Co. v. Cont'l Cas. Co.*, 896 F.2d 865 (5th Cir.



1990). In that case, excess insurers and the insured had coverage issues related to the insured's settlement of asbestos claims by several Texas school districts. The underlying tort suit was filed in Texas and then settled, and the insurers were joined in that suit. The court found that New York had the most significant relationship to the issues in the case. *Id.* at 873. The court pointed out that the insured and three of the eleven excess insurers had their principal places of business in New York. *Id.* The court pointed out that the insurance broker was in New York. Most of the policies were solicited, negotiated, and delivered in New York, and the premiums were paid in New York. The insured gave notice of the claims in New York. *Id.*

The court concluded that New York was the center of the relationship between the insured and insurers and that New York had a strong and overriding interest in the outcome of the insurance coverage disputes that involved a New York insured and contractual relations with insurers doing business in New York. *Id.*

The *W.R. Grace* court rejected the insured's argument that Texas law should apply because it would determine the source of funds for settlement. 896 F.2d at 873. The court pointed out that school districts were already paid. The coverage lawsuit would only determine the insured's recovery from its insurers. *Id.* Texas had an interest in the plaintiffs' recovery in the underlying suit, but that interest ended with the settlement. New York had an interest in the remaining insurance disputes. *Id.* at 873-74.

The *W.R. Grace* court went on to note that New York and Texas law conflicted on some issues, while on other issues the law was not clear. *Id.* at 874. The court reasoned that it was best to leave the issues to be decided in a New York state court. *Id.* at 874-75. The court concluded that the trial court erred by applying Texas law to claims that were hotly disputed and important to the development of New York insurance law, and that New York was the state with the most significant relationship to the dispute. *Id.* at 877.

Another case to consider is *Seguros Tepeyac, S.A. Compania Mexicana de Seguros Generales v. Bostrom*, 347 F.2d 168 (5th Cir. 1965). In that case the Texas insured bought an auto policy to provide coverage while driving in Mexico, where a serious accident occurred. Ultimately, the court applied Mexican law to issues relating to breach of contract and Texas law to the tort issues relating to the breach of the *Stowers* duty.

The *Seguros Tepeyac* court applied Mexican law to the breach of contract issues, because the contract was executed in Mexico, there was a Mexican insurer, and the policy was expected to cover liability in Mexico. 347 F.2d at 172.

Regarding the *Stowers* tort duty, the court first noted that the place of injury, Mexico, was not relevant to the insurer's liability. The court found Texas law applied because:

- (1) there was a Texas insured,
- (2) the offer to settle was made in Texas,
- (3) the suit was filed in Texas against a Texas defendant,
- (4) the insurer's misconduct in failing to settle and defend took place in Texas,

- (5) the insurer was qualified to do business in Texas, and
- (6) Texas had an interest in protecting its citizens when there was a breach of the insurer's duty to an insured Texan.

347 F.2d at 375. Thus, under *Seguros Tepeyac*, Texas law may apply to the claims-handling, even though another state's law controls the contract.

This can get complicated where the claims-handling is intertwined with contractual liability. For example, under Texas law a liability insurer is not liable for failing to settle if the demand exceeds the policy limits. In other states, a liability insurer may have a duty to respond and attempt to settle. If another state has greater contacts with the contract, then failing to apply that state's law to settlement may undercut the expectations of an insured under that state's law.

An interesting case from New York is *Booking v. General Star Management Co.*, 254 F.3d 414 (2nd Cir. 2001). The issue in that case involved Texas versus New York law. New York allows an insurer to complain about defective notice from the insured, even without showing prejudice. Texas law was construed to require a showing of prejudice, which was more favorable to the insured. The court decided to apply Texas law in part based on the fact that if New York applied it would be impossible for the injured party to collect, but the injured party might collect if Texas law applied. The court called it "a substantial injustice" to apply New York law. 254 F.3d at 419.

A case illustrating this kind of overlap is *Northwestern Mutual Life Insurance Co. v. Wender*, 940 F. Supp. 62 (S.D.N.Y. 1996). The court considered the insurer's failure to pay a claim to be a tort issue, but recognized that determining where the tort occurred was not that simple. The policy was signed, and an application was delivered in New York, where the first premium was paid, and the policy was delivered. However the insurer had its headquarters in Wisconsin, the request for benefits was sent to Wisconsin, and all correspondence went to Wisconsin, where the benefits were paid from an account in Wisconsin. 940 F. Supp. at 66. Faced with contacts with two states, the court considered a significant factor the fact that Wisconsin would allow a private cause of action for unfair settlement practices, but New York would not.

The court concluded that the tort occurred in New York. Although the cause of action sounded in tort, it arose from an insurance contract, so the court considered the contract rules for resolving insurance policy claims. The court concluded:

However, whether the insurance policy was delivered to New York or Defendant wrote letters to Wisconsin, the fact remains that insurance companies' conduct, including the Plaintiff's, is regulated in New York, hence what they do in New York with New York consumers, whether that consists of sending a policy to New York or denying benefits, occurs in New York. The effect of their actions occurs in New York; accordingly the tort occurred in New York.

940 F. Supp. at 67.

## **9. How do you prove what the law is?**

You ask the court to take judicial notice of the other laws, and then you provide copies of the relevant authorities. Rule 202 provides:

A court upon its own motion may, or upon the motion of a party shall, take judicial notice of the constitutions, public statutes, rules, regulations, ordinances, court decisions, and common law of every other state, territory, or jurisdiction of the United States. A party requesting that judicial notice be taken of such matter shall furnish the court sufficient information to enable it properly to comply with the request, and shall give all parties such notice, if any, as the court may deem necessary, to enable all parties fairly to prepare to meet the request. A party is entitled upon timely request to an opportunity to be heard as to the propriety of taking judicial notice and the tenor of the matter noticed. In the absence of prior notification, the request may be made after judicial notice has been taken. Judicial notice of such matters may be taken at any stage of the proceeding. The court's determination shall be subject to review as a ruling on a question of law.

Tex. R. Evid. 202.

## **10. Is it a "false conflict"?**

Sometimes, even though two states may have contacts with the parties or issues, the issue is important to one state but not the other. This is called a "false conflict." In such a case, the law of the interested state will apply. *Duncan v. Cessna Aircraft Co.*, 665 S.W.2d 414, 422 (Tex. 1984).

*Duncan v. Cessna* illustrates the principle. The issue was whether a release would extend to release another party. Under New Mexico law, the defendant would be released; under Texas law it would not. The court reasoned that the New Mexico rule was intended to benefit New Mexico defendants, but there was no New Mexico defendant in the case. On the other hand, the Texas rule was intended to encourage settlements, and would be frustrated if Texas plaintiffs entering into to such an agreement in Texas could have their rights affected by New Mexico law. In short, failing to apply Texas law would frustrate an important Texas interest, whereas applying Texas law would not harm any New Mexico interest. This was a false conflict, so Texas law would apply.

Another "false conflict" case is *Ford Motor Co. v. Aguiniga*, 9 S.W.3d 252 (Tex. App.—San Antonio 1999, pet. denied). A Texan died in a crash in Mexico while driving an American car made in Michigan and sold in Louisiana. Mexican law would limit recovery. The court held that, even though the wreck occurred there, Mexico had no interest in the litigation, and Texas had a strong interest in protecting its citizens from defective products and providing compensation. Texas law applied. *Id.* at 260-61.

This principle may come up in insurance cases. Suppose, for example, that a New York insurer provides coverage to a Colorado company with sales representatives nationwide. If one

of the salesman commits tortious conduct in Texas, then arguably the laws of any of the three states may apply. What if the issue is which law applies to the insurer's failure to settle, and the laws of New York and Colorado would provide greater protection to the insured? New York has an interest in regulating its insurers in a consistent manner, and the insurer can't complain since that is its domicile. Colorado has an interest in protecting its citizens from unfair insurance practices. The insurer can't complain about application of Colorado law, since it chose to insure a Colorado business. Texas, on the other hand, has no interest in applying Texas law to give less protection to a Colorado insured against a New York insurer – even though the conduct occurred here. This is a false conflict as far as Texas is concerned, so the laws of one of the other states should apply.