COMMONWEALTH OF KENTUCKY
COURT OF APPEALS
CASE NO. 2017-CA-001252

CRYSTAL LEE MOSLEY, individually and as
Administratrix of the Estate of Rhett Lee Mosley, deceased
And RHETT MOSLEY, JR., a minor, by and through his
Mother and Next Friend, Crystal Lee Mosley — APPELLANTS

VS.

APPEAL FROM HARLAN CIRCUIT COURT
CIVIL ACTION NO. 11-CI-00349

ARCH SPECIALTY FIRE INSURANCE COMPANY and
NATIONAL UNION FIRE INSURANCE COMPANY — APPELLEES

BRIEF OF APPELLANT

This is to certify that an original and four copies of the Brief of Appellants was served by hand-delivering same to Hon. Samuel P. Givens, Jr., Clerk, Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601, and that true and accurate copies have been served by first-class mail to Hon. Jeffrey Thomas Burdette, Pulaski County Judicial Center, 50 Public Square, Somerset, KY 42501; Harlan Circuit Clerk, Justice Building, 129 South 1st St., Harlan, KY 40831; Mindy G. Barfield, Dinsmore & Shohl LLP, Lexington Financial Center, 250 W. Main St., Ste. 1400, Lexington, Kentucky 40507; Jeffrey R. Morgan, Jeffrey R. Morgan & Associates, PLLC, 850 Morton Blvd, Hazard 41701; Christopher S. Burnside, Christopher G. Johnson, Griffin Terry Sumner, Frost Brown Todd LLC, Ageon Center, Ste. 3200, 400 West Market St., Louisville, Kentucky 40202; Kenneth R. Friedman, Henry G. Jones, Friedman Rubin, 1126 Highland Avenue, Bremerton, WA 98337, on November 27, 2017.

This is to further certify that the Circuit Court record was checked out on October 3, 2017, and returned on October 12, 2017.

Respectfully submitted,
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STATEMENT OF POINTS AND AUTHORITIES

INTRODUCTION

This is an appeal from the trial court's summary dismissal of insurance bad faith allegations entered prior to Appellants having a meaningful opportunity to conduct discovery and while motions to compel discovery were pending. The Appellants' appeal, maintaining sufficient evidence of bad faith existed, includes significant evidence that the insurers failed to attempt a fair and equitable settlement after liability became reasonably clear.

STATEMENT CONCERNING ORAL ARGUMENT

Appellants defer to the judgment of the Court as to whether they believe oral argument would be helpful to their determination. Appellants do not request oral argument, as they believe the matters to be addressed involve straightforward application of established law.

I. STATEMENT OF THE CASE

A. Factual background of the underlying tort.

Prior to his death, Rhett Mosley resided in Yeaddiss, Kentucky, with his wife and young son.[1] Mosley worked for Regional Contracting, LLC, from September 2009 until his death on November 23, 2010, but had nearly six years of combined mining experience.[2] Terry Loving, the sole owner of Regional Contracting, described Rhett Mosley as one of his best employees, having a conscientious character with a high concern for safety.[3]

At the time of the accident, Mosley was working on mining operations at Rex 20 as a lube truck operator during the nightshift.[4] Rex 20 was permitted to Rex Coal, Inc., for mining, but Rex claims to have had no role in the active mining operations.[5] Allegedly, Jean Coal operated the mine for Rex Coal.[6] However, as Jean Coal had no employees, it worked with Regional Contracting to provide employees.[7] Terry Loving, the sole member of both Jean Coal and Regional Contracting, signed an agreement with himself to provide employees to the Rex 20 Mine site.[8] Adding yet another layer of complexity, the lube truck that Rhett Mosley operated was owned by another entity, Dixie Fuel.[9]

At 12:05 a.m. on November 23, 2010, Mosley was following instructions to bring the lube truck from the high-splint work area to the low-splint work area.[10] Traveling on the non-permanent haul road connecting the two work areas, the vehicle descended toward

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[1] *See* Complaint, Record on Appeal (hereinafter "ROA") 1-2.
[2] *See* ROA 7621.
[3] *See* deposition of Terry Loving, PP. 23-24, ROA at 1187-1188.
[4] *See* ROA 7621.
[5] *See* deposition of Terry Loving, ROA 1183-1185.
[6] *See* Contract Mining Agreement, Supplemental ROA (hereinafter "SROA"), Vol. 4, 299-321.
[7] *See* Contract Labor Agreement, SROA, Vol. 4, 322-330.
[8] *Id.* at 329-330.
[9] *See* deposition of Terry Loving, PP. 19-21, ROA 1183-1185.
[10] *See* MSHA Report of Accident, P. 2, ROA 7664.

the low-splint work area.[11] The truck was observed traveling at an extraordinary rate of speed, followed by a loud crashing sound.[12] Mosley was thrown from the vehicle and was found underneath the service bed of the truck, his body cut in half.[13] The coroner pronounced Mosley's death at 2:15 a.m.[14]

Rex Coal, the approved operator and permittee, was cited by MSHA for several violations of Federal regulations in connection with this mining accident.[15] No other entity was cited because Jean Coal was not a listed or approved operator on the permit.

The condition of the truck, particularly the brakes, played an integral role in Mosley's accident. MSHA found at least six defective conditions on the truck, including the brakes and seatbelt.[16] A year prior to Mosley's accident, MSHA cited Rex Coal for safety violations involving the subject truck on August 24, 2009, finding "the brake for the right front steering axle was not working . . . the right rear tandem brake was not working" and "the seat belt provided for the driver was not working."[17] The MSHA investigator's notes indicated that the defective conditions on August 24, 2009, "create[d] a possible crash scene. The lack of a seatbelt could contribute to the operator being thrown around in or out of cab in event of a crash."[18] Ultimately, it is not surprising that MSHA determined that several of the accident conditions were known prior to Mosley's death:

> During the investigation and interviews, the following defects affecting safety were revealed to exist on the truck, without recording or correcting the conditions:
> 1. Five of the six service brake chamber pushrod strokes for the truck exceeded the maximum allowable pushrod stroke adjustment limit.

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[11] *See* MSHA Report of Investigation, P. 2, ROA 7664.
[12] *Id.*
[13] *Id.*
[14] *See* MSHA Report of Investigation, P. 2, ROA 7664.
[15] *See* MSHA Report of Investigation, P. 8, ROA 7670.
[16] *See* MSHA Report of Investigation, PP. 4-5, ROA 7666-7667.
[17] *See* MSHA Citation dated 8/24/2009 and Citation Continuation dated 8/24/2009, ROA 7693-7694.
[18] *See* MSHA Investigator notes from August 24, 2009 (emphasis added), ROA 7696-7699.

2. Three of the four parking brakes were ineffective or compromised.
3. The operator seatbelt was improperly installed.
4. Both sections of the front windshield were cracked prior to the accident.[19]

Based on the aforementioned facts, the Appellants contend that the Defendants' liability was reasonably clear, particularly for Dixie Fuel, which (1) stipulated that there was no up-the-ladder immunity; and (2) owned the truck at issue.

B. Procedural history as to the violation of the UCSPA and conspiracy claims.

On November 23, 2010, Rhett Mosley lost his life in an accident stemming from the negligence of Rex Coal, Dixie Fuel, Jean Coal, and Terry Loving.[20] Jean Coal and Terry Loving were insured by Arch, while Dixie Fuel and Rex Coal were insured by National.[21] The underlying tort action against Arch's insureds settled on September 28, 2013,[22] for limits, leaving only the bad faith claims, while settlement with National's insureds was not accomplished until early August 2015.

The Appellants' claims of violation of the Kentucky Unfair Claims Settlement Practices Act and conspiracy arose from the Appellees' conduct throughout the pendency of the underlying action.[23] During the course of two mediations in 2013, the Appellees separately and in concert with one another attempted to leverage claims, insisting on globalized and unitemized negotiations with respect to all underlying tortfeasors, as opposed to negotiating the claims separately.[24] Most notably, during the second mediation

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[19] *See* MSHA Report of Investigation, P. 9, ROA 7671.
[20] *See* Complaint, ROA 1-7.
[21] *See* chart showing relationship among companies and identity of insurer, ROA 6829, attached hereto at **Appendix 3.** Dixie Fuel and Rex Coal were insured by National Union with Dixie Fuel being the named insured and Rex Coal being an additional insured. Jean Coal and Terry Loving were insured by Arch.
[22] *See* Motion to Enforce Settlement ROA 2123-2136.
[23] *See* Motion to Amend Complaint and Amended Complaint, ROA 2121-2122; 2315-2316; 6733-6742.
[24] *See* KRS 304.12-230(13).

conducted on September 12, 2013, one attorney, Tom Goodwin, was sent to negotiate on behalf of both insurance carriers and their insureds. During mediation, Attorney Goodwin would not negotiate the claims separately and explicitly refused to allow the Plaintiffs to accept a previous offer of $1,000,000 from Arch unless the Appellants also accepted a reduced sum from National to resolve all claims.[25]

Accordingly, on September 29, 2013, the Appellants moved to amend their Complaint to add Arch and National, asserting claims of violation of the Kentucky Unfair Claims Settlement Practices Act (hereinafter "KUCSPA") and civil conspiracy.[26] In response, both Appellees argued that the Appellants' claims were futile and would not be able to withstand a motion to dismiss.[27] This line of argument by the Appellees turned their responses into *de facto* motions to dismiss. In turn, these dispositive issues were fully briefed by both Arch and National, and both parties were present at oral arguments on the matter. Ultimately, the trial court disagreed with Appellees' assertions that the bad faith claims were futile, and the Appellants' Amended Complaint was deemed filed. Discovery on these claims was stayed pending the resolution of the underlying tort action.

When the tort claim was settled, the Appellants propounded discovery upon Arch and National on August 20, 2015, and August 21, 2015, respectively.[28] During the week of September 14, 2015, Appellants' counsel made multiple attempts to communicate with the Appellees to remind them of their upcoming deadline to respond to discovery. Both of

[25] *See* correspondence, ROA 7704.
[26] *See* Plaintiffs' Motion for Leave to Amend, ROA 2121-2122; *See also* Plaintiffs' Reply, ROA 2260-2302.
[27] *See* Arch's Response, ROA 2137-2185; *See also* National's Response, ROA 2186-2209.
[28] *See* ROA 6154-6186; 6187-6217.

Appellees' counsel were unresponsive. In lieu of answering discovery, Appellees filed Motions for Judgment on the Pleadings and Motions to Stay Discovery in the interim.[29]

With no discovery of Appellees being completed, the trial court granted Arch's Motion for Judgment on the Pleadings, finding:

> ... that, even if the facts as alleged in the Amended Complaint are true as it relates to Arch's alleged acts or omissions, this conduct is legally insufficient to maintain the Plaintiff's claims for bad faith, violation of KRS 304.12-230 and KRS 304.12-235, civil conspiracy, and punitive damages.[30]

The Court denied National Union's Motion for Judgment on the Pleadings. Appellants cooperated with National Union's request to depose Attorney Jeff Morgan, who was Appellants' lead counsel in the tort action. However, during that same time, National Union continued to refuse to provide complete answers to Appellants' discovery requests and objected to their subpoenas for materials, forcing Appellants to file a Motion to Compel.[31] While the Motion to Compel was pending and prior to being heard by the trial court, National Union renewed its dispositive motion.[32] After the extensive briefing was completed, a hearing was held on June 16, 2017, in which the trial court acknowledged he had not read the briefs and asked each counsel to submit a detailed order for him.[33] Appellants filed a Declaration on June 9, 2017, in conjunction with their response, listing the documentation needed to respond to the dispositive motion.[34] However, the trial court granted National Union's Motion for Summary Judgment without addressing Appellants' outstanding discovery requests.

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[29] *See* ROA 6364-6389; 6390-6391; 6394-6559; 6560-6618.
[30] *See* Order of March 30, 2016, ROA 6873-6874.
[31] *See* Motion to Compel of March 14, 2017, ROA 6912-7018.
[32] *See* Motion and Memorandum in Support of Summary Judgment dated April 20, 2017, ROA 7166-7556.
[33] *See* ROA 7770.
[34] *See* Friedman Declaration of June 2, 2017, ROA 7644-7769. Interestingly, in response to Appellants' Motion for Trial Date, Appellee, National Union, argued too much insurance discovery to be completed within a year. *See* ROA 7641-7643.

II. ARGUMENT

The issue presently before this Court is not whether Appellants' claims against Appellees will ultimately succeed, but whether Appellants are entitled to answers to basic written discovery before having their claim summarily dismissed. In the case of Appellee Arch and its successful Motion for Judgment on the Pleadings, the matter for review is quite narrow – based on Appellants' Amended Complaint, if all allegations as alleged are true – did Appellants plead a recognized cause of action? In the case of Appellee National Union and its successful Motion for Summary Judgment, the issue at hand is simply whether there are any genuine issues of material fact as to the claims asserted by Appellants. In both instances, the answer is in the affirmative: Appellants successfully pled an action under the KUCSPA and for civil conspiracy, and material questions of fact remain concerning the actions of Appellees.

A. Standard on Review.

Appellee Arch Specialty Company was granted a judgment on the pleadings. Under CR 12.03, a judgment based on a motion for judgment on the pleadings is reserved for those cases in which the pleadings demonstrate that one party is conclusively entitled to judgment. *KentuckyOne Health, Inc. v. Reid,* 522 S.W.3d 193, 194 (Ky. 2017). When a party moves for a judgment on the pleadings, he admits for the purposes of his motion not only the truth of all his adversary's well-pled allegations of fact and fair inferences therefrom, but also the untruth of all his own allegations which have been denied by his adversary. *Archer v. Citizens Fidelity Bank & Trust Co.,* Ky., 365 S.W.2d 727 (1963); and *City of Pioneer Village v. Bullitt County ex rel. Bullitt Fiscal Court,* 104 S.W.3d 757, 759 (Ky. 2003). The standard on review on appeal of a judgment on the pleadings is *de novo.*

Appellee National Union was granted summary judgment. The standard of review on appeal of summary judgment is whether the trial court correctly found there are no genuine issues of material fact and if the moving party is entitled to judgment as a matter of law. *Hammons v. Hammons,* 327 S.W.3d 444, 448 (Ky.2010); CR 56.03. The record must be viewed in a light most favorable to the nonmoving party and all reasonable doubts must be resolved in that party's favor. *Steelvest, Inc. v. Scansteel Serv. Ctr., Inc.,* 807 S.W.2d 476, 480 (Ky.1991). The Kentucky Supreme Court has further cautioned:

> Furthermore, with our recommitment to a very stringent standard for summary judgment in *Steelvest* and the rejection of the much more lenient federal standard, we expressed our support for a policy that summary judgment is not to be used as a defense mechanism. Instead, summary judgment is to be cautiously employed for cases where there is no legitimate claim under the law and it would be impossible to assert one given the facts. Legitimate claims should be allowed to proceed to a jury. And we should not fear jury determinations.

Shelton v. Kentucky Easter Seals Soc., Inc., 413 S.W.3d 901, 916–17 (Ky. 2013), *as corrected* (Nov. 25, 2013) (internal citations omitted). A trial court's determination that a sufficient amount of time has passed for discovery is reviewed for abuse of discretion. *See Blankenship v. Collier* 302 SW3d 665, 668 (Ky. 2010).

Whether an insurance company acts in bad faith is a question of fact for the jury. *Hamilton Mut. Ins. Co. of Cincinnati v. Buttery,* 220 S.W.3d 287, 293 (Ky. App. 2007) (citing *Farmland Mut. Ins. Co. v. Johnson,* 36 S.W.3d 368, 376 (Ky. 2000)). Kentucky courts have consistently stated that if there is evidence of suspect claim handling, "[t]he issue of whether or not there was a violation of the UCSPA needs to be argued before a trier of fact during a trial." *Dailey v. American Growers,* 103 S.W.3d 60, 66 (Ky. 2003). In *Curry v. Fireman's Fund Ins. Co.,* 784 S.W.2d 176, 178 (Ky. 1989), the Kentucky Supreme Court recognized that bad faith liability may lie even if a claim is debatable on the law or

facts. Insurers still must conduct adequate investigations, act reasonably in making settlement offers, and promptly pay those claims that they legitimately owe. *Farmland,* 36 S.W.3d at 376. If "[t]he manner in which [National Union] adjusted [Mosley's] claim is valid point of contention between the parties," then it should be "put before a trier of facts." *Dailey,* 103 S.W.3d at 66.

B. Appellants were entitled to have the outstanding discovery issues addressed before dispositive motions were heard.[35]

In the present matter, Appellants were thwarted in their efforts to conduct the discovery of Appellees by their motion practice. At the time the Court ruled on both dispositive motions, basic discovery was still outstanding. In the case of Arch, despite answers to discovery being overdue and a Motion to Compel being outstanding, it filed its Motion for Judgment on the Pleadings. As to National Union, discovery was answered. However, the majority of its answers were objections, with 4,534 pages of documents, including the entirety of the claims file, withheld based on privilege, despite the entry of an Agreed Protective Order.[36] A Motion to Compel the documents was pending at the time the Motion for Summary Judgment was heard.[37]

In the Order granting National Union's Motion for Summary Judgment, the trial court inexplicably states that "Plaintiffs' opportunity to conduct discovery regarding liability in the underlying case began on June 7, 2011, when they filed their initial Complaint."[38] Said statement belies the basic fact that Appellants did not amend their Complaint to assert claims of violation of the KUCSPA and civil conspiracy until

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[35] Preserved for appeal at ROA 6699-6864; 6218-6363; 6912-7018; 7615-7640; 7644-7769.
[36] *See* ROA 6218-6232; 6875-6879; 7035-7165.
[37] *See* ROA 6912-7018.
[38] *See* ROA 7856-7874.

November 14, 2013, with all discovery concerning the claims stayed pending the resolution of the underlying tort claim.[39] Discovery was propounded on Appellees on August 24, 2015.[40] A Motion to Compel Appellees' answers to discovery was filed on September 23, 2015, and the next day Appellees filed motions for judgment on the pleadings and sought to extend the stay on discovery.[41] The Motions were not addressed by the Court until February 3, 2016.[42] At that time and without Appellants ever receiving any discovery response from Arch, the action was dismissed on the pleadings.[43] National Union's Motion was overruled and it was ordered to answer the discovery propounded to it.[44]

During this time, it is important to note the transfer of this matter between multiple judges, the necessity of which caused significant delay in getting hearing dates for the pending Motions.[45] Such delay was of no fault of the Appellants and should not be used as a penalty against them as they were prevented from proceeding with discovery while awaiting hearing on their Motion.

(1) National Union's Motion for Summary Judgment.

At the time of National Union's Motion for Summary Judgment, Appellants had filed a Motion to Compel seeking to compel National Union to more fully answer the written discovery propounded to it and to provide the withheld 4,534 pages to Appellants or to the trial court for an *in camera* review.[46] The Motion to Compel had been pending for over a month before National Union filed its Motion for Summary Judgment.[47]

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[39] *See* ROA 2121-2122; 2315-2317.
[40] *See* 6154-6186; 6187-6217.
[41] *See* ROA 6218-6363; 6364-6389; 6390-6391; 6394-6559; 6560-6618; 6619-6620.
[42] *See* ROA 6869; 6870-6872.
[43] *See* ROA 6870-6872.
[44] *Id.*
[45] *See* Special Judge Assignment, ROA 6627-6628.
[46] *See* ROA 6912-7018.
[47] *See* ROA 6912-7018; 7021-7165.

Additionally, Appellants sought via subpoena duces tecum the file of underlying defense counsel, to which National Union objected.[48] Neither the objection nor the Motion to Compel were addressed by the trial court prior to its Order granting National Union's Motion for Summary Judgment.

The Kentucky Court of Appeals in an unpublished opinion recently overturned a grant of summary judgment when there were outstanding discovery issues, finding:

> A defendant should not be able to escape its obligation to answer discovery requests that have already been propounded by the plaintiff by moving for summary judgment. If the defendant believes he or she should not have to answer, a motion for protective order is the appropriate remedy. In the absence of a protective order, Nelson was entitled to have the trial court consider her motion to compel before taking up summary judgment. This is especially so where there was no pretrial order in place that required Nelson to complete discovery by any specific date.

Nelson v. Jefferson County Board of Education, 2015-CA-000467-MR, 2017 WL 464797, at *2 (Ky. App. Feb. 3, 2017).

Appellants, in their response to National Union's Motion for Summary Judgment set forth the items of discovery they required in order to respond to the Motion and provided a declaration from counsel in support of the necessity of the same as required by Rule. The trial court completely ignored the discovery dispute in its Order dismissing Appellants' claims. The trial court's Order found that Appellants had failed to produce evidence to show that a material fact exists despite Appellants' declaration stating what discovery was needed to fully respond to the dispositive motion. Appellants were denied access to the very evidence cited by the trial court as necessary to prove their claim. The discovery sought by the Appellants has been recognized by Kentucky's courts as discoverable and relevant to a claim of violation of the KUCSPA. *See Grange Mut. Ins. Co. v. Trude,* 151

[48] *See* ROA 6896-6902; 6903-6904.

S.W.3d 803 (Ky. 2004). The documents to which National Union asserts privilege have not yet been reviewed *in camera* to determine if the privilege claimed is even applicable. Kentucky has recognized the strict requirements of the privileges asserted by National Union. As expressed in KRE 503, "[p]rivileges are generally disfavored and should be strictly construed." *Foster v. American Fire and Casualty Company,* 5:13-CV-426-GFVT-REW, 2016 WL 8135350, at *4 (E.D. Ky. Apr. 1, 2016) citing *Collins v. Braden*, 384 S.W.3d 154 at 159.

"Whether a summary judgment was prematurely granted must be determined within the context of the individual case." *Suter v. Mazyck,* 226 S.W.3d 837, 842 (Ky. App. 2007). While there is no exact limitation on the time parties have to complete discovery absent a pretrial order, for the sake of judicial efficiency, this time is not indefinite. *Id.* at 844. On appeal, if the issue of failure to allow for discovery is raised, "a reviewing court must ... consider whether the trial court gave the party opposing the motion an ample opportunity to respond and complete discovery before the court entered its ruling." *Blankenship v. Collier,* 302 S.W.3d 665, 668 (Ky. 2010).

In this case, summary judgment should not have been granted without a full opportunity to ascertain evidence of the insurer's state of mind. For example, conduct that might appear reasonable if an attorney is advising the company that the claim is defensible might appear a whole lot less reasonable if the claim file reveals actual knowledge that liability was reasonably clear and efforts were only being made to delay payment in an effort to force a lower settlement. The bad faith inquiry essentially probes whether, "in the investigation, evaluation, and processing of the claim, the insurer acted unreasonably and either knew or was conscious of the fact that its conduct was unreasonable." *Phelps v. State*

Farm Mut. Auto. Ins. Co., 680 F.3d 725, 732 (6th Cir. 2012) (internal quotation marks omitted). That inquiry requires discovery.

(2) Arch's Motion for Judgment on the Pleadings.

Appellants' Amended Complaint states a cognizable cause of action with admissible supporting evidence of the same which, under Kentucky law, is enough to survive a motion for judgment on the pleadings. As recently noted by the Kentucky Supreme Court in reviewing a grant of a judgment on the pleadings:

> Under CR 8.01(1), a complaint merely needs to contain "(a) a short and plain statement of the claim showing that the pleader is entitled to relief and (b) a demand for judgment for the relief to which he deems himself entitled." This rule does not require a claim to be stated "with technical precision ... as long as a complaint gives a defendant fair notice and identifies the claim." *Grand Aerie Fraternal Order of Eagles v. Carneyhan*, 169 S.W.3d 840, 844 (Ky. 2005) (citing *Cincinnati Newport & Covington Transp. Co. v. Fischer,* 357 S.W.2d 870, 872 (Ky. 1962)).)). In this case, Reid's complaint, although couched in general and conclusory terms, complied with CR 8.01(1).
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> In response to Reid's complaint, the Hospital filed an answer generally in conformity with CR 8.02, in that it stated in "short and plain terms [its] defenses to each claim asserted and ... admit[ted] or den[ied] the averments upon which the adverse party relie[d]."
>
> Based on this complaint and answer, we fail to perceive that either party would have been entitled to judgment on the pleadings, within the formulation set out in *City of Pioneer Village*, for the simple reason that neither complaint or answer contain sufficient "well-pleaded allegations of fact" by which either could be gauged.[4] Once the parties undertook their motion practice before the trial court, they added detail which had been omitted from the pleadings: committee meeting dates, letters, conversations between Monarch and Reid, phone calls from a nurse supervisor, impracticality for Reid to procure the services of a proctor. Under CR 12.03, once "matters outside the pleadings are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided for in Rule 56."
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> Our further review of the record is that summary judgment at this very preliminary stage of the proceedings was inappropriate. The parties seem to have a very real dispute as to the events leading up to and culminating in the conversation between Reid and Monarch on or about February 27, 2013.

KentuckyOne Health, Inc. v. Reid, 522 S.W.3d 193, 197–98 (Ky. 2017).

In the present action before this Court, the Plaintiff sufficiently pled the elements of violation of the Kentucky Unfair Claims Settlement Practices Act and civil conspiracy which Appellee Arch denied in short and plain terms. However as in *KentuckyOne Health*, there remains very real dispute as to the conduct of Arch in its handling and negotiation of the subject claim, which is enough to withstand a motion for judgment on the pleadings.

C. Appellants can satisfy the elements of bad faith under Kentucky Law.[49]

Both Orders issued by the trial court found that Appellants did not satisfy the *Wittmer v. Jones,* 864 S.W.2d 885 (Ky. 1993), elements for a bad faith claim under the KUCSPA. However, the Appellees' arguments, which were adopted wholesale by the trial court, distort the meaning of the elements as interpreted by Kentucky's courts.

(1) The obligation to pay.

The trial court found, in its Order granting summary judgment to National Union, that "National Union's duty to pay Plaintiffs' claim was in dispute and Plaintiffs cannot satisfy even the first element of *Wittmer*."[50] Both the trial court and Appellees misconstrue the first element under *Wittmer*, "the insurer must be obligated to pay the claim under the terms of the policy." *Id.* at 890. Both Appellees argued in their respective dispositive motions that their indemnity provisions are not triggered unless and until their insureds become legally obligated to pay damages to a claimant. However, the "obligation to pay" refers to whether an obligation to pay exists under the language of the insurance policy at issue, as recognized by the Kentucky Supreme Court in *Kentucky Nat. Ins. Co. v. Shaffer,* 155 S.W.3d 738, 742 (Ky. App. 2004*), as modified* (Feb. 4, 2005). The United States District Court for the Eastern District of Kentucky summarized the evolution of the

[49] Preserved for appeal at ROA 7615-7640; 7644-7769.
[50] *See* Order, P. 6, ROA 7862.

obligation to pay in *Tennant v. Allstate Ins. Co.,* CIV.A. 04-54, 2006 WL 319046, at *7–8 (E.D. Ky. Feb. 10, 2006):

> Here, however, there has been no determination that Allstate was not contractually obligated to pay the Tennants' claim. Instead, there has only been a determination that any claim that Allstate breached its express contractual obligation to pay for the Tennants' loss is time-barred pursuant to *Smith.*
>
> In *Davidson,* the plaintiffs asserted a bad faith claim against the defendant who was not the insurance company and had not entered into any contract at all with the plaintiffs. *Id.* at 100. Thus, it was clear that the defendant never had any contractual obligation to pay the plaintiffs and the Kentucky Supreme Court ruled that any bad faith claim against the defendant must therefore fail. *Id.* at 102.
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> More recently, in *Kentucky National Insurance Co. v. Shaffer,* 155 S.W.3d 738 (Ky.App.2004), the plaintiffs asserted a bad faith claim against an insurance company and, as the Court of Appeals expressly noted, "all parties and experts in this matter agree that an exclusion applied" in the insurance policy and that "there was never any actual coverage under the policy" for the automobile accident at issue. *Id.* at 741.
>
> Thus, in *Davidson* and *Kentucky National,* it would have been impossible for the plaintiffs to establish the first element of a bad faith claim: that the insurer was obligated to pay the claim under the terms of the policy. *Davidson,* 25 S.W.3d at 100. Here, in contrast, there is an insurance policy and there has been no finding that Allstate was not obligated to pay the Tennants' claim under the express provisions of the policy. A finding that the claim is now time barred does not preclude the Tennants from arguing that Allstate indeed 1) had an obligation to pay the claims under the terms of the policy; 2) denied the claim without a reasonable basis; and 3) either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed. *Davidson,* 25 S.W.3d at 100. *See The Frog, Switch & Manufacturing Co. v. The Travelers Insurance Co.,* 193 F.3d 742, 751 n. 9 (3rd Cir.1999).

Kentucky's courts have maintained that position most recently in the Kentucky Supreme Court Decision in *Indiana Ins. Co v. Demetre*, 527 S.W.3d 12 (Ky. 2017):

> Indiana Insurance misconstrues the holding and reasoning of *Philadelphia Indemnity* by suggesting that it stands for the proposition that an insurer can raise coverage disputes without opening itself to a bad faith claim. On the contrary, *Philadelphia Indemnity* indicates that whether bad faith liability exists is predicated on the reasonableness of the insurer's conduct—namely was there a "genuine dispute" as to the pertinent facts or law. *Id.* at 650 (citing *Empire Fire,* 880 S.W.2d at 889-90). In particular, "a bad faith claim is precluded as a matter of law as long as there is room for reasonable

> disagreement as to the proper outcome of a contested legal issue," but where the insurer's coverage obligation is not fairly debatable seeking to avoid coverage through a declaratory judgment claim can expose the insurer to a bad faith claim. *Id.*

It was established that National Union was obligated to pay the claim as against Dixie Fuel under the terms of the policy issued to Dixie Fuel on or before March 28, 2013, when it stipulated that there was no up-the-ladder workers' compensation immunity for Dixie Fuel and that Dixie Fuel owned the truck at issue. As to Arch, despite its insistence that coverage was not owed under the policy, Arch never filed a declaratory judgment action to determine the same. Regardless, a jury issue as to the claim of coverage does not preclude a claim for bad faith. In *Phelps v. State Farm Mut. Auto. Ins. Co.,* 736 F.3d 697, 704 (6th Cir. 2012), the Sixth Circuit found that a district court's grant of summary judgment to an insurer in a bad faith action was improper based on its review of Kentucky case law:

> The Kentucky Supreme Court revisited the definition of "fairly debatable" in *Farmland Mutual,* which clarified that "*Empire Fire* does not stand for the proposition ... that a disputed factual matter requires dismissal of a bad faith claim as a matter of law" and explained that "the existence of jury issues on the [underlying] contract claim does not preclude the bad faith claim." *Farmland Mut.,* 36 S.W.3d at 375. It distinguished *Empire Fire* as a case involving unresolved legal questions about the insurer's liability. *Id. Farmland Mutual* then held that "although elements of a claim may be 'fairly debatable,' an insurer must debate the matter fairly" and "still is obligated under the KUCSPA to investigate, negotiate, and attempt to settle the claim in a fair and reasonable manner." *Id.* Whether a claim may be considered "fairly debatable" is a question of fact for the jury. *Id.* at 376.

Phelps v. State Farm Mut. Auto. Ins. Co., 736 F.3d 697, 704 (6th Cir. 2012).

As the *Phelps* and *Farmland Mutual* courts recognized, Appellees' assertion of a question as to coverage does not preclude a claim of bad faith and presents a question of fact for a jury to decide.

(2) Whether liability is fairly debatable.

The Court also relies on *Wittmer* for the false contention that a bad faith action can never proceed where liability is fairly debatable. However, the Kentucky Supreme Court dispelled this myth in *Farmland Mut. Ins. Co. v. Johnson,* 36 S.W.3d 368 (Ky. 2000), stating that the existence of jury issues in an underlying case does not preclude bad faith. The court elaborated, providing clarification on the concept of liability being reasonably clear or fairly debatable:

> Although matters regarding investigation and payment of a claim may be 'fairly debatable,' an insurer is not thereby relieved from its duty to comply with the mandates of the KUCSPA. Although there may be differing opinions as to the value of the loss and as to the merits of replacing or repairing the damaged structure, an insurance company still is obligated under the KUCSPA to investigate, negotiate, and attempt to settle the claim in a fair and reasonable manner. In other words, although elements of a claim may be 'fairly debatable,' an insurer must debate the matter fairly.

Id. at 375.

Wittmer itself belies the Appellees' contention regarding the disputed or debated nature of claims. In *Wittmer*, the Court stated:

> Wittmer sued Jones in tort, alleging property damage to her automobile and, in the same Complaint, sued State Farm charging violation of the UCSPA, demanding damages sustained by reason of such violation, plus prejudgment interest, attorney's fees and court costs.

Wittmer, 864 S.W.2d at 887.

Not only did the Kentucky Supreme Court condone a tort claim and a bad faith claim proceeding simultaneously in the same action, it also noted that the liability issue was hotly contested. In fact, the court specifically noted that there was "...sufficient evidence of negligence to apportion fault against Wittmer." Therefore, *Wittmer* specifically recognizes that the spectre of bad faith can arise before any judgment is entered and

notwithstanding the fact that the parties to the litigation contest liability and allege comparative fault.

The recent *Hollaway v. Direct Gen. Ins. Co. of Mississippi, Inc.*, 497 S.W.3d 733 (Ky. 2016), decision does not compel a contrary result. In that third-party case, the plaintiff could not establish that the insurance company should have necessarily concluded that any of her damages were caused by the accident. *Id* at 739. The *Hollaway* court held that there was no bad faith liability because the insurer's duty to pay the claim was not "clearly established" by the plaintiff. *Id.* There was a real possibility that the insurer owed nothing to the plaintiff based on the nature of the accident and the injuries of which she complained. In contrast, in this action there is no dispute the accident caused the death of Mr. Mosley, and there can be no dispute that Appellees had an obligation to pay something for his death. The only "dispute" was over the amount of damages. Such a dispute does not negate the possibility of bad faith liability, nor does it remove the obligation of insurance companies in Kentucky from the requirements of the KUCSPA. There can be a dispute in every case over the exact amount of a "reasonable" settlement, but that does not relieve a company from making a good faith effort to reach one.

(3) Third requirement of *Wittmer*.

As to the third requirement of *Wittmer* that "the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed" (*Id.* at 890), the failure to allow Appellants to conduct discovery as to the claims file and related discoverable documentation prevents a full presentation of this element. Appellants allege that the settlement conduct of the Appellees rises to the level of reckless disregard. However, to fully flesh out and support its argument, Appellees need to

depose claims personnel and further need access to the claims file materials, both of which they were denied access to prior to the trial court's rendering of its judgment. As indicated by the Sixth Circuit Court of Appeals, in reviewing the case law from Kentucky's appellate courts, there are numerous factors to be considered when evaluating the third prong of *Wittmer*:

> Moreover, based on the facts pleaded by Pedicini, a reasonable jury could conclude that the third element of the bad-faith test is satisfied: that LICOA acted knowingly or in reckless disregard of the lack of legal basis for its interpretation. LICOA did not alter its benefit-payment practices in an open and transparent manner. Those currently receiving benefits learned of the change only upon receiving a decreased benefit payment after the change came into effect, and other policyholders not yet qualifying for the receipt of benefits, like Pedicini, did not learn of the change until years later when they became ill and eligible to receive benefits. As a result of the change, LICOA was able to transform its profitability from a loss of over two million dollars in calendar year 2000 to a profit of approximately one million and seven hundred thousand dollars in calendar year 2001. From these facts a reasonable jury could conclude that LICOA acted in bad faith by concealing changes in its benefit-payment practices to avoid the loss of premium payments essential to its profitability in calendar year 2001. The Kentucky Supreme Court has found summary judgment on a bad-faith claim improper amidst similar allegations of deceit in furtherance of pecuniary gain. *See Johnson,* 36 S.W.3d at 372, 375 (denying summary judgment on bad-faith claim where insurer allegedly conspired with appraisers to undervalue policyholder's claim); *see also Zilisch v. State Farm Mut. Auto. Ins. Co.,* 196 Ariz. 234, 995 P.2d 276 (2000) (en banc) (denying summary judgment in favor of insurer where insurer allegedly refused to negotiate a reasonable settlement with insured, who ended up receiving an arbitration award more than six times greater than that offered by the insurer).

Pedicini v. Life Ins. Co. of Alabama, 682 F.3d 522, 529–30 (6th Cir. 2012). *See also Shepherd v. Unumprovident Corp.,* 381 F. Supp. 2d 608, 614 (E.D. Ky. 2005).

In the present action, Appellants have been denied the opportunity to review the claims documentation regarding the claim and to question the Appellees concerning their handling of the claim in order to fully counter the Appellees' arguments. Again, the issue before this Court is not whether Appellants will ultimately be successful in their claims --

it is whether the Appellants have stated a claim and/or created a genuine issue of material fact with regard to the allegations plead.

D. The conduct of Arch and National Union in settlement negotiations can be used as evidence to support Appellants' claims. [51]

(1) Mediation can be introduced to support a claim of bad faith.

In both of their respective dispositive Motions, Arch and National Union argue that the settlement conduct cited to by the Appellants in their Amended Complaint cannot form the basis of a claim for bad faith and violation of KUCSPA, which the trial court wholeheartedly adopted. However, the position taken by the trial court and advocated by Appellees conflates mediation with that of settlement conduct.

The KUCSPA cites that "[f]ailing to promptly settle claims, where liability has become reasonably clear, under one (1) portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage" is specific evidence of bad faith. KRS 304.12-230 (13). Kentucky's courts have specifically held that evidence of an insurer's settlement behavior *throughout* the litigation may be examined and presented in order to establish an insurer's bad faith. *Hamilton Mut. Ins. Co. of Cincinnati v. Buttery,* 220 S.W.3d 287, 294 (Ky. App. 2007), citing *Knotts v. Zurich Ins. Co.,* 197 S.W.3d 512 (Ky. 2006) (emphasis added). Under the reasoning advanced by the Appellees, the protections offered by the KUCSPA would be rendered impotent. Appellants did not seek to introduce statements as to liability made by counsel or the mediator during the mediation, nor did they introduce the back and forth of the settlement numbers. Appellants sought to introduce via correspondence occurring outside of the mediation specific settlement conduct that violated the KUCSPA. Appellees are arguing

[51] Preserved for appeal at ROA 7615-7640; 6699-6864.

for an absolute cloak of secrecy over the mediation process which, if granted, would give insurers carte blanche to insist on whatever terms they desire during "settlement" without fear of consequence.

Furthermore, this cloak of secrecy is not counseled for in either the Model Mediation Rules or KRE Rule 408. Model Mediation Rule 12, Confidentiality, simply recognizes that mediation is closed to all persons outside of the litigation, is regarded as settlement negotiations for purposes of KRE 408, and that mediators shall not be subject to process requiring the disclosure of any matter discussed during mediation, none of which are applicable in the present action. Kentucky Rule of Evidence 408 is not a blanket prohibition on the use of mediation statements but, rather, it prohibits the use of evidence of "accepting or offering or promising to accept a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount." In the present matter, Appellants seek to introduce the mediation conduct of Appellees to show that the conduct in question constituted a clear breach of the KUCSPA, not to assert the value of the claim. Additionally, KRE 408 "does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations." Again, this exclusion applies to the present matter before this Court. There are numerous appellate cases in which settlement conduct was introduced during the course of trial. *See Hamilton Mut. Ins. Co. of Cincinnati, Ohio v. Barnett,* 2007-CA-000029-MR, 2008 WL 3162321, at *6 (Ky. App. Aug. 8, 2008) (unpublished), and *Hamilton Mut. Ins. Co. of Cincinnati v. Buttery,* 200 S.W.3d 287 (Ky. 2007).

Specifically, in *Hale General Contracting, Inc. v. Motorist Mutual Insurance Company,* 2015-CA-000396-MR, 2016 WL 1068997, at *2–3 (Ky. App. Mar. 18, 2016), *review denied* (Sept. 15, 2016), this Court recognized that mediation conduct could be introduced in bad faith actions "for another purpose." In *Hale*, the insurer, Motorist Mutual, actually sought to introduce evidence of its mediation offers to Hale to prove that they were not engaging in outrageous conduct:

> As to Hale's first argument, Motorist did not introduce evidence of its settlement negotiations with Hale to prove either its liability for or the invalidity of Hale's UM/UIM claim or its amount. KRE 408 prohibits such a use for this type of evidence. Moreover, doing so would have been pointless because the prior jury verdict following the September 2012 trial (which Motorist never appealed) had already resolved the matter of Motorist's liability.
>
> Instead, it is readily apparent from the record that Motorist introduced this evidence for "another purpose" that the language of KRE 408 does not prohibit. Specifically, Motorist used this evidence to establish that any failure on its part to offer a settlement with Hale between the January 10, 2012 mediation and September, 2012 trial did not injure Hale in any cognizable way. It demonstrated (1) all of Hale's multiple settlement demands, which ranged between $1.3 million and $400,000, were well in excess of what he eventually recovered in his UM/UIM judgment; and (2) Hale admitted, over the course of his deposition testimony, that he never would have settled for the amount he was awarded in his UM/UIM judgment.
>
> Motorists also points out in its brief that the tort of bad faith can warrant punitive damages and requires proof that an insurer engaged in outrageous conduct due to an evil motive or reckless indifference. ***How a jury can be expected to determine whether the insurer's settlement conduct was outrageous without knowing something of its negotiations with the insured is, as Motorists notes, a mystery.*** The circuit court accordingly did not violate KRE 408 by admitting this evidence, and *Hale* cites no rule of law that otherwise would have excluded it.

Hale General Contracting, Inc. v. Motorist Mutual Insurance Company, 2015-CA-000396-MR, 2016 WL 1068997, at *2–3 (Ky. App. Mar. 18, 2016), *review denied* (Sept. 15, 2016). (emphasis added)

As in *Hale*, the purpose for which Appellants seek to introduce the mediation conduct is "for another purpose" namely to show that the conduct that occurred during the

same was in violation of the KUCSPA. Therefore, said conduct is admissible as a foundation for a claim of bad faith against the Appellees.

(2) The mediation conduct of Appellees is a violation of the KUCSPA.

The mediation conduct of Appellees as alleged by the Appellants is a violation of the KUCSPA. Appellees attempt to distract the issue by arguing that they must defend their respective insureds and insist upon a release, but that was not the issue with their conduct. National Union and Arch refused to negotiate the respective claims against their insureds separately – *i.e.,* Appellants could not settle with Arch's insureds without also settling with National Union's insureds. This is patent claims leveraging. Additionally, as each insurer insured multiple entities, the refusal of Arch and National Union to settle the claims against each insured individually is also clear claims leveraging. This is especially true considering the admissions made on behalf of Dixie Fuel as to its liability outside of mediation. This behavior has been recognized by the Supreme Court of Montana to be claims leveraging:

> We also conclude that the leveraging of undisputed claims in order to settle disputed claims is exactly what the Montana Legislature sought to prohibit when it enacted § 33–18–201(13), MCA, of the Unfair Claims Practices Act.

Ridley v. Guaranty Nat. Ins. Co., 286 Mont. 325, 336, 951 P.2d 987, 993 (1997), *as modified on denial of reh'g* (Jan. 30, 1998).

With the actions of Appellees admissible, the question is for a jury to determine whether the claims leveraging behavior constituted a violation of the KUCSPA.

Appellees try to skirt the issue by impugning the motivations of Appellants' counsel for their desire to have itemized, individual settlements. However, the Massachusetts Court of Appeals recognized that irrespective of counsel's tactics insurers have a duty to respond to a demand:

> In any event, we note that Attorney Christian's alleged tactics did not, as a matter of law, relieve Arbella of its duty to respond to a demand when liability was clear and damages exceeded the policy limits. Where liability has become reasonably clear, we have recognized that, consistent with the purpose of G.L. c. 176D, § 3(9), to protect claimants and encourage settlements, "[a]n insurer's statutory duty to make a prompt and fair settlement offer does not depend on the willingness of a claimant to accept such an offer." *Hopkins v. Liberty Mut. Ins. Co.,* 434 Mass. at 567, 750 N.E.2d 943, citing *Metropolitan Property & Cas. Ins. Co. v. Choukas,* 47 Mass.App.Ct. 196, 200, 711 N.E.2d 933 (1999), overruled on other grounds by *Murphy v. National Union Fire Ins. Co.,* 438 Mass. 529, 533 n. 7, 781 N.E.2d 1232 (2003).
>
> In *Choukas,* although the insured's liability was "reasonably clear," the insurer failed to tender a settlement offer, defending its failure by pointing out that the claimant's attorney would have rejected it. We held that a claimant's conduct is not relevant to the insurer's duty ("In these circumstances, [the claimant's] attorney's settlement tactics did not relieve [the insurance company] of its statutory duty to attempt to effectuate a prompt, fair settlement of [the] claim and therefore tender an offer to reach that goal"). 47 Mass.App.Ct. at 200, 711 N.E.2d 933.

Gore v. Arbella Mut. Ins. Co., 77 Mass. App. Ct. 518, 529, 932 N.E.2d 837, 847–48 (2010).

E. The mediation conduct of Appellees can support a claim of civil conspiracy.[52]

The trial court's 17-page Order granting National Union's summary judgment failed to address the Appellants' claims of civil conspiracy and the supporting allegations as pled, despite dismissing their claims in their entirety. However, Appellants' Amended Complaint sufficiently alleges a claim of civil conspiracy based on the claims leveraging conduct of Appellees at mediation. In the present action Appellants have alleged that the Appellees acted in concert and provided assistance to each other in breaching their duty owed to Appellees' under the KUCSPA. To maintain a claim of civil conspiracy under Kentucky law one must allege:

> For harm resulting to a third person from the tortious conduct of another, one is subject to liability if he (a) does a tortious act in concert with the other or pursuant to a common design with him, or (b) knows that the other's conduct constitutes a breach of duty and gives substantial assistance or encouragement

[52] Preserved for appeal at ROA 7615-7640.

> to the other so to conduct himself, or (c) gives substantial assistance to the other in accomplishing a tortious result and his own conduct separately considered, constitutes a breach of duty to the third person.[62]

James v. Wilson, 95 S.W.3d 875, 897 (Ky. App. 2002).

Again, this issue before the Court is not whether the claims of civil conspiracy will ultimately be successful -- it is whether Appellants successfully pled a cause of action and created a question of material fact as to the claims asserted.

F. The Reply of Appellee National Union should have been stricken from the record.[53]

In both its original Motion for Summary Judgment and its Reply, Appellee National Union cited to *Cincinnati Ins. Co. v. Hofmeister*, Nos. 2004-CA-002296-MR, 2004-CA-002362-MR, 2008 Ky. App. LEXIS 302 (Ct. App. Sep. 26, 2008), an opinion which was withdrawn by the Court of Appeals and which contained an inflammatory statement concerning undersigned counsel. A motion to strike the subject language was filed and was sustained by the Court of Appeals, with a new Opinion being issued on October 17, 2008. Appellee National Union, however, chose specifically to use the withdrawn opinion "for consideration of the Court because it is instructive of how this case has/will be litigated by Plaintiffs' counsel and how Kentucky's Court of Appeals may have viewed a similar case." Appellee National Union is admittedly using the unpublished opinion for an improper purpose, not even attempting to argue that it is citing the case for a legal precedent. This conduct violates not only the Civil Rules, but the basic tenets of civility that should be observed in any motion practice.

CR 76.28(4)(c) indicates that opinions not to be published shall not be cited or used as binding precedent in any other case. Appellee did not even attempt to meet the criteria

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[53] Preserved for appeal at ROA 7962-7988.

of CR 76.28(4)(c) wherein the prerequisite for citing an unpublished decision is, "if there is no published opinion that would adequately address the issue before the court."

In *Jones v. Commonwealth,* 593 S.W.2d 869 (Ky. App. 1979), the court noted that a proper remedy for counsel purposefully citing to an unpublished opinion can be "the striking of the offending brief without leave to refile." *Id.* at 871. *See also Yocom v. Justice,* 569 S.W.2d 678, 679 (Ky. App. 1977). In *Yocom* and *Jones*, there is no evidence that the offending conduct of trial counsel was intentional and calculated misconduct. However, in the case subjudice, by Appellees' own statements, it is clear that Appellees purposely avoided citing to the correct *Hofmeister* opinion in order to interject a reference to an opinion that has been "withdrawn," which bears no factual or legal resemblance to the case at bar.

III. CONCLUSION

Appellees' dispositive motions were prematurely granted. Appellants' Amended Complaint pled recognizable causes of action with supporting factual basis that is admissible to prove the acts complained thereof. Appellees respectfully ask the Court to reverse the grant of Judgment on the Pleadings and Summary Judgment to Appellees and return the matter to the trial court for further discovery.

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APPENDIX

ENTERED IN MY OFFICE THIS THE
30 DAY OF March 2016
WENDY FLANARY, CLERK
BY: UAP D.C.

COMMONWEALTH OF KENTUCKY
26TH JUDICIAL CIRCUIT
HARLAN CIRCUIT COURT
CIVIL ACTION NO. 11-CI-349

CRYSTAL LEE MOSLEY ET AL — PLAINTIFF

v. **ORDER**

ARCH SPECIALTY INSURANCE COMPANY ET AL. — DEFENDANTS

* * * * * *

This matter is before the Court on the Defendant, Arch Specialty Insurance Company's ("Arch") Motion for Judgment on the Pleadings ("the Motion"). This Court, having reviewed the memoranda of the parties and heard oral argument at a hearing on February 3, 2016, and having concluded that, even if the facts as alleged in the Amended Complaint are true as it relates to Arch's alleged acts or omissions, this conduct is legally insufficient to maintain the Plaintiff's claims for bad faith, violation of KRS 304.12-230 and KRS 304.12-235, civil conspiracy and punitive damages, and thus the Court hereby GRANTS the Motion and enters a JUDGMENT on the pleadings in favor of Defendant Arch Specialty Insurance Company.

Dated this 28th day of MAR February, 2016.

Hon. Jeffrey Burdette – Special Judge

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CLERK'S CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of the foregoing was served on this 30th day of ~~February~~ March, 2016 upon:

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ENTERED IN MY OFFICE THIS THE 11 DAY OF July 2017
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BY: D.C.

COMMONWEALTH OF KENTUCKY
26th JUDICIAL DISTRICT
HARLAN CIRCUIT COURT
CIVIL ACTION NO. 11-CI-00349

CRYSTAL LEE MOSLEY, *et. al.* PLAINTIFFS

v.

NATIONAL UNION FIRE INSURANCE COMPANY DEFENDANT

ORDER GRANTING DEFENDANTS' MOTION FOR SUMMARY JUDGMENT

This matter came before the Court on the Defendant's April 20th, 2017 Motion for Summary Judgment in regards to the Plaintiffs' third-party bad faith claims. In response, Plaintiff requested the Court to defer ruling on the matter until there is an opportunity for more complete discovery. After hearing arguments of counsel on June 16th, 2017, reviewing relevant motions and memoranda, and being otherwise sufficiently advised, the Defendant's Motion for Summary Judgment is **GRANTED.** The Defendant, National Union Fire Insurance Company of Pittsburgh, PA (hereinafter, "National Union"), is entitled to summary judgment as a matter of law.

Background

Plaintiffs do not deny the scores of undisputed facts proffered by National Union in its Motion for Summary Judgment.[1] By way of summary, Plaintiffs' third-party bad

[1] In addition to referencing such facts, and incorporating them by reference, this Court also relies upon pleadings and factual evidence contained in its record of the underlying case. "[I]t is a well-established principle that a trial court may take judicial notice of its own records and rulings, and of all matters patent on the face of such records, including all prior proceedings in the same case." *M.A.B. v. Commonwealth Cabinet for Health and Family Services*, 456 S.W.3d 407, 412 (Ky. App. 2015) (citing *Adkins v. Adkins*, 574 S.W.2d 898, 899 (Ky. App. 1978). To the extent relied upon

faith claims against National Union arise out of the death of Rhett Mosley on November 23, 2010. Mr. Mosley was killed in an accident while driving a truck in the scope of his employment at a surface mine near Harlan, Kentucky. In 2011, Plaintiffs filed claims against National Union's insureds: Dixie, which owned the truck that Mr. Mosley was operating, and Rex, the owner of the mine. Plaintiffs also sued several others who were not insured by National Union, including, (a) Jean Coal Co., LLC, which operated the mine where the accident took place; (b) Regional Contracting, Mr. Mosley's employer; (c) Terry Loving, the sole managing member of Jean Coal and Regional Contracting; and (d) Cardinal Mining LLC. Both Rex and Dixie defended against Plaintiffs' underlying allegations for more than four years, making various reasonable arguments throughout that period.

Plaintiffs received a $1 million policy limits settlement from the insurer of Jean Coal and Terry Loving in 2014, and also received a large workers' compensation settlement from Regional Contractors' insurance carrier for an undisclosed amount. Plaintiffs' counsel, Jeffrey Morgan, acknowledged that, because of these settlements, Mrs. Mosley was not under financial pressure to resolve her case when later negotiating with counsel for Rex and Dixie. Counsel for Rex and Dixie continued to defend the case and assert legitimate defenses related to duty, breach and damages. Counsel and National Union also reasonably refused to settle claims separately against Dixie and Rex to prevent each from being targeted for an excess judgment. On April 15, 2013, the Court ordered the parties to mediation. Pursuant to this order, the parties mediated on June 19, 2013, and September 12, 2013, but did not settle.

herein, the facts contained in the record of this Court are supported by deposition testimony or other admissible evidence.

For years, including throughout both mediations, Plaintiffs' counsel repeatedly and persistently demanded policy limits of $6 million to settle their tort claims against Rex and Dixie. In the meantime, the parties prepared the case for trial and engaged in an interlocutory appeal. Finally, in July 2015, Plaintiffs' demands began to drop. In August 2015, the parties settled Plaintiffs' claims against Rex and Dixie for $2 million, a third of the amount they had previously demanded. There lacks any credible evidence that National Union ever denied coverage to its insureds, or misrepresented its available coverage.

Summary Judgment Standard

Summary judgment procedure is employed to avoid unnecessary trials. *Transportation Cabinet, Bureau of Highways v. Leneave*, 751 S.W.2d 36, 38 (Ky. App. 1988). CR 56.03 authorizes summary judgment if the pleadings, depositions, answers to interrogatories, stipulations, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. All doubts of an issue considered for summary judgment are to be resolved in favor of the party opposing the motion. *Steelvest, Inc. v. Scansteel Serv. Ctr., Inc.*, 807 S.W.2d 476, 480 (Ky. 1991) (citations omitted). Once the moving party has met the initial burden of showing that no genuine issue of a material fact exists, the other party must refute the contentions of the moving party with at least some affirmative evidence showing that there is a genuine issue of material fact for trial. *Davis v. Devers*, 617 S.W.2d 56, 57 (Ky. App. 1981), (citing *Roberts v. Davis*, 422 S.W.2d 890 (Ky. App. 1968).

In applying this standard, the Court must view all materials offered in support of a motion for summary judgment in the light most favorable to the non-moving party.

Lewis v. B & R Corp., 56 S.W.3d 432, 436 (Ky. App. 2001) (citing *Steelvest*, 807 S.W.2d at 480-482). The moving party bears the initial burden of demonstrating that no genuine issue of material fact exists and then the burden shifts to the party opposing summary judgment to produce at least some affirmative evidence showing that there is a genuine issue of material fact requiring trial. *Hubble v. Johnson*, 841 S.W.2d 169 (Ky. 1992); *James Graham Brown Foundation, Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273 (Ky. 1991); *Steelvest*, 807 S.W.2d 476; *Paintsville Hospital Co. v. Rose*, 683 S.W.2d 255 (Ky. 1985). A trial court's function in considering a motion for summary judgment is to determine whether there are issues of fact to be tried. *Mitchell v. Jones*, 283 S.W.2d 716 (Ky. 1955). The inquiry should be whether, from the evidence of record, facts exist which would make it possible for the non-moving party to prevail. In the analysis, the focus should be on what is of record rather than what might be presented at trial. *Welch v. Am. Publ'g Co. of Kentucky*, 3 S.W.3d 724, 730 (Ky. 1999). Here, the facts must be viewed in the light most favorable to Plaintiffs, giving them the benefit of all favorable inferences that may be reasonably drawn from the evidence and resolving all doubts against the moving party. *Hines v. Louisville Figure Skating Club, Inc.*, 342 S.W.2d 395 (Ky. 1961). This Court having examined the evidence in light of that standard agrees there are no genuine issues of material fact.

Analysis

Plaintiffs claim that National Union was in some fashion responsible for the case against its insureds not being settled fast enough, despite substantial issues regarding the liability of those insureds; the overall complexity of the underlying dispute; Plaintiffs' previous settlement with other parties for a seven-figure sum; National Union's obligation to protect and defend its insureds under Kentucky law; Plaintiffs' decision not to decrease

their demand below $6 million until shortly before the claims against Rex and Dixie settled; the fact that seven Circuit Court Judges have presided over this case causing unavoidable delays; and significant issues regarding allocation of fault to various entities and individuals, including Mr. Mosley himself. Further, Plaintiffs claim National Union acted in bad faith because it required that the claims against both of its insureds be released as a condition of settlement. It did so after consideration of Kentucky law, and to guard against the possibility of Plaintiffs settling with one insured, then seeking an excess verdict against the other with diminished policy limits. Under Kentucky law, National Union is entitled to Summary Judgment because liability was not reasonably clear, because Plaintiffs' bad faith claims are premised on litigation conduct, and because Plaintiffs have not produced evidence of a material issue of fact despite having ample time to conduct discovery.

As one of the only states that permits a private cause of action for third-party bad faith, Kentucky imposes a very high threshold for bad faith claims to be presented to a jury, and asks trial courts to act as gatekeepers to dispose of unmeritorious claims. *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993); *United Servs. Auto. Ass'n v. Bult*, 183 S.W.3d 181, 186 (Ky. App. 2003); *Motorists Mut. v. Glass*, 996 S.W.2d 437, 454 (Ky. 1997). Plaintiffs have not cleared that threshold in this case.

A. Because Plaintiffs cannot satisfy the elements of bad faith under Kentucky law, their bad faith claims must be dismissed.

Wittmer v. Jones holds that a plaintiff must provide evidence of the following three elements to sustain any bad faith claim: "(1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such

a basis existed...." 864 S.W.2d at 890 (internal citation omitted). "[T]he common thread running through each of the three *Wittmer* elements is that the insurer has tort liability for bad faith if, and only if, its liability for paying the claim in question was 'beyond dispute.' Absent that, an insurer has a right to defend the case, without making any settlement offer at all, until appellate review is final." *Hollaway v. Direct General Ins. Co. of Mississippi, Inc.*, 2014 WL 5064649, (Ky. App., Oct. 10, 2014) (aff'd in relevant part by *Hollaway v. Direct Gen. Ins. Co. of Mississippi, Inc.*, 497 S.W.3d 733 (Ky. 2016)); *see also Coomer v. Phelps*, 172 S.W.3d 389, 395 (Ky. 2005). "[A]ll elements of the test must be established to prevail on a third-party claim for bad faith under the KUCSPA." *Hollaway*, 497 S.W.3d at 738.

KRS 304.12-230(6), the provision of Kentucky's Unfair Claims Settlement Practice Act upon which Plaintiffs base their delay claims, imposes liability for failing to make good faith efforts to effectuate a fair, prompt and equitable settlement only in those cases in which an insured's liability has become "reasonably clear." Similarly, KRS 304.12-230(13), upon which Plaintiffs base their "leveraging" claims, also applies only "where liability has become reasonably clear." Kentucky's Supreme Court has held that for liability to be "reasonably clear," it must be "beyond dispute." *Coomer*, 172 S.W.3d at 395 ("[the] statute only requires that an insurer make a good faith attempt to settle any claim, for which liability is beyond dispute, for a reasonable amount."). A "defendant ha[s] a right to litigate its case as long as liability [i]s not 'beyond dispute'" *Lee v. Medical Protective Co.*, 904 F. Supp. 2d 648, 656 (E.D. Ky. 2012).

Because a genuine dispute exists regarding Rex's and Dixie's liability for the death of Rhett Mosley, National Union's duty to pay Plaintiffs' claims was in dispute and Plaintiffs cannot satisfy even the first element of *Wittmer*. As the Kentucky Supreme

Court recently reiterated in *Hollaway*, the UCSPA "only requires insurers to negotiate reasonably with respect to claims; it does not require them to acquiesce to a third party's demands." *Hollaway*, 497 S.W.3d at 739. Simply put, a "genuine dispute as to liability" renders a "bad faith claim a de facto nullity." *Id.* at 738.

1. Rex reasonably argued it owed no duty to Plaintiffs because it was entitled to "up the ladder" Workers' Compensation immunity.

"Up-the-ladder" immunity posed a significant legal barrier to any recovery against Rex from the outset of the case because Rex consistently argued it was Mr. Mosley's statutory employer and was entitled to dismissal as a matter of law. In its pleadings before this Court, Rex reasonably relied on the plain language of KRS 342.610(2), as well as cases such as *Beaver v. Oakley*, 279 S.W.3d 527 (Ky. 2009), *Ramler v. Spartan Const. Inc.* 2003 WL 22064334 (Ky. App. Sept. 5, 2003) and *Hensley v. First Healthcare Corp.*, 2003 WL 22149385, (Ky. App. Sept. 19, 2003). Although this Court denied Rex's Motion for Summary Judgment on this point, the Kentucky Court of Appeals recognized that, because of potential workers' compensation immunity, this was a rare case that fit an exception to the final judgment rule and passed it to the panel for an interlocutory ruling on the merits. Rex's worker compensation immunity argument was, therefore, reasonably made in good faith; it was not "wrongful."

2. Dixie disputed that it owed any duty as the bailor of the vehicle involved in the accident.

Plaintiffs argue that Dixie's ownership of the truck, plus the fact that the truck had bad brakes, means Dixie's underlying liability was beyond dispute, and that National Union should have settled this case sooner. Plaintiffs' conclusion is not supported by the law or the facts of this case.

In its filings with this Court, Dixie reasonably argued it did not owe any duty to Mr. Mosley as the bailor of the truck at issue. Because it had not had control over the truck for over a year prior to the accident, and because it had no right or duty to exercise control over the truck, Dixie maintained it was not responsible for Jean Coal's (the bailee's) negligent use or maintenance of the truck. Dixie also argued events occurring after the truck left its control--namely, repairs by a mechanic, Burnett Combs, and other individuals--severed the chain of causation with respect to Dixie's alleged negligence, relieving Dixie of any liability. While this Court eventually denied Dixie's Motion for Summary Judgment, it was clear that Dixie had a good faith basis to make those arguments. *See American Fid. & Cas. Co. v. Pennsylvania Cas. Co.*, 258 S.W.2d 5, 7 (Ky. 1953) ("[i]t is generally established that a bailor who does not retain control of the article bailed is not responsible to others for its negligent use by the bailee.").[2] Also, an underlying jury could have determined that Mr. Combs and other individuals--rather than Dixie—were liable for Mr. Mosley's death.[3] For these reasons, liability against Dixie was never beyond dispute during the relevant time period.

3. Apportionment of liability to other entities and individuals was likely.

Further, the undisputed factual record shows that the liability of Rex and Dixie was never "beyond dispute" because the jury would have been able to apportion fault to Jean Coal or Regional Contracting, the entities who were actually responsible for maintaining the truck Mr. Mosley was driving and who, themselves, settled. Dixie did not have control

[2] Further, *S. Ry. Co. v. Kelly Const. Co.*, 406 S.W.2d 305, 308 (Ky. 1966) provides, "[a]s a general rule, in the absence of statute, the negligence of the bailee is not imputed to the bailor where the latter does not have control, or the right and duty to exercise control, of the conduct of the bailee with respect to the acts or omissions which caused the injury to the thing bailed".

[3] Kentucky law allows argument that non-defendant individuals or entities were responsible for damages severing the chain of causation and defeating a plaintiffs' negligence claims. *Bruck v. Thompson*, 131 S.W.3d 764, 769 (Ky. App. 2004),

over the truck at any time during the year prior to the accident, and a jury could reasonably conclude it was not responsible for maintenance. Plaintiffs' Amended Complaint alleged that Regional Contracting and Jean Coal were negligent.

A genuine dispute also existed as to the liability of third-party mechanics who were hired to adjust the brakes on the truck after the Mine Safety and Health Administration ("MSHA") found that the brakes were defective the year before the accident. Any improper or incomplete repairs by those mechanics were an intervening or superseding cause of Plaintiffs' injuries. None of these parties were insured by National Union.

4. A question existed as to whether Rex or Dixie knew about any issues with the truck's brakes, creating another major liability issue.

Plaintiffs were also unable to provide any evidence that Jean Coal or Regional Contracting were aware of the alleged issues with the truck's brakes at the time of the accident, or that Dixie or Rex (who were not responsible for the maintenance of the truck) were on notice of such issues. While MSHA had previously identified issues with the truck's brakes, a subsequent MSHA remediation document shows that the brakes had been repaired. Mr. Mosley expressed no concerns about the truck in the days leading up to the accident, and he did not report any problems with the truck's brakes. The day-shift driver, Matthew Blanton, testified that he drove the truck on the day of the accident, performed a pre-shift check, and drove the same stretch of road that Mr. Mosley traveled, but had no problems with the vehicle. Mr. Blanton further testified that the truck's brakes were working when he left his shift that day. These facts lend themselves to the proposition that liability was not beyond dispute.

5. Fault could have been apportioned to Mr. Mosely in the underlying case.

During the underlying pretrial conference on January 5, 2015, this Court indicated it felt confident the record would support a comparative negligence instruction, which would allow the jury to consider apportioning fault to Mr. Mosley. This Court also ruled Plaintiffs would not be entitled to pain and suffering damages.

B. Plaintiffs' allegations are based on litigation conduct and settlement communications during a confidential mediation and cannot form a basis for their bad faith claims.

Plaintiffs' bad faith claims also fail as a matter of law because they seek recovery related to National Union's litigation conduct, including alleged conduct during court-ordered, confidential mediations. The introduction of evidence of an insurance company's litigation conduct, strategies, and techniques in an underlying suit is prohibited in a subsequent bad faith action. *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512 (Ky. 2006). The Kentucky Supreme Court's decision in *Knotts* adopted "an absolute prohibition on the introduction" of evidence of litigation conduct as proof of an insurer's bad faith. absolute prohibition on the introduction. Id. at 522. In issuing that prohibition, the Court explained that the distinguishing feature between "litigation conduct" and "settlement conduct" is whether the Rules of Civil Procedure provide a remedy for the alleged misconduct. If they do, the conduct is "litigation conduct" and is not actionable as bad faith. *See generally, id.* Further refining that distinction, the Court noted that, "[w]here improper litigation conduct is at issue, generally the ... Rules of Civil Procedure provide adequate means of redress, such as motions to strike, compel discovery, secure protective orders, or impose sanctions." *Id.* (internal citations omitted). In fact, "given the chilling effect that allowing introduction of evidence of litigation conduct would have on the exercise of an insurance company's legitimate litigation rights, any exception threatens to turn our adversarial system on its head." *Id.* at 522.

To the extent Plaintiffs believed Rex or Dixie engaged in improper conduct at the court-ordered mediation or caused unnecessary delays during the underlying litigation, Plaintiffs could have addressed these issues through a motion with the Court, but did not.[4] Plaintiffs, however, never sought relief from the Court related to National Union's alleged mediation and litigation conduct. Regardless, a careful examination of the underlying record shows any delays are attributable to normal litigation conduct and also the fact that seven Circuit Court Judges have presided over this case, causing delays associated with several case transfers.

Moreover, as a matter of law, attorneys hired by National Union had the right, and even the duty, defend their clients. *See Shaheen v. Progressive Cas. Ins. Co.*, 114 F. Supp. 3d 444, 449 (W.D. Ky. 2015) (aff'd 6th Cir. Dec. 15, 2016) (discussing the problems created by an insurer's dual, conflicting roles in third-party cases and noting that an insurer's primary obligation is to the defense of its insured). Kentucky's Supreme Court also explained, "[i]n addition to the duties owed to [the plaintiff], both insurers owed a duty to their liability insured ... to protect him from a potential excess judgment...."[5] *Glass*, 996 S.W.2d at 454.

Although Plaintiffs now allege that National Union's attempt to obtain a global settlement on behalf of both of its insureds is somehow evidence of improper "leveraging," in his deposition, Mr. Morgan admitted he was trying to force settlement on behalf of one of National Union's insureds so that he could litigate--and seek an excess verdict--against

[4] The civil rules give courts the inherent authority to enforce its own orders and to correct counsel's conduct; where they apply, Plaintiffs must seek a remedy under those rules rather than create a separate bad faith lawsuit. *Knotts*, 197 S.W.3d 512.

[5] The Kentucky Supreme Court has recognized that some attorneys exhibit a "personal bias against insurance companies and in favor of using bad faith and UCSPA allegations to extort payment of underlying claims from insurers." *Glass*, 996 S.W.2d at 447. If counsel was so concerned about settling the case for Ms. Mosley, they should have brought the alleged bad conduct to the attention of the Judge charged with overseeing litigation conduct, and who ordered the mediation in the first instance.

the other. This is precisely the type of conduct that National Union had a duty to protect both of its insureds against. *Shaheen*, 114 F. Supp. 3d at 449; *Glass*, 996 S.W.2d at 454.[6]

Further, there is no evidence that the underlying confidential mediations that would support bad faith claims. After agreeing to keep all mediation conduct confidential, A bad faith claim was filed based almost entirely on alleged mediation conduct. This conduct is inadmissible under KRE 408. Also, courts routinely hold confidential mediation conduct to be inadmissible because, "[t]he integrity of the mediation process depends on the confidentiality of discussions and offers made therein." *Goodyear Tire & Rubber Co. v. Chiles Power Supply, Inc.*, 332 F.3d 976, 979 (6th Cir. 2003). "There exists a strong public interest in favor of secrecy of matters discussed by parties during settlement negotiations." But "[i]n order for settlement talks to be effective, parties must feel uninhibited in their communications." *Id.* at 980.[7]

Even if mediation conduct were admissible, Plaintiffs have presented no evidence that National Union acted in bad faith during the underlying mediations, violative of KRS 304.12-230(13).[8] There is no evidence that National Union failed to settle claims "under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage." And KRS 304.12-230(13) applies only "where liability has become reasonably clear" which is not the case here.

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[6] When refusing to settle without releases for both insureds, counsel for Rex and Dixie properly explained they had a duty to both of their clients to not "diminish the available coverage limits by resolving claims against one insured to the detriment of another." Their position was more than reasonable, and was not taken in bad faith. Moreover, these global settlements, concluding litigation against all defendants, are common practice and should be encouraged.

[7] Mediation has proven to be a very effective mechanism whereby civil parties in Kentucky can resolve cases without substantial Court involvement. But lack of confidentially during mediations could cause parties to "more often forego negotiations for the relative formality of trial. Then, the entire negotiation process collapses upon itself, and the judicial efficiency it fosters is lost." *Goodyear Tire*, 332 F.3d at 980.

[8] Two mediations were held in this case: one on June 19, 2013, and the other on September 12, 2013. The parties did not settle at either mediation. Throughout both mediations, Plaintiffs never lowered their collective demand to National Unions' insureds, Dixie and Rex, below the full policy limits of $6 million, even though National Union's insureds increased their offers.

A good faith dispute existed as to the liability of National Union's insureds. Both sides litigated. Both sides conducted intense discovery and thoroughly briefed numerous, complex issues in preparation for trial. The Court conducted a final pretrial conference and made significant rulings.

C. Plaintiffs have had ample opportunity to conduct discovery.

Both parties agree that this Court has the discretion to rule upon whether they have had a sufficient opportunity to conduct discovery. CR 56.02 provides that the defending party may move for summary judgment at any time. In *Garland,* Kentucky's Court of Appeals granted summary judgment after the Plaintiffs "had nearly a year and had not yet developed any evidence" to defeat summary judgment. *Garland v. Certainteed Corp.*, 2003 WL 1240465, at *1 (Ky. App. Feb. 7, 2003) (citing *Hasty v. Shephard,* Ky.App., 620 S.W.2d 325 (1981) (affirming summary judgment just six months after the complaint had been filed) and *Hartford Ins. Grp. v. Citizens Fid. Bank & Trust Co.*, 579 S.W.2d 628, 630 (Ky. App. 1979) (similarly affirming summary judgment after a discovery period of roughly six months). Significantly, "[t]here is no requirement that discovery be completed, only that the non-moving party have 'had an *opportunity* to do so.'" *Carberry v. Golden Hawk Transp. Co.*, 402 S.W.3d 556 (Ky. App. 2013) (*quoting Hartford,* at 630.)

Plaintiffs' opportunity to conduct discovery regarding liability in the underlying case began on June 7, 2011, when they filed their initial Complaint. In the six years this case has been pending, Plaintiffs have had ample opportunity to conduct far-reaching discovery, and have done so extensively with respect to the key liability questions at issue in National Union's Motion for Summary Judgment. More than two-dozen depositions were taken, including six expert depositions. The parties have made numerous filings, encompassing varied and complex liability issues. Since this Court ruled bad faith

discovery could commence on February 3, 2016, Plaintiffs had over sixteen months to conduct any additional discovery that might be relevant to their bad faith claim. Plaintiffs' arguments that they need more time to complete additional discovery fail to persuade this Court. For the sake of judicial efficiency, the time to conduct discovery cannot be indefinite. The evidence is clear on the relevant issues before this Court.

Further, Plaintiffs' attempts to pierce the attorney-client privilege and obtain portions of National Union's claim file materials developed during National Union's defense of its insureds does not preclude summary judgment. Kentucky courts have explicitly refused to create an exception to the attorney-client privilege in the bad faith context. *See Shaheen*, 2012 WL 692668, (citing *Guaranty Nat'l Ins. Co. v. George*, 953 S.W.2d 946, 948 (Ky. 1997)). In this third-party case, the privilege at issue belongs not to National Union, but to its insureds, Rex and Dixie. Neither of these insureds has waived the privilege.

D. Plaintiffs have failed to produce evidence, as required by CR 56, to show that a material issue of facts exists.

After National Union provided evidence that no genuine issue of material fact exists, Plaintiffs failed to meet their burden under CR 56 to offer evidence of a genuine issue of material fact. *Neal v. Welker*, 426 S.W.2d 476, 479 (Ky. 1968) ("[w]hen the moving party has presented evidence showing that despite the allegations of the pleadings there is no genuine issue of any material fact, it becomes incumbent upon the adverse party to counter that evidentiary showing by some form of evidentiary material reflecting that there is a genuine issue pertaining to a material fact."). Instead, Plaintiffs rely on unsubstantiated allegations and arguments that--even if they had been supported--are immaterial to the facts supporting National Union's Motion for Summary Judgment. Plaintiffs did not provide any evidence to support their claim that liability was beyond

dispute and that their claims were based on more than litigation conduct.[9] For purposes of this Motion, the Court accepts the argument that Dixie owned the truck and that the brakes caused the accident. This does not mean, as Plaintiffs' argue, that Dixie and Rex's, liability was beyond dispute. Moreover, Rex legitimately filed an appeal, which the appellate court sent to a merits panel for resolution, to address workers' compensation immunity issues.

The factual allegations set forth in Plaintiffs' response are not material because they do not impact the key summary judgment issues: specifically, whether Plaintiffs' bad faith claim is based on litigation conduct and whether liability in the underlying case was beyond dispute. Although Plaintiffs allege certain unsupported facts, doing so merely highlights the parties' legitimate dispute regarding underlying liability, evidencing a situation where, as in *Hollaway*, "both parties rely on their own accounts of the series of events [surrounding] the accident." *Hollaway*, 497 S.W.3d at 734.

Counsel for Plaintiffs have argued--and Mr. Morgan testified at his deposition--that they believe underlying liability was reasonably clear. It comes as no surprise that Plaintiffs' attorneys, who are acting as zealous advocates for their clients, opine they are entitled to prevail on the ultimate issue at the summary judgment stage. Yet Plaintiff Counsels' opinions on this issue does not overcome the substantial evidence that the underlying liability of Rex and Dixie was in question, for which this Court has become very familiar.

[9] While genuine disputes of material fact preclude summary judgment, a respondent's bare allegations, devoid of evidentiary support, are not enough to create such a dispute. *De Jong v. Leitchfield Deposit Bank*, 254 S.W.3d 817 (Ky. Ct. App. 2007), (ruling summary judgment was ripe, the Court explained, although "the appellants [had] stated potentially valid causes of action...they [had] failed to produce any evidence, in the record, to support such legal theories" and "unsupported allegations are insufficient to create a genuine issue of material fact[.]")

For example, on May 23, 2014, Plaintiffs filed an all-inclusive Motion for Summary Judgment, asking the Court to "enter a judgment as a matter of law regarding both [Rex's and Dixie's] culpability for negligence." Plaintiffs indicated, "[u]ltimately, this Motion is designed to be a comprehensive statement of the Plaintiffs' position on the issues of immunity and liability based upon the present constellation of facts and law." This Court eventually denied Plaintiffs' Motion for Summary Judgment because a reasonable jury could find for Defendants on liability. In arguing its bad faith claims should go forward, Plaintiffs are essentially arguing that this Court was incorrect in denying summary judgment to Plaintiffs. But their remedy was to address these issues in the underlying lawsuit, not a new lawsuit.

Plaintiffs also argue that *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368 (Ky. 2000) and *Hamilton Mut. Ins. Co. of Cincinnati v. Buttery*, 220 S.W.3d 287, 290 (Ky. App. 2007) compels a general ruling that "whether an insurance company acts in bad faith is a question of fact for the jury." But Plaintiffs' reading of these cases is overly broad. Kentucky Courts routinely, and properly, grant summary judgment in bad faith cases; not every allegation of bad faith presents a material issue of fact. *Hollaway v. Direct General Ins. Co. of Mississippi*, 497 S.W.3d 733 (Ky. 2016); *United Services Auto. Ass'n v. Bult*, 183 S.W. 3d 181 (Ky. App. 2003); *Guar. Nat. Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997); *Pryor v. Colony Ins.*, 414 S.W. 3d 424, (Ky. App. 2013). Moreover, both *Farmland* and *Buttery* were first-party cases in which the claimants presented evidence that their insurance companies sought to misrepresent or hide coverage from their insureds. No such evidence exists here.

CONCLUSION

In the underlying case, National Union's insureds, Dixie Fuel Company ("Dixie") and Rex Coal Company, Inc. ("Rex"), presented more than sufficient evidence that would have permitted a jury attribute liability to others. In fact, they fairly contested all three elements of negligence: duty, breach, and consequent damages. Thus, National Union had no obligation to pay Plaintiffs' claims under the Unfair Claims Settlement Practices Act. It had a duty and right under Kentucky law to defend its insureds against excess judgment until it ultimately settled the claims filed against them for $2 million, which occurred soon after Plaintiffs belatedly reduced their previous $6 million policy limit demand. "Because [National Union's] absolute duty to pay [Plaintiffs'] claim is not clearly established, this alone [is] enough to deny [Plaintiffs'] bad-faith claim under *Wittmer*." *Hollaway v. Direct Gen. Ins. Co. of Mississippi, Inc.*, 497 S.W.3d 733, 739 (Ky. 2016).

Kentucky Courts have long recognized the "important public policy of encouraging settlements." *See Wehr Constructors, Inc. v. Assurance Co. of Am.*, 384 S.W.3d 680, 689 (Ky. 2012). In taking judicial notice of the records and rulings in the underlying case, and after careful consideration of the case law cited by both parties, this Court finds there was clearly a good-faith, underlying dispute regarding whether Dixie and Rex were liable to Plaintiffs. Simply put, liability in the underlying case was never beyond dispute.

National Union's Motion for Summary Judgment is **HEREBY GRANTED**; all claims against National Union are **DISMISSED WITH PREJDUICE**. This is a final and appealable Order, there is no just cause for delay.[10]

[10] Plaintiffs also asserted "concert of action/civil conspiracy" claims against Arch and National Union. However, those claims are conditioned on Plaintiffs' ability to properly assert bad faith claims, which Plaintiffs cannot do. *See James v. Wilson*, 95 S.W.3d 875, 896-902 (Ky. Ct. App. 2002). Further, the claims against Arch have been

So Ordered this 07 day of July, 2017.

Hon. Jeffrey T. Burdette, Judge

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cse/oc 7-11-17

dismissed, vitiating Plaintiffs concert of action/civil conspiracy claims against National Union. Finally, Plaintiffs have presented no genuine issue of material fact with respect to these claims. *Id.*

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APPENDIX

2016 WL 8135350
Only the Westlaw citation is currently available.
United States District Court,
E.D. Kentucky,
Central Division at Lexington.

Ernest Foster, Plaintiff,
v.
American Fire and Casualty Company, Defendant.

No. 5:13-CV-426-GFVT-REW
|
Signed 04/01/2016

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ORDER

Robert E. Wier, United States Magistrate Judge

*1 Discovery in insurance bad faith cases often can become contentious. The central evidence is likely to include the insurer's internal claim process and files, leading unsurprisingly to assertions of privilege and work-product protection when an adverse party seeks to discover such documents. The cases, limited though they are, grapple with this tension in the distinct first-party bad-faith context.

The Court here addresses numerous such discovery disputes and topics at issue in this case. Procedurally, in mid-December 2015, Plaintiff's counsel contacted Chambers regarding the disputes. *See* DE #141 (Order requiring letters). Following an early January 2016 telephonic conference, DE #144 (Minute Entry Order), the parties formally briefed the issues. DE ##145 (American Fire brief substantiating discovery-related assertions); 151 (Foster response); 155 (American Fire reply). Certain exhibits are at DE ##146 and 156.

The Court recounts the history of the case, addresses generally the attorney-client privilege's and the work product doctrine's applicability to this case, evaluates the need (and states the process) for *in camera* review, and finally assesses the various relevance / overbreadth objections to particular interrogatories and requests for production. In summary, the Court will closely apply an attorney-client privilege and work product doctrine analysis to documents at issue, and the Court orders specific production regarding the documents subject to the general relevance and other objections. Because the Court has not yet received documents in issue, *in camera* review is the next step in the privilege fight.

Background

On June 8, 2008, Plaintiff Ernest Foster and Gary Washabaugh were in a motor vehicle accident in Stanton, Kentucky. Washabaugh had minimal limits. Foster had contracts with American Fire and former Defendant Philadelphia Indemnity to provide him with underinsured motorists (UIM) coverage. Following years of medical treatment and payment negotiations, and settlement with Washabaugh, Foster brought suit against both his insurers. This suit alleged entitlement to UIM benefits and various claims to relief under Kentucky statutory and common law related to unfair claims settlement / bad faith (the Court will collectively refer to these as the "bad faith" claims). *See* DE #26 (Amended Complaint). The District Court bifurcated the UIM and bad faith claims and stayed consideration of the bad faith claims (counts II-IV), including bad-faith-related discovery, pending resolution of the underlying UIM claim. DE #45 (Order).

Foster and Philadelphia eventually settled all claims between them. DE ##85, 86. Following significant pretrial motion practice, Foster and American Fire settled the UIM claim. DE ##129, 131, 132. The District Court then lifted the bad faith stay, and the case proceeded between Foster and American Fire on counts II-IV. *See* DE ##133 (Order lifting stay); 136 (Scheduling Order). After a few months of discovery, Foster raised with the Court the disputes now at issue.

Choice of Law and General Principles

***2** "In a diversity case, the court applies federal law to resolve work product claims and state law to resolve attorney-client claims." *In re Powerhouse Licensing, LLC*, 441 F.3d 467, 472 (6th Cir. 2006) (citing, *inter alia*, Fed. R. Evid. 501). This is a diversity suit, so Kentucky law governs attorney-client privilege claims, and federal law governs assertions of work product doctrine protection. *See* Fed. R. Civ. P. 26(b)(3); *see also Reg'l Airport Auth. of Louisville v. LFG, LLC*, 460 F.3d 697, 713-17 (6th Cir. 2006). Additionally, the Federal Rules alone govern relevancy determinations. Fed. R. Civ. P. 26(b)(1); *Surles ex rel. Johnson v. Greyhound Lines, Inc.*, 474 F.3d 288, 296 n.1, 305 (6th Cir. 2007); *see also Cnty. of Ontonagon, Mich. v. Land Located in Dickinson Cnty., Mich.*, 902 F.2d 1568, at *2 n.6 (6th Cir. 1990) (table) (*per curiam*).

As to the core of the current disputes, "the burden of establishing the existence of the privilege rests with the party asserting the privilege [.]" *In re Grand Jury Investigation No. 83-2-35*, 723 F.2d 447, 454 (6th Cir. 1983). Privileges generally receive a narrow construction because they deny access to otherwise discoverable information. *See Fisher v. United States*, 96 S. Ct. 1569, 1577 (1976); *United States v. Collis*, 128 F.3d 313, 320 (6th Cir. 1997).

Attorney-Client Privilege

First, the parties debate the foundational applicability of the attorney-client privilege in the context of a first-party bad-faith suit following settlement of the underlying UIM claim. [1]

Kentucky's attorney-client privilege applies to "confidential communication[s] made for the purpose of facilitating the rendition of professional legal services to the client[.]" Ky. R. Evid. 503(b). As relevant here, the communication must be "[b]etween the client or a representative of the client and the client's lawyer or a representative of the lawyer[.]" KRE 503(b)(1). The privilege is a general rule subject to certain enumerated exceptions. KRE 503(d). "[P]rivileges are generally disfavored and should be strictly construed." *Collins v. Braden*, 384 S.W.3d 154, 159 (Ky. 2012) (quoting *Stidham*, 74 S.W.3d at 722-23).

"Despite the historic and modern sanctity of the attorney-client privilege, not all communications between an attorney and a client are privileged, and the burden is on the party claiming the privilege to prove that it exists as to the communications so claimed." *St. Luke Hosps., Inc. v. Kopowski*, 160 S.W.3d 771, 775 (Ky. 2005). The attorney-client privilege "protects only those disclosures necessary to obtain legal advice which might not have been made absent the privilege[.]" *Lexington Pub. Library v. Clark*, 90 S.W.3d 53, 60 (Ky. 2002) (internal quotation marks removed). Stated another way, "[t]he attorney-client privilege attaches to a confidential communication made to facilitate the client in his/her legal dilemma and made between two of the four parties listed in KRE 503[:] the client, the client's representatives, the lawyer, or the lawyer's representatives." *Kopowski*, 160 S.W.3d at 776 (internal quotation marks and alternation removed). "A communication is 'confidential' if not intended to be disclosed to third persons other than those to whom disclosure is made in furtherance of the rendition of professional legal services to the client or those reasonably necessary for the transmission of the communication." KRE 503(a)(5). [2]

***3** "Claims of attorney-client privilege often collide with legitimate requests for discovery in bad faith litigation. Common law claims of bad faith generally fall into two categories: (1) first-party bad faith claims, where the insured sues the insurer for failing to use good faith to resolve a claim brought by the insured, and (2) third-party bad faith claims, where the victim of the insured's tortious behavior sues the insurer for failure to settle the previous claim against the insured." *Shaheen v. Progressive Cas. Ins. Co.*, No. 5:08-CV-34-R, 2012 WL 692668, at *3 (W.D. Ky. Mar. 2, 2012). *Shaheen* stated an oft-repeated (though perhaps underscrutinized) observation: "For discovery requests in first-party cases, because the insurance file is created on behalf of the insured, the entire file is typically discoverable by the plaintiff." *Id.*

Judge Russell continued:

> Questions of privilege are less definite in third-party bad faith actions and the discovery of the insurance file created during the previous litigation is a complicated issue. On one hand, almost all of the evidence of an insurer's potential bad faith in failing to settle was created either proceeding up to or during legal action

against the insured. Thus, much of the insurance file maintained by the insurer necessarily raises issues of attorney-client and work-product privilege.... On the other hand, the evidence that would most assist the plaintiff to show bad faith on the part of the insurer is the communications between the insured, insurer, and the attorney in the insurance file. Often, the plaintiff in a third-party bad faith suit has no reasonable means of proving his or her claim without the benefit of certain documents contained in the claim file.... Courts are caught between the competing interests of protecting privileged communications and supplying the plaintiffs with relevant evidence to their suits.

Recognizing the difficulty lower courts have weigh[ ]ing these issues, appellate courts around the country have attempted to offer guidance.... To date, the Kentucky Supreme Court has not squarely ruled on the issue.

Notwithstanding Kentucky's silence, the state's precedent is clear that an insurer enjoys at least some ability to withhold portions of the insurance file on the basis of the attorney-client privilege. On three occasions, the Kentucky Supreme Court reviewed the limits of discovery in third-party bad faith claims against insurers. *See Grange Mut. Ins. Co. v. Trude*, 151 S.W.3d 803 (Ky. 2004); *Riggs v. Schroering*, 822 S.W.2d 414 (Ky. 1991); *Terrell v. Western Cas. & Sur. Co.*, 427 S.W.2d 825 (Ky. 1968). None of these cases confronted the limits of discovery in the context of claims of attorney-client privilege. In *Riggs* however, the court recognized that discovery requests in a third-party claim necessarily implicated the attorney-client privilege for the insurer.

Id. at *3-*4; *see also id.* at *4 ("Additionally, at least one Kentucky Court has declined to create an express exception to the attorney-client privilege in bad faith litigation."); *see also Guaranty Nat'l Ins. Co. v. George*, 953 S.W.2d 946, 948 (Ky. 1997) ("To develop an exception in bad faith cases against insurers would impede the free flow of information and honest evaluation of claims. In the absence of fraud or criminal activity, an insurer is entitled to the attorney-client privilege to the same extent as other litigants." (quoting the case's prior unpublished Kentucky Court of Appeals decision)).

Some courts have opined, "first-party bad-faith actions against an insurer can only be proved by showing exactly how the company processed the claim and why the company made the decisions it did. Without the claims file, a contemporaneously-prepared history of the handling of the claim, it is difficult to see how an action for first-party bad faith could be maintained without requiring an overwhelming number of depositions, whose costs would thereby render all but the rare wealthy few first-party bad faith claimants financially unable to proceed." *Minter v. Liberty Mut. Fire Ins. Co.*, No. 3:11CV-249-S, 2012 WL 2430471, at *2 (W.D. Ky. June 26, 2012) (analyzing a bad faith claim under the fraud exception to attorney-client privilege applicability). The Western District was "therefore unwilling to predict that Kentucky's highest court would enter an opinion that would shield portions of a claims file from discovery in a first-party bad faith case on the basis of the attorney-client privilege, and therefore rule[d] that the attorney-client privilege does not shield materials contained in [the claimant's] underlying claims file." *Id.* [3] Another Western District court followed this lead: "[T]he attorney-client privilege ... [is] generally inapplicable in first party bad faith cases." *Madison v. Nationwide Mut. Ins. Co.*, No. 1:11-CV-157-R, 2012 WL 4592135, at *2 (W.D. Ky. Oct. 1, 2012) (citing *Minter*); *see also Graham v. Gallant Ins. Grp.*, 60 F. Supp. 2d 632, 635 (W.D. Ky. 1999) ("[E]vidence of post-filing conduct that is relevant to the bad faith claim ... is discoverable[.]").

***4** The Court finds unsupportable the suggestion that Kentucky **categorically** withholds from insurers the attorney-client privilege in first-party bad faith claims. The courts that have said so have cited, without developing, the crime-fraud exception (as in *Minter* [4]), have simply incanted other courts (as in *Madison*), or have cited the first-party relationship as fundamentally changing the analysis. Surely, the first-party situation **could** be different, *e.g.*, where a lawyer hired by an insurer is acting to defend an insured, who later makes first-party claims against the insurer related to the defense or claim. That really speaks more to client identity or possible shared interests than a default rule on all first-party claims. KRE 503 itself—which is the source for the answer—cardinally extends the privilege to confidential communications by which a client seeks legal advice from a lawyer. There is no stated exception as to the subject matter of first-party bad faith claims, and the Court treats the privilege as rising or falling, as is almost universally the case, on the facts and law of the particular application. [5] *See* DE #23, *Gaddis v. Garrison Prop. & Cas. Ins. Co.*, case

no. 6:15-CV-132-HAI ("The Court finds that, in general, the attorney-client privilege and work-product immunity have continuing validity and application to the bad faith claim. Without such protection, defending the bad faith component of the case would be a practical impossibility. But that general applicability does not mean that such protection applies to the specific documents at issue.").

Defendant, while not providing much fact-specific analysis, grouped the documents withheld on a claim of attorney-client privilege into four categories: (1) communication by underlying counsel regarding litigation strategy; (2) communication providing summaries of documents and depositions; (3) communications regarding attorney fees and billing; and (4) communication regarding settlement and settlement conferences. DE #145, at 6. American Fire explains that it hired attorneys Dave Richardson, Michael Bartlett, and their law firm to defend the UIM claim. *Id.* at 7. Defendant states that the lawyers "never represented Plaintiff" and "were only hired after Plaintiff sued American Fire on the UIM claim, and placed his legal interests adverse to American Fire's legal interests." *Id.* at 9. American Fire elaborated on particulars in the Reply. DE #155, at 3-4 (setting out details of various emails and letters).

The Court reminds Defendant of the strict requirements of Kentucky attorney-client privilege, as expressed in KRE 503, *Kopowski*, and *Clark*. "[P]rivileges are generally disfavored and should be strictly construed." *Collins*, 384 S.W.3d at 159. Following the discussion of the work product doctrine below, the Court establishes the procedure to follow for *in camera* review, if such a step remains necessary. The Court will hold American Fire to properly circumspect privilege protection, as the Kentucky Rule cases dictate, if the parties do not collegially resolve any remaining disagreement and require *in camera* review.[6] The Court will reserve full analysis for the document review.

Work Product Doctrine

***5** Next, the parties argue about the applicability of the work product doctrine in the specific circumstances of this case.[7]

Generally, "a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative[.]" Fed. R. Civ. P. 26(b)(3). "The work-product doctrine protects an attorney's trial preparation materials from discovery to preserve the integrity of the adversarial process." *In re Professionals Direct Ins. Co.*, 578 F.3d 432, 438 (6th Cir. 2009) (citation omitted). The work product doctrine "is distinct from and broader than the attorney-client privilege." *LFG, LLC*, 460 F.3d at 713.

In the Sixth Circuit, for a document or other tangible thing to be prepared "in anticipation of litigation," it must have been " 'prepared or obtained *because of* the prospect of litigation.' " *United States v. Roxworthy*, 457 F.3d 590, 593 (6th Cir. 2006) (quoting *United States v. Adlman* (*Adlman II*), 134 F.3d 1194, 1202 (2d Cir. 1998)) (emphasis in original). This "because of" test has two prongs, reflecting "both a subjective and objective element to the inquiry[.]" *Id.* at 594. Specifically, the test "asks (1) whether a document was created because of a party's subjective anticipation of litigation, as contrasted with an ordinary business purpose, and (2) whether that subjective anticipation of litigation was objectively reasonable." *Id.* "[D]ocuments prepared in the ordinary course of business, or pursuant to public requirements unrelated to litigation, or for other nonlitigation purposes, are not covered by the work product privilege." *Id.* at 593. A document would even lose protection "if it would have been prepared in substantially the same manner irrespective of the anticipated litigation." *Id.* at 593-94. "A party asserting the work product privilege bears the burden of establishing that the documents he or she seeks to protect were prepared in anticipation of litigation." *Id.* at 593 (internal quotation marks removed). The Court must pan for the driving force behind targeted product, per *Roxworthy*.

Again, quoting Judge Russell:

> [C]ourts in other jurisdictions have openly diagramed how the parameters of the work-product doctrine function in third-party bad faith cases.... While Kentucky courts have not offered such explicit guidance, the Sixth Circuit has. In an unpublished decision, the Sixth Circuit considered the role of the work-product rule in bad faith actions under Kentucky law. In *Bongartz v. State Farm Fire & Cas. Co.*, 30 F.3d 133 (6th Cir. 1994) (table), the appeals court reviewed the grant of summary judgment against plaintiffs where they asserted claims under the UCSPA. *Id.* at *1. In the underlying dispute between the parties, the

defendant-insurer denied coverage for fire damage in plaintiff's residence. *Id.* Besides the unfavorable ruling on dismissal, the plaintiffs appealed the decision by the trial court to deny a discovery request for the insurance file because it was prepared in anticipation of litigation. *Id.* at *4. The court of appeals upheld the district court's ruling that work product 'created by defendant ... in anticipation of litigation' was not discoverable and the plaintiff had not shown a substantial need for such materials to prepare her claims of bad faith. *Id.* at *5. *Bongartz* convinces the Court that the work-product privilege is alive and well, to some extent, in bad faith litigation under Kentucky law.

***6** *Shaheen*, 2012 WL 692668, at *6. As with attorney-client privilege, whether work product protection applies depends on whether American Fire can establish that particular materials fall within the protection under Rule 26 (and then, whether Plaintiff can override the protection).

Madison did remark that the "work product doctrine [is] generally inapplicable in first party bad faith cases." 2012 WL 4592135, at *2 (citing *Minter*). The Court does not read *Minter* to stand for such a general proposition. *Minter* applied the work product doctrine to various documents at issue and ordered limited production on specific terms. 2012 WL 2430471, at *3-*4. As in the attorney-client privilege discussion above, consistent with *Shaheen* and *Minter*'s application of the work product doctrine, and with Rule 26 itself, the Court employs a more nuanced approach than a blanket declaration that the work product privilege is inapplicable. *Accord* DE #23, *Gaddis v. Garrison Prop. & Cas. Ins. Co.*, case no. 6:15-CV-132-HAI.

As the parties discuss, cases from around the country generally differentiate between "fact" work product and "opinion" work product, with "opinion" work product generally receiving heightened protection. *See, e.g.*, *In re Columbia/HCA Healthcare Corp. Billing Practices Litig.*, 293 F.3d 289, 304-07 & 307 n.30 (6th Cir. 2002); *In re Antitrust Grand Jury*, 805 F.2d 155, 163-64 (6th Cir. 1986); *In re HealthSouth Corp. Securities Litig.*, 250 F.R.D. 8, 10 (D.D.C. 2008). The Rule includes this tiering. Fed. R. Civ. P. 26(b)(3)(A) & (B) (Court "must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party's attorney or other representative concerning the litigation.").

Here, Defendant asserts the following are protected against discovery by the work-product doctrine: [8]

***7** Handwritten Notes Containing Opinions: Defendant states that these documents "contain handwritten notes by the attorney or the client in preparation for trial[.]" DE #145, at 16; *see id.* at 17 (describing the numerous types of notes the documents include). As Defendant argues, in general, attorney notes of this type are prime examples of attorney trial preparation material typically protected by the work product doctrine. *Shaheen*, 2012 WL 3644817, at *7; *Gruenbaum v. Werner Enters., Inc.*, 270 F.R.D. 298, 305 (S.D. Ohio 2010) (finding that attorney's notes were protected work product).

Counsel's Summaries, Correspondence, and Strategy: Defendant says that these "documents contain Defense counsel's summaries and communications to American Fire[,]" including "summaries of medical records or Plaintiff's deposition." DE #145, at 17. Again, as the defense argues, counsel communication containing evidence summaries made in anticipation of litigation or trial is generally a prototypical work product example. *Cf., e.g.*, *Norwood v. FAA*, 993 F.2d 570, 576 (6th Cir. 1993).

Bodily Injury Evaluation Worksheets: Defendant argues that these worksheets were "prepared for litigation and shared with the attorney" and disclose opinions, strengths and weaknesses of the case, and litigation strategy. DE #145, at 18. It appears American Fire created the documents. *Id.* As above, documents of this sort typically would receive work product protection, if prepared in anticipation of litigation and not in the ordinary course of business. *Cf. Parry*, 125 F.R.D. at 453.

Agency Markets Auto/Liability Evaluation and Negotiation Worksheet; Negotiation Planning and Strategy: American Fire essentially makes the same argument as to these documents as it did for the bodily injury evaluation worksheets. DE #145, at 19. As with those documents, worksheets that contain opinions, evaluations of case strengths and weaknesses, and litigation strategy typically would receive work product protection, if prepared in anticipation of litigation and not in the ordinary course of business.

Loss Notice Notes: Finally, Defendant argues that the work product doctrine protects from disclosure certain

lines from these documents.[9] DE #145, at 20. These lines contain American Fire notes regarding various case-related aspects, including Answer strategy, dealing with the extra-contractual claims, settlement negotiations, counsel's opinions and strategies, mediation strategies, and notes from a counsel conference. *See id.* (bullet point list). As with other documents, the work product doctrine would ordinarily protect from disclosure information of this ilk. *See* Fed. R. Civ. P. 26(b)(3)(B) (specifically excluding attorneys' "mental impressions, conclusions, opinions, or legal theories" from discovery of items that are otherwise work product).

* * * *

With this general guidance on attorney-client privilege and the work product doctrine, Defendant shall, **within 14 days**, reassess the subject documents and confer with Plaintiff on the subject. If Defendant agrees that any particular document no longer warrants protection (or is no longer subject to an objection), it shall immediately produce that document to Plaintiff. (This includes documents potentially listed in the privilege log if Plaintiff still seeks them and they are not argued and included in the briefing.[10]) If Plaintiff still asserts a right to discover a particular document(s) and the parties continue to dispute the privilege's or the doctrine's applicability as to that document, the parties shall follow the following process to resolve the dispute.

***8** Defendant shall file a notice in the record indicating by Bates number the documents it is producing *in camera* and shall simultaneously submit those documents *ex parte* to Chambers for *in camera* review. To submit a document, counsel shall email it, *ex parte*, to Chambers (wier_chambers@kyed.uscourts.gov) in PDF format. Counsel may send one collective email (and as to redacted documents, American Fire shall clearly show both redacted and unredacted forms). The Court will then assess all documents and will issue a subsequent order addressing discoverability.[11] The parties shall first confer about status; the point is to winnow down, based on the Court's general guidance, the documents that remain in dispute.

Relevance / Overbreadth / Other Similar Objections

Finally, the Court addresses numerous objections to various interrogatories and requests for production. Of course, federal law governs these discovery disputes, even in a diversity case. *See, e.g.*, *Doan v. Allstate Ins. Co.*, No. 5:07-CV-13957, 2008 WL 2223123, at *2 (E.D. Mich. May 23, 2008).

"Parties may obtain discovery regarding any nonprivileged matter that is relevant to any party's claim or defense and proportional to the needs of the case, considering the importance of the issues at stake in the action, the amount in controversy, the parties' relative access to relevant information, the parties' resources, the importance of the discovery in resolving the issues, and whether the burden or expense of the proposed discovery outweighs its likely benefit." Fed. R. Civ. P. 26(b)(1).[12] The amended Rule "codified a proportionality requirement, ... exhort[ing] judges to exercise their preexisting control over discovery more exactingly." *Robertson v. People Magazine*, No. 14 Civ 6759 (PAC), 2015 WL 9077111, at *2 (S.D.N.Y. Dec. 16, 2015) (denying motion to compel). "Restoring proportionality is the touchstone of revised Rule 26(b)(1)'s scope of discovery provisions." *Siriano v. Goodman Mfg. Co., L.P.*, No. 2:14-cv-1131, 2015 WL 8259548, at *5 (S.D. Ohio Dec. 9, 2015); *see also* Fed. R. Civ. P. 26 advisory committee's note to 2015 amendment. The amendments "also contemplate active judicial case management." *Id.* at *7. Overall, even post-amendments, "the scope of discovery is within the sound discretion of the trial court." *Coleman v. Am. Red Cross*, 23 F.3d 1091, 1096 (6th Cir. 1994); *see also Surles ex rel. Johnson v. Greyhound Lines, Inc.*, 474 F.3d 288, 305 (6th Cir. 2007).[13]

The Court has attempted to cut through the clutter and discern the core of these disputes in an effort to efficiently resolve them.

Interrogatories 7 & 8;[14] Requests 9 & 10: Interrogatories 7 and 8 generally seek information regarding "each and every reserve placed upon the claim of Plaintiff" and the basis on which "all reserves were established and by whom they were established." DE #146-1, at 10-13. Similarly, Requests 9 and 10 generally seek all documents "which provide definitions, methods of calculating, or guidelines

for the establishment of reserves," and "[a]ll documents, memoranda, letters, summaries, or data compilations that were used or relate to the computation of reserves, and the establishment of reserves in this case, for the Plaintiffs [sic] claim." *Id.* at 25.

*9 These interrogatories and requests thus relate to discovery of information concerning "reserves." The term "reserves," in this context, essentially means a sum of money set aside (reserved) as a fund to satisfy current in-force insurance policies or other outstanding liabilities. *See, e.g.*, KRS 304.6-100.

As Plaintiff argues, the Western District of Kentucky has squarely held that evidence of reserves is discoverable. *Madison*, 2012 WL 4592135, at *4. *Madison* specifically distinguished *Meador*,[15] relied on by Defendant, as a case about evidence *admissibility*, not *discoverability*. Relying on the Kentucky Supreme Court's conclusion that evidence of reserves is relevant to bad faith claims, *see Grange Mut. Ins. Co. v. Trude*, 151 S.W.3d 803, 813 (Ky. 2004), the Western District compelled production. *Madison*, 2012 WL 4592135, at *4; *see also, e.g.*, *Park-Ohio Holdings Corp. v. Liberty Mut. Fire Ins. Co.*, No. 1:15-CV-943, 2015 WL 5055947, at *4 (N.D. Ohio Aug. 25, 2015) (compelling production); *Retail Ventures, Inc. v. Nat'l Union Fire Ins. Co.*, No. 2:06-CV-443, 2007 WL 3376831, at *4-*5 (S.D. Ohio Nov. 8, 2007) ("[T]his Court concludes that information regarding reserves in this case, even if not determinative of every issue, is nevertheless reasonably calculated to lead to the discovery of admissible evidence.").

In this diversity suit, the Court finds its sister District's treatment (and the treatment of other intra-Circuit Districts) well-taken and will likewise compel production. In this bad faith suit, evidence of reserves, targeted at the incident in play, is relevant and discoverable under the Rule 26 standard. Defendant must respond to Interrogatories 7 and 8 and Requests 9 and 10, limited in scope to reserves information and procedural documents specifically relevant to reserves in Foster's claim.

Request 15: Request 15 seeks "[a]ll quality control audits or surveys for the offices handling the Plaintiff's claim, including, but not limited to: (1) Home audits or regional audits; (2) Manuals or guidelines for audits; (3) Claim handling quality criteria." DE #146-1, at 28. Defendant's brief treated the dispute over Request 15 as a separate issue. DE #145, at 24. Plaintiff subsumed Request 15 within its discussion of reserves. DE #151, at 24. Because Plaintiff provides no separate discussion, the Court agrees with Defendant that "[a]udits are not at issue." DE #145, at 24. The Court compels no production on this discrete topic as inadequately briefed / supported.

Request 7: Request 7 seeks "[a]ll personnel records, performance goals, job descriptions, and objectives" and other documents of the individuals named in the answers to Interrogatories 14 and 15 "in the time period of ten years prior to the date of service of these requests through the present." DE #146-1, at 23-24. Defendant states it has no objection to providing employee files, with personal identifiers and "other irrelevant information for claims representatives" redacted, but that it does object to providing supervisors' and higher tier employee records. DE #145, at 24. Plaintiff responds, still seeking the information, but conceding that personal information like "job applications, marital information, tax and dependent data, medical information, and the like" could be redacted. DE #151, at 26.

*10 Given the substantial agreement here, and as appropriate under the Rule, the Court will compel further production on Request 7, though limited in scope. Defendant shall produce the documents sought, within limits. The relevant and proportional scope will be personnel records for all involved adjusters, and performance reviews and goals for all such adjusters and their supervisors involved in the decisional chain in this case. The temporal scope shall be from 2007 until and through 2015. Defendant may further redact personal identifiers and information that it, in good faith, finds to be confidential in nature and irrelevant to this dispute (such as marital information, tax/dependent status, and medical information).

Request 11: Request 11 generally seeks personnel or salary administration manuals or other guidance manuals applicable to adjusters and contractors who were involved in Plaintiff's claims, including seven types of specific documents. DE #146-1, at 25-26.

The Court finds some narrowing suggested by Defendant appropriate under the (b)(1) standard. The following is discoverable under Rule 26: Defendant shall produce personnel and salary administration manuals applicable to the involved adjusters and their supervisors (including

enumerations (a)-(g), but not (d)) for the period from 2007 through 2015. This gives Plaintiff proportional discovery by which to measure adjuster incentives, performance metrics, and duties as relevant to this claim, all within an apt temporal context.

Request 13: Request 13, to the extent not redundant, generally seeks employee handbooks. DE #146-1, at 27. As Defendant argues, the request is patently overbroad. The Court finds Defendant's suggested narrowing appropriate under Rule 26. Accordingly, Defendant shall produce employee handbooks applicable to Kentucky bodily injury / UIM claims adjusters in effect from 2007 through 2015.

Request 4: Request 4 generally seeks records, manuals, documents, and communications that relate to a record of claims for unfair claim settlement practices. DE #146-1, at 22. Again, the request is overbroad, and the Court finds certain limitations appropriate and necessary to bring the request in line with the Rule 26 scope. *See Jones*, 2008 WL 490584, at *2. As in *Jones*, the Court will compel production of records, documents, and communications (as stated in Request 4) related to allegations of unfair claims settlement practices involving UIM claims in Kentucky in the period from 2005 to 2015. *Id.*

Request 5: Request 5 generally seeks manuals, handbooks, and other materials "respecting claims handling procedures ... in the time period of ten years prior to the date of service of these requests through the present." DE #146-1, at 22. As with other claims previously discussed, the Court finds certain limitations appropriate. The Court finds the following is within the proper discovery scope in this case: Defendant shall produce manuals, handbooks, and other claims handling materials applicable to Kentucky bodily injury / UIM claims in effect from 2007 through 2015.

Request 12: Request 12 generally seeks documents pertaining to programs designed to control claims costs, including five particular types. DE #146-1, at 26. Defendant maintains a relevance objection. DE #145, at 29. Plaintiff barely briefed the issue. In this bad faith claim, the Court finds a sharply limited production appropriate under the Rule. Defendant shall produce documents responsive to Request 12 related to programs designed to control claims costs that applied to Kentucky bodily injury / UIM claims from 1 year prior to Foster's accident through the date of settlement of Foster's underlying claim. The Court does not order the RFP 12(5) production.

***11** Request 20: Request 20 generally seeks documents that set Defendant's policies and / or philosophies, including seven particular types. DE #146-1, at 31. The Court again finds the information, in a narrowed scope, discoverable under Rule 26. Defendant shall produce documents that set Defendant's policies and / or philosophies applicable to Kentucky bodily injury / UIM claims and proper claims handling in effect from 2007 through 2015.

Request 14: Request 14 generally seeks company newsletters for the past 10 years "dealing with claims or sales of insurance policies." DE #146-1, at 27. Defendant maintains a relevance objection. DE #145, at 30-31. The Court finds, on this record and given case allegations, a sharply constrained group of company newsletters discoverable. Information in a newsletter is potentially relevant to these bad faith claims. Defendant shall produce company newsletters addressing Kentucky bodily injury / UIM claims and/or claims handling from 1 year prior to Foster's accident through the date of settlement of Foster's underlying claim.

Conclusion

To summarize, the Court will apply an appropriately circumspect attorney-client privilege and work product doctrine analysis to documents at issue in this case, and the Courts orders specific production regarding the documents subject to the general relevance and other discovery objections. All production herein ordered shall occur **within 14 days**, and the parties shall comply with the above terms to proceed with further privilege or work product issues, if and as necessary.

* * * * *

The Court issues this Order resolving non-dispositive pretrial matters under 28 U.S.C. § 636(b)(1)(A). Any party objecting to this Order should consult the statute and Federal Rule of Civil Procedure 72(a) concerning its right of and the mechanics for reconsideration before the

District Court. Failure to object waives a party's right to review.

All Citations

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Footnotes

1 Defendant's brief (DE #145) defines the universe of documents potentially covered by attorney-client privilege. *See* DE ##155 (Reply), at 3 ("Plaintiff critiques American Fire for inconsistencies in the privilege log, but American Fire's brief delineates exactly which entries are protected by the attorney-client privilege."); 145, at 6 nn. 3-5 (listing documents).

2 "[I]t was GM's burden to provide enough detail in its Privilege Log to convince the lower courts that the privilege applied to the documents in question." *Gen. Motors Corp. v. Chauvin*, No. 2004-SC-0338-MR, 2005 WL 119747, at *7 (Ky. Jan. 20, 2005).

3 *See also, e.g., In re Equine Oxygen Therapy Resources, Inc.*, No. 14-51611, 2015 WL 1331540, at *4 (Bankr. E.D. Ky. Mar. 20, 2015) (stating, "Bad faith claims also inevitably result in costly and time-consuming discovery. It is common for plaintiffs to seek the insurer's litigation file, which frequently results in discovery disputes over work product and attorney-client privilege.").

4 The exception hinges on retention of counsel for the purpose of aiding crime or fraud, per KRE 503(d)(1); Plaintiff does not seriously pursue this as the governing analysis here.

5 As the court observed in *Palmer by Diacon v. Farmers Ins. Exch.*, 861 P.2d 895, 906 (Mont. 1993) (citation omitted):

> The nature of the relationship, not the nature of the cause of action, controls whether communications between attorney and client can be discovered. The attorney-client privilege protects communications in first-party bad faith cases when the insurer's attorney did not represent the interests of the insured in the underlying case. That is the nature of the relationship here; therefore, the attorney-client privilege applies in this case.

Here, Foster does not suggest that relevant counsel at any point represented him or acted in his interests, and American Fire expressly describes the subject lawyers as "retained ... to defend an underinsured motorist lawsuit (UIM)." DE #145, at 7.

6 Without reviewing the documents, and knowing only the defense's 4-category-characterization, the Court especially has significant doubts over the privilege's applicability to category 3. It appears questionable whether fee communications are "made for the purpose of facilitating the rendition of professional legal services[.]" KRE 503(b); *cf. Monin v. Monin*, 156 S.W.3d 309, 318 (Ky. Ct. App. 2004); *Morganroth & Morganroth v. DeLorean*, 123 F.3d 374, 383 (6th Cir. 1997); *United States v. Haddad*, 527 F.2d 537, 538-39 (6th Cir. 1975) (applying federal law and holding that amount of fees or payment of a fee is generally not protected by the attorney-client privilege). These concerns are also present in the rather stark defensive privilege log. DE #151-1. The often terse descriptions and characterizations create difficulty in assessing privilege elements. *See, e.g., Cooey v. Strickland*, 269 F.R.D. 643, 649 (S.D. Ohio 2010).

7 While the work product assertion at dispute inception may have been broader, American Fire has limited the universe of potentially protected documents to those discussed in its brief. DE #155 (Reply), at 6.

8 Plaintiff categorically argued that "[w]ork product is not a basis for withholding the claim file documents[,]" DE #151, at 13, but it later assessed the merits of work product claims. *Id.* at 21-22. Ultimately, the parties mostly talk past each other in the briefing. Because the lawyers largely argue in generalities and may not even agree on the universe of documents at issue, the Court will proceed to give general guidance, all this record supports.

Plaintiff also makes no mention in the papers or attempt to satisfy the "substantial need" or other inquiries of Rule 26(b)(3)(A)(ii). "Rule 26(b)(3) places a twofold burden on the party seeking to overcome the work product privilege and discover protected materials; the requesting party must show both substantial need and undue hardship." *Spirit Master Funding, LLC v. Pike Nurseries Acquisition, LLC*, 287 F.R.D. 680, 686 (N.D. Ga. 2012); *see also id.* at 684 (Once the party asserting work product privilege "has shown the application of" the privilege, "the burden shifts to [the party seeking discovery] to demonstrate the existence of exceptional circumstances for the discovery of otherwise privileged documents.").

The Court notes Plaintiff's division of the work-product assertions into "pre-litigation" and "post-litigation" (and undated) categories. DE #151, at 21. While timing is a relevant factor in the "anticipation of litigation" analysis, it by no means decides the issue. *Parry v. Highlight Indus., Inc.*, 125 F.R.D. 449, 451 (W.D. Mich. 1989); *In re OM Securities Litig.*, 226 F.R.D. 579, 584-85 (N.D. Ohio 2005).

Defendant curiously lists loss notice notes, bodily injury evaluation worksheet, and medical and deposition summaries under its attorney-client privilege discussion in the Reply. DE #155, at 4-5. The Court will defer further comment until it sees the records.

9 Defendant says it produced much of the information from these loss notice notes to Plaintiff. DE #145, at 20.

10 Thus, the defense has listed the universe of what it seeks to protect, and only those documents should be part of the *in camera* review. As to the rest, which no longer are under consideration, American Fire should promptly produce.

11 Based on Defendant's brief, the Court agrees with Plaintiff, DE #151, at 14, that a defensive "litigation conduct" objection is no longer at issue in these disputes.

12 Applying the Rule as amended on December 1, 2015, is just and practicable in this case. *See, e.g., Doe v. Trs. of Bos. Coll.*, No. 15-10790-DJC, 2015 WL 9048225, at *1 (D. Mass. Dec. 16, 2015) (applying amended rule "insofar as just and practicable to all proceedings pending on Dec. 1, 2015" (internal quotation marks omitted)).

13 There is some mention of a medical-record-related dispute in the papers, *see, e.g.*, DE #145, at 21-22, but the briefing (which is really limited to some defensive statements) on the topic is too indeterminate for the Court to adequately address (or even determine if its involvement is necessary).

14 Defendant first identified Interrogatories 8 and 9 before addressing Interrogatories 7 and 8. DE #145, at 22. Interrogatory 9 is unrelated to reserves. DE #146-1, at 13.

15 *Meador v. Indiana Ins. Co.*, No. 1:05CV-00206-TBR, 2007 WL 1098208 (W.D. Ky. Apr. 12, 2007).

End of Document

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NOT TO BE PUBLISHED
Court of Appeals of Kentucky.

Hale General Contracting, Inc.; Terry Hale; and Brenda Hale, Appellants
v.
Motorist Mutual Insurance Company, Appellee

NO. 2015–CA–000396–MR
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Discretionary Review Denied by Supreme Court September 15, 2016

APPEAL FROM WARREN CIRCUIT COURT, HONORABLE STEVE ALAN WILSON, JUDGE, ACTION NO. 09–CI–00864

Attorneys and Law Firms

BRIEF FOR APPELLANT: Matthew J. Baker, Bowling Green, Kentucky

BRIEF FOR APPELLEE: Kim F. Quick, Elizabethtown, Kentucky

BEFORE: COMBS, KRAMER, AND NICKELL, JUDGES.

OPINION

KRAMER, JUDGE:

*1 The Warren Circuit Court entered judgment in conformity with a jury verdict dismissing, with prejudice, Terry Hale's claim of bad faith against the appellee, Motorist Mutual Insurance Company ("Motorist"). Hale now appeals, [1] arguing the circuit court committed error in admitting certain evidence during trial. Finding no error, we affirm.

On May 24, 2008, Hale was operating a motor vehicle owned by Hale General Contracting, Inc., on a public road in Warren County, Kentucky, when he was involved in a motor vehicle accident with another vehicle driven by Joyce Button. At the time, Hale had a policy of insurance with Motorist Mutual Insurance Company which provided uninsured and underinsured (UM/UIM) coverage. He initiated an action in Warren Circuit Court on May 20, 2009, against Motorist for UM/UIM coverage because the cost of treating his injuries resulting from the accident exceeded the $25,000 limit of Button's auto insurance policy.

Discovery commenced, and Hale first itemized the extent of his damages on January 12, 2010—an amount he alleged was $1,394,656.84. The circuit court directed the parties to mediation, and mediation was held on January 10, 2012. In his brief, Hale describes what happened next as follows: "At this mediation, Motorist failed and refused to mediate and negotiate in good faith; therefore, at the conclusion of the mediation, the Hales immediately prepared and filed a motion to amend their complaint, asserting a first party bad faith claim against Motorist."

Shortly thereafter, the circuit court bifurcated Hale's action and a jury trial was set for the month of September, 2012, for the sole purpose of resolving Hale's UM/UIM claim. One month prior to the trial date, Motorist offered Hale $50,000 to settle. Hale refused. The trial proceeded with Hale and his spouse (who claimed loss of consortium due to the accident) collectively asking for a maximum amount of $856,905 in damages. A jury ultimately rejected the loss of consortium claim and awarded Hale $300,000 for past and future pain and suffering; $33,750 in medical expenses; and $45,000 in past and future economic loss. Hale's total recovery was reduced, however, by 15% for his comparative negligence in failing to wear a seatbelt, and was further reduced by $35,000 to reflect his receipt of $10,000 in no-fault benefits and Button's $25,000 policy limits. Accordingly, the net sum of his recovery was $286,838. Motorist filed no appeal.

In January of 2015, Hale's bad faith claim against Motorist proceeded to trial. The circuit court ultimately dismissed this claim with prejudice after a jury made the following findings: (1) Motorist had not failed to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies; (2) Motorist had not refused to pay Hale's claims without

conducting a reasonable investigation based upon all available information; (3) Motorist had not violated its duty to attempt in good faith to effectuate a prompt, fair and equitable settlement of a claim in which liability had become reasonably clear; and (4) Motorist had not compelled Hale to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amount Hale ultimately recovered in his lawsuit.

*2 Hale's arguments on appeal are two-fold. First, he contends the circuit court committed reversible error by allowing Motorist to introduce evidence regarding its negotiations with Hale and the parties' settlement positions during and after the January 10, 2012 mediation. This, he asserts, is because Kentucky Rule of Evidence (KRE) 408[2] provides that settlement negotiations are *always* inadmissible. Second, Hale argues the circuit court committed reversible error by also allowing Motorist to introduce expert opinion evidence that tended to prove he had exaggerated his estimate of economic damages resulting from the May 24, 2008 accident, and that he had also been comparatively negligent in causing the accident and a large extent of his own injuries by failing to avoid or lessen the severity of the accident by keeping a proper lookout, and by admittedly failing to wear a seatbelt. Hale asserts this expert evidence became irrelevant for all purposes after the jury in the September, 2012 trial found in his favor.

Both of Hale's arguments have no merit because they are predicated upon a misapprehension of the issues presented in the January 2015 trial. To reemphasize, the overarching issue was whether Motorist committed the tort of bad faith by denying coverage and otherwise failing to offer Hale an adequate settlement prior to the September 2012 trial date. The essential elements of such an action—elements which are not referenced or discussed in Hale's brief—were explained in *Wittmer v. Jones,* 864 S.W.2d 885 (Ky.1993) as follows:

> [A]n insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed ... [A]n insurer is ... entitled to challenge a claim and litigate it if the claim is debatable on the law or facts.

Id. at 890 (quoting *Federal Kemper Ins. Co. v. Hornback,* 711 S.W.2d 844, 846–47 (Ky.1986) (Leibson, J., dissenting)).

As to Hale's first argument, Motorist did not introduce evidence of its settlement negotiations with Hale to prove either its liability for or the invalidity of Hale's UM/UIM claim or its amount. KRE 408 prohibits such a use for this type of evidence. Moreover, doing so would have been pointless because the prior jury verdict following the September 2012 trial (which Motorist never appealed) had already resolved the matter of Motorist's liability.

Instead, it is readily apparent from the record that Motorist introduced this evidence for "another purpose" that the language of KRE 408 does not prohibit. Specifically, Motorist used this evidence to establish that any failure on its part to offer a settlement with Hale between the January 10, 2012 mediation and September, 2012 trial did not injure Hale in any cognizable way. It demonstrated (1) all of Hale's multiple settlement demands, which ranged between $1.3 million and $400,000, were well in excess of what he eventually recovered in his UM/UIM judgment; and (2) Hale admitted, over the course of his deposition testimony, that he never would have settled for the amount he was awarded in his UM/UIM judgment.

*3 Motorists also points out in its brief that the tort of bad faith can warrant punitive damages and requires proof that an insurer engaged in outrageous conduct due to an evil motive or reckless indifference. How a jury can be expected to determine whether the insurer's settlement conduct was outrageous without knowing something of its negotiations with the insured is, as Motorists notes, a mystery. The circuit court accordingly did not violate KRE 408 by admitting this evidence, and Hale cites no rule of law that otherwise would have excluded it.

Hale's second argument similarly misses the mark. To begin, Hale cites no rule of law standing for the proposition that evidence, once disbelieved by a jury at some point in time, ceases to be evidence for any and all purposes thereafter. This is because no such rule of law exists. Furthermore, by reintroducing the expert evidence it had previously introduced in the September, 2015 UM/UIM trial, Motorist was not attempting, as Hale repeatedly insists throughout his brief, to retry the UM/UIM action.

Instead, Motorist introduced this evidence because it was relevant to the second element of the tort of bad faith, which requires an insurer to "lack a reasonable basis in law or fact for denying the claim." *Wittmer,* 864 S.W.2d at 890. A central issue in the January 2015 trial was whether it was reasonable for Motorist to rely upon its own experts' assessments of the facts and circumstances of the accident, Hale's injuries, and Hale's estimates of economic loss as a basis for refusing to settle with Hale prior to the September, 2012 trial date.

At or about the time of the January 12, 2010 mediation, these experts had opined to Motorist that Hale had overestimated the economic damages component of his various settlement demands, and that Hale had been comparatively negligent in causing the May 24, 2008 accident and most of his resulting injuries. Hale does not question these experts' respective qualifications or the methodologies underpinning their conclusions; Hale does not argue it was unreasonable for Motorist to have relied upon these experts' conclusions as a basis for determining, under the facts, that it had a legitimate comparative negligence defense; and, as noted in *Curry v. Fireman's Fund Ins. Co.,* 784 S.W.2d 176, 178 (Ky.1989), an insurance carrier has no duty to settle if doing so would force it to "abandon legitimate defenses."

We have addressed the breadth of Hale's appellate arguments and have determined they are without merit. The Warrant Circuit Court is therefore AFFIRMED.

NICKELL, JUDGE, CONCURS.

COMBS, JUDGE, CONCURS IN RESULT ONLY.

All Citations

Not Reported in S.W.3d, 2016 WL 1068997

Footnotes

1 Hale General Contracting, Inc., and Brenda Hale were listed as parties below and were likewise added as appellants. However, both of these parties were dismissed as plaintiffs prior to the trial of Hale's bad faith claim, and neither has any legal interest in the outcome of this appeal.

2 KRE Rule 408 provides:

> Evidence of:
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> (1) Furnishing or offering or promising to furnish; or
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> (2) Accepting or offering or promising to accept a valuable consideration in compromising or attempting to compromise a claim which was disputed as to either validity or amount, is not admissible to prove liability for or invalidity of the claim or its amount. Evidence of conduct or statements made in compromise negotiations is likewise not admissible. This rule does not require the exclusion of any evidence otherwise discoverable merely because it is presented in the course of compromise negotiations. This rule also does not require exclusion when the evidence is offered for another purpose, such as proving bias or prejudice of a witness, negativing a contention of undue delay, or proving an effort to obstruct a criminal investigation or prosecution.

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NOT TO BE PUBLISHED
Court of Appeals of Kentucky.

HAMILTON MUTUAL INSURANCE COMPANY OF CINCINNATI, Ohio and EMC Insurance Company, Appellants/Cross–Appellees
v.
Harlon BARNETT, Administrator of the Estate of Steven Ray Barnett, Appellee/Cross–Appellant.

Nos. 2007–CA–000029–MR, 2007–CA–000064–MR.
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Aug. 8, 2008.
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Discretionary Review Denied by Supreme Court May 13, 2009.

Appeal and Cross–Appeal from Taylor Circuit Court, Action No. 00–CI–00004; Doughlas M. George, Judge.

Attorneys and Law Firms

Steven C. Call, David A. Nunery, Campellsville, KY, for appellant.

M. Austin Mehr, Lexington, KY, for appellee.

Before LAMBERT, MOORE, and WINE, Judges.

OPINION AND ORDER

LAMBERT, Judge.

*1 Hamilton Mutual Insurance Company (hereinafter "Hamilton Mutual") appeals from a jury verdict in favor of Harlon Barnett, finding that Hamilton Mutual acted in bad faith by delaying payment on a policy for underinsured motorists coverage. Hamilton Mutual additionally moves this Court to remove EMC Insurance Company from the style of the case. For the reasons set forth herein, we grant the motion to dismiss EMC as a party to the appeal, and we affirm in part and reverse in part the judgment below.

Steven Ray Barnett was a passenger in a fatal head-on collision on June 2, 1995. The drivers of both vehicles were intoxicated. The estates of all five of the young men killed in the accident filed various lawsuits in Marion Circuit Court, which were promptly consolidated into one action.

Harlon Barnett, Steven's father and administrator of Steven's estate, filed an underinsured motorist insurance claim (hereinafter "UIM"), requesting the full policy limits of $900,000.00 in May of 1996. Simultaneously, Barnett filed a complaint in Marion Circuit Court seeking damages as a result of his son's death. On December 6, 1996, the Marion Circuit Court issued an order stating that (1) Steven was at all times a resident of the Barnett household; (2) it was uncontested that the Barnetts had UIM coverage on three automobiles and paid premiums for all three vehicles; (3) there was UIM coverage of $300,000.00 per vehicle; (4) "stacking" was allowable under Kentucky law; and therefore (5) there was $900,000.00 available in UIM protection.

On January 9, 1997, Barnett's attorney sent a letter to one of Hamilton Mutual's attorneys demanding settlement for the policy limits of $900,000.00. Hamilton Mutual responded to this demand in a letter dated January 31, 1997, which proposed a structured settlement with a present value of $200,000.00. The letter explained that there were two concerns with Barnett's claim. First, Steven was riding with an intoxicated driver, which invoked comparative negligence. Second, while Barnett could claim damages in excess of $2,000,000.00, the reality was that conservative juries in Kentucky and Marion County specifically rarely awarded such substantial verdicts in wrongful death cases, especially where liability was not clear. Barnett rejected this offer.

On July 14, 1997, Barnett lowered his demand to $850,000.00. Mediation was held on November 7, 1997, with all parties to the consolidated action being present. As a result of the mediation, Barnett reduced his demand to $775,000.00, and Hamilton Mutual offered a structured settlement with a present value of $300,000.00. Barnett rejected this offer.

With a trial date set for January 9, 1999, Barnett resumed settlement negotiations. In early December 1998, Barnett

made a $690,000.00 settlement demand and indicated that he was not interested in a structured settlement. Hamilton Mutual responded to this demand with an offer of a structured settlement with a present value of $410,000.00. On December 21, 1998, Barnett reduced his settlement demand to $675,000.00, and Hamilton Mutual responded the following day with an offer of a structured settlement with a present value of $500,000.00. Barnett again refused. A follow-up letter reiterating the initial concerns Hamilton Mutual had regarding Barnett's claim was then sent, which concluded by urging Barnett to demand $587,500.00, the midpoint between the parties' last settlement positions. This demand was forwarded to Hamilton Mutual and, on January 8, 1999, the parties settled for an unstructured settlement amount of $587,500.00.

*2 The complaint in this action was filed January 4, 2000, and proceeded to trial September 25, 2006. Barnett alleged that Hamilton Mutual violated its duty to exercise good faith in the handling and settlement of his UIM claim. Furthermore, he asserted that Hamilton Mutual violated duties established under the Unfair Claims Settlement Practice Act and the Consumer Protection Act. Barnett contended that said actions were done fraudulently, maliciously, intentionally, oppressively, and with reckless disregard of his rights. He complained that he sustained the following damages: 1) enormous amount of pain, suffering, and emotional distress; 2) embarrassment and humiliation; 3) court costs and legal expenses; and 4) loss of interest and investment income on the money ultimately settled. He also claimed that he was entitled to recover punitive damages against Hamilton Mutual.

At trial, Hamilton Mutual asserted that it had relied on the experience of its attorneys in handling wrongful death claims to place a reasonable settlement value on the Barnett claim. On September 27, 2006, a jury returned a verdict in favor of Barnett with an award of $150,000.00 for loss of interest and investment income; $5,000.00 for legal costs expended in the underlying case; and punitive damages in the amount of $600,000.00. The court subsequently awarded Barnett an additional $195,833.33 pursuant to KRS 304.12–235 for legal expenses incurred in the underlying action. This appeal followed.

Hamilton Mutual first argues that the trial court erred in admitting evidence of litigation conduct and settlement offers in contravention of the Kentucky Supreme Court decision in *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512 (Ky.2006). We disagree.

Abuse of discretion is the proper standard of review of a trial court's evidentiary rulings. *See Woodard v. Commonwealth*, 147 S.W.3d 63, 67 (Ky.2004). The test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair, or unsupported by sound legal principles. *Commonwealth v. English*, 993 S.W.2d 941, 945 (Ky.1999).

In *Knotts*, the Kentucky Supreme Court held that,

> [t]he commencement of litigation by the filing of a complaint, even when the claim adjustment process is underway [ ] does not change the fundamental nature of what the claimant seeks. The "claim"—for compensatory payment under the insurance policy—is the same as before the litigation began. The claimant has simply opted to seek satisfaction of the claim through a different procedure. Nothing in KRS 304.12–230 limits its applicability to pre-litigation conduct, and since the statute applies to "claims," it continues to apply to an insurer so long as a claim is in play. As such, we hold that KRS 304.12–230 applies both before and during litigation.

Knotts, 197 S.W.3d at 517. Moreover,

> [o]ne should note a distinguishing factor between the insurer's settlement behavior during litigation and its other litigation conduct. The Rules of Civil Procedure provide remedies for the latter. To permit the jury to pass judgment on the defense counsel's trial tactics and to premise a finding of bad faith on counsel's conduct places an unfair burden on the insurer's counsel, potentially inhibiting the defense of the insurer. An insurer's settlement offers, on the other hand, are not a separate abuse of the litigation process itself. If a litigant refuses to settle or makes low offers, his adversary cannot avail himself of motions to compel, argument, or cross-examination to correct his failure.

*3 In principle, an insurer's duty to settle should continue after the commencement of litigation. If the insurer were immunized for objectional [sic] settlement conduct occurring after litigation begins, the insured would be left without a remedy. It makes sense, therefore, to hold the insurer responsible for such conduct. The rules, however, provide litigants with protection against other forms of litigation [conduct], and for that reason a court could rationally exclude evidence of the insurer's other misdeeds committed during the litigation process.

See Knotts, at 523, *quoting* Stephen S. Ashley, *Bad Faith Actions Liability and Damages* § 5A:6 (2005). After carefully reviewing the record, it is clear that the trial court considered these meticulous distinctions. In its order on September 5, 2006, the court carefully laid out the nuances of the *Knotts* opinion and then reasoned that,

> [t]he majority of the litigation conduct that occurred after the December 6, 1996, ruling centered on settlement discussions between the parties. [Barnett] would not be able to rely on the rules of civil procedure for sanctions if [Hamilton Mutual] failed to make reasonable offers and delayed in making these offers. Therefore, the facts of this case encompass very little litigation conduct.

Hamilton Mutual attempts to define all its settlement discussions as litigation conduct. We, however, agree with the trial court's sound reasoning that the majority of the alleged litigation conduct was actually settlement discussions, and is therefore admissible both before and after the December 6, 1996, order.

As to any actual "litigation conduct" that was admitted, we reiterate the holding in our recent decision in *Hamilton Mutual Ins. Co. of Cincinnati v. Buttery,* 220 S.W.3d 287 (Ky.App.2007).

> In *Knotts,* the [Kentucky Supreme] Court allowed evidence of an insurer's settlement behavior during litigation to be used to demonstrate bad faith. However, it clearly distinguished that settlement conduct from an insurer's litigation tactics in general, holding that: ['] [w]e are confident that the remedies provided by the Rules of Civil Procedure for any wrongdoing that may occur within the context of the litigation itself render unnecessary the introduction of evidence of litigation conduct.['] *[Knotts],* at 522. Consequently, evidence of an insurer's general litigation tactics (distinguished from evidence of its settlement behavior during the course of litigation) is generally not admissible on the issue of bad faith.

In *Knotts,* litigation against the insurer was resolved by means of summary judgment. Therefore, the Kentucky Supreme Court did not address any evidence presented to the jury by the insured. In this case, after having reviewed the record, we are not persuaded that the introduction of the challenged evidence requires reversal of the judgment. Hamilton Mutual aggressively defended its actions based upon the "advice-of-counsel" defense. Throughout the bad faith action, it argued that its delay in ultimately satisfying Buttery's claim resulted from litigation decisions that it had made during the trial of the underlying action. Hamilton Mutual claimed that it had a reasonable basis to deny Buttery's claim because it had consistently acted on the advice of counsel. Because Hamilton Mutual effectively "opened the door" by presenting evidence of its litigation conduct, we hold that Buttery was entitled to comment on the evidence in rebuttal. *Harris v. Thompson,* 497 S.W.2d 422, 430 (Ky.1973). The admission of the challenged evidence does not constitute reversible error.

*4 *Buttery,* 220 S.W.3d at 294. Similarly, in the case at hand, Hamilton Mutual aggressively defended its actions under the "advice-of-counsel" defense. Therefore, we again find that they "opened the door" by introducing their litigation conduct as a defense. Accordingly, we do not find that the trial court abused its discretion in admitting the disputed evidence.

Hamilton Mutual then argues that it was entitled to a judgment notwithstanding the verdict (hereinafter "JNOV"). We disagree.

> In ruling on a JNOV motion, the trial court is required to consider the evidence in a light most favorable to the party opposing the motion and to give that party every reasonable inference that can be drawn from the record. *Taylor v. Kennedy,* 700 S.W.2d 415, 416 (Ky.1985). The motion is not to be granted "unless there is a complete absence of proof on a material issue in the action, or if no disputed issue of fact exists upon

which reasonable men could differ." *Taylor,* 700 S.W.2d at 416. On appeal, we are to consider the evidence in the same light. *Lovins v. Napier,* 814 S.W.2d 921, 922 (Ky.1991).

See Brewer v. Hillard, 15 S.W.3d 1, 9 (Ky.App.1999). Moreover,

> [w]here there is conflicting evidence, it is the responsibility of the jury to determine and resolve such conflicts.... *Cf. Taylor v. Kennedy,* 700 S.W.2d 415 (Ky.App.1985). The reviewing court, upon completion of a consideration of the evidence, must determine whether the jury verdict was flagrantly against the evidence so as to indicate that it was reached as a result of passion or prejudice. If it was not, the jury verdict should be upheld. *Cf. Lewis v. Bledsoe Surface Mining Co.,* 798 S.W.2d 459 (Ky.1990); *NCAA v. Hornung,* 754 S.W.2d 855 (Ky.1988).

See Bierman v. Klapheke, 967 S.W.2d 16, 19 (Ky.1998).

The litany of issues Hamilton Mutual assert that could only fairly and equitably be found in their favor all involve issues of fact upon which reasonable minds could differ. Additionally, there is no evidence in the record that the jury's verdict was flagrantly against the evidence or a result of passion or prejudice. Therefore, we will not now substitute our judgment for the jury's.

Hamilton Mutual also contends that the jury should not have been instructed under KRS 304.12–235 because Barnett did not file a claim but instead filed a lawsuit and additionally that Barnett was not entitled to attorneys' fees because of the timing of the fee agreement. We disagree.

Barnett's attorney sent a letter to Hamilton Mutual on May 10, 1996, which notified that a claim was being made, the fact of Barnett's death, the accident report, and a draft complaint. Pursuant to the policy, Hamilton Mutual requires written notice to identify the injured person and to obtain information regarding time, place, and circumstances of the accident. These elements were satisfied. Moreover, the trial court noted that "[a]fter the [c]ourt's ruling on December 6, 1996, there appears to be no question as to the insurer's obligation to pay."

***5** In *Knotts,* the Kentucky Supreme Court clearly stated that,

> [t]his general use [of the word claim] is applicable to KRS 304.12–230. The "right" being asserted arises under the insurance policy and is the right to compensation for injuries for which liability has been established. Thus, "claim," as used in the statute, means an assertion of a right to remuneration under an insurance policy *once liability has reasonably been established.* This is usually done by making the claim directly to the insurance company, which then engages in the claim adjustment process. But it *may also be accomplished by instituting litigation, which is simply another means of asserting the right under the insurance policy.* Though litigation is distinct from the claims adjustment process in that it specifically invokes the courts' power to decide the issue of liability, both procedures are simply methods of pursuing claims under an insurance policy. It is often the case that both methods are employed, with litigation following (or preempting) the claim adjustment process.

Knotts, at 516–17 (emphasis added). We see no reason that a different definition of claim would be applicable in KRS 304.12–235 than in KRS 304.12–230, as the two statutes are part of the same legislative scheme. Therefore, we find no merit in Hamilton Mutual's assertion that Barnett's decision to file a lawsuit in lieu of filing a formal claim precludes instructions to the jury under KRS 304.12–235. Accordingly, we also conclude that there was no error in granting reasonable attorney's fees under KRS 304.12–235(3), which states that "[i]f an insurer fails to settle a claim within the time prescribed ... and the delay was without reasonable foundation ... the insured person ... *shall be entitled* to be reimbursed for his reasonable attorney's fees incurred." (Emphasis added).

Hamilton Mutual additionally argues that the jury should not have been instructed on Barnett's claim for loss of interest and investment income. Barnett alternatively contends that the trial court should not only have instructed on loss of interest and investment income but also on prejudgment interest under KRS 304.12–235.

First, KRS 304.12–235(2) is mandatory in nature. It states that "[i]]f an insurer fails to make a good faith attempt to settle a claim ... the value of the final settlement *shall bear interest* at the rate of twelve percent (12%) per annum from and after the expiration of the thirty (30) day period." (Emphasis added). Since the jury found that Hamilton Mutual failed to make a good faith attempt to settle the claim within thirty days of notice of the claim, Barnett's assertion that he is entitled to interest on the value of the final settlement from and after January 5, 1997, is correct.

The statutory scheme governing bad faith conduct by insurance companies contemplates how to properly compensate the insured adequately. That is the function of KRS 304.12–235(2) discussed above. We agree with the trial court that allowing Barnett to collect both interest under KRS 304.12–235(2) and loss of interest and investment income would amount to double recovery. Estimating the loss of interest and investment income on Barnett's claim is simply too speculative in nature. More importantly, we would be deviating from clear legislative intent on how to adequately compensate an injured insured under KRS 304.12–235 if we endorsed loss of interest and investment income over the statutorily established 12% per annum. Therefore, we find that awarding loss of interest and investment income was an abuse of discretion, and we instruct the trial court to award 12% per annum from January 5, 1997, to the date of settlement, January 8, 1999, on the final settlement amount of $587,500.00. After careful review, however, we decline to reverse the trial court's decision to deny pre-judgment interest after January 8, 1999, as it was within its sound discretion to do so. *See Dalton v. Mullins,* 293 S.W.2d 470, 477 (Ky.1956); *see also, e.g., Curtis v. Campbell,* 336 S.W.2d 355 (Ky.1960); *Beckman v. Time Fin. Co.,* 334 S.W.2d 898 (Ky.1960); *Avritt v. O'Daniel,* 689 S.W.2d 36 (Ky.App.1985).

***6** Hamilton Mutual next asserts that the jury instructions were prejudicial, thereby warranting a new trial. "An error in a court's instructions must appear to have been prejudicial to the appellant's substantial rights or to have affected the merits of the case or to have misled the jury or to have brought about an unjust verdict in order to constitute sufficient ground for reversal of the judgment." *Miller v. Miller,* 296 S.W.2d 684, 687 (Ky.1956), *quoting* Stanley's Instructions to Juries, Sec. 44, p. 60. Hamilton Mutual argues that questions two, four, six, and eight of the jury instructions were repetitive and simply rephrased the applicable law in a manner that could only confuse the jury. After carefully reviewing the jury instructions, we find that the trial court correctly outlined the common law and statutory requirements for a finding of bad faith.

In order to sustain a claim of bad faith,

> an insured must prove three elements ...:(1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying [or delaying] the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying [or delaying] the claim or acted with reckless disregard for whether such a basis existed.... [A]n insurer is ... entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.

Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky.1993). The issue of delaying the claim was an essential element of the jury instructions, and there is no evidence that its inclusion in the disputed questions resulted in any prejudice or an unjust verdict. Moreover, despite Hamilton Mutual's contention, outrageous conduct is not required to prove bad faith. Thus there was also no error in the court not including that element in its jury instructions.

Furthermore, Hamilton Mutual fails to provide any evidence that the inclusion of denial of the claim as an element of the instructions prejudiced a substantial right, affected the merits of the case, or resulted in an unjust verdict. Therefore, we find any error in its inclusion harmless. "The test for harmless error is whether there is any reasonable possibility that absent the error the verdict would have been different." *See Crane v. Commonwealth,*

726 S.W.2d 302, 307 (Ky.1987). The record indicates that the jury answered every question affirmatively, meaning that even excluding the alleged improper instructions on denying the claim, the jury still found Hamilton Mutual's conduct constituted a violation of Kentucky's bad faith law. Therefore, we find that any error was harmless and thus not reversible.

Hamilton Mutual finally argues that the trial court abused its discretion in refusing to admit into evidence Judge Spragen's handwritten notes from the November 7, 1997, mediation, regarding the value of the Barnett Estate. The trial court excluded the notes as inadmissible hearsay, finding that there was no way to verify what each number was intended to represent. Hamilton Mutual wanted to assert that the values represented the fair range of values on the claim. However, hearsay is "a statement, [oral or written,] other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." Kentucky Rules of Evidence (KRE) 801(c). They contend that the notes are exceptions to the general rule against hearsay either as a regular conducted activity or to establish an existing state of mind. However, it is illogical to imply that numbers alone written by a mediator rather than a party to the action indicate an existing state of mind pertinent to the action at hand. Moreover, despite that it was routine for Judge Spragen to keep notes during mediations, there is no evidence of what the numbers mean and no routine system to discern their meaning. Therefore, after reviewing the record and the Kentucky Rules of Evidence, we find that the trial court did not abuse its discretion in declining to submit the handwritten notes as inadmissible hearsay.

*7 As to the motion to dismiss EMC as a party, Barnett asserts that because EMC is the parent company of Hamilton Mutual, EMC should not be dismissed as a party. However, the complaint contains no allegation that Hamilton is the alter ago of EMC or that the corporate veil should be pierced. Nor does the complaint allege facts sufficient to state a claim for piercing corporate veil. Barnett does not allege that Hamilton is a shell corporation or mere facade for EMC, that Hamilton is fraudulently or otherwise undercapitalized, that Hamilton is fraudulently organized, that EMC's ownership and control of Hamilton has deprived Barnett of a remedy, that separate treatment will promote a fraud or injustice, that Hamilton's officers and directors are non-functioning, that Hamilton does not maintain corporate formalities, or that EMC siphons Hamilton's funds. *See White v. Winchester Land Dev., Inc.,* 584 S.W.2d 56, 60 (Ky.App.1979) (*citing Poyner v. Lear Siegler, Inc.,* 542 F.2d 955, 958 (6th Cir.1976), *cert. denied,* 430 U.S. 969, 97 S.Ct. 1653, 52 L.Ed.2d 361 (1977)); *Big Four Mills, Ltd. v. Commercial Credit Co.,* 211 S.W.2d 831 (Ky.1948). Accordingly, EMC should be dismissed from this action.

Based upon the foregoing, we order that the motion to dismiss EMC as a party be and is hereby granted, and we affirm the judgment of the trial court in part and reverse and remand in part with instructions to award prejudgment interest as outlined in this opinion.

ALL CONCUR.

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CINCINNATI INSURANCE COMPANY, Appellant/Cross–Appellee,

v.

George HOFMEISTER and Kay Hofmeister, Appellees/Cross–Appellants.

Nos. 2004–CA–002296–MR, 2004–CA–002362–MR.

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Oct. 17, 2008.

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Discretionary review denied; ordered not to be published May 13, 2009.

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v.

George HOFMEISTER and Kay Hofmeister, Appellees/Cross–Appellants.

Nos. 2004–CA–002296–MR, 2004–CA–002362–MR.

Sept. 26, 2008.

Opinion withdrawn on grant of modification October 3, 2008.

All Citations

Not Reported in S.W.3d, 2008 WL 4367827

End of Document

Cincinnati Ins. Co. v. Hofmeister

Court of Appeals of Kentucky

September 26, 2008, Rendered

NO. 2004-CA-002296-MR AND NO. 2004-CA-002362-MR

Reporter
2008 Ky. App. LEXIS 302 *

CINCINNATI INSURANCE COMPANY, APPELLANT/CROSS-APPELLEE v. GEORGE HOFMEISTER AND KAY HOFMEISTER, APPELLEES/CROSS-APPELLANTS

Notice: TO BE PUBLISHED. [UNLESS OTHERWISE ORDERED BY THE KENTUCKY SUPREME COURT, OPINIONS DESIGNATED "TO BE PUBLISHED" BY THE COURT OF APPEALS ARE NOT TO BE PUBLISHED IF DISCRETIONARY REVIEW IS PENDING, IF DISCRETIONARY REVIEW IS GRANTED, OR IF ORDERED NOT TO BE PUBLISHED BY THE COURT WHEN DENYING THE MOTION FOR DISCRETIONARY REVIEW OR GRANTING WITHDRAWAL OF THE MOTION.]

Subsequent History: Opinion withdrawn by *Cincinnati Ins. Co. v. Hofmeister, 2008 Ky. App. LEXIS 313 (Ky. Ct. App., Oct. 17, 2008)*

US Supreme Court certiorari denied by *Hofmeister v. Cincinnati Ins. Co., 2009 U.S. LEXIS 7442 (U.S., Oct. 13, 2009)*

Prior History: [*1] APPEAL AND CROSS-APPEAL FROM SCOTT CIRCUIT COURT. HONORABLE PAUL F. ISAACS, JUDGE. ACTION NO. 00-CI-00030.

Core Terms

insurer, trial court, settlement, coverage, bad faith, independent contractor, documentation, attorney's, insurance company, fraudulent misrepresentation, policy limit, keys, amended complaint, discovery, damages, issues, settle, businesses, parties, supplied, rights, excess policy, claimant, common law, deposition, adjuster, motions, hired, vicarious liability, insurance contract

Case Summary

Procedural Posture

Appellee accident victims sued appellant insurer in the Scott Circuit Court (Kentucky), for fraudulent misrepresentation and violation of the Kentucky Unfair Claims Settlement Practices Act (UCSPA), *Ky. Rev. Stat. Ann. § 304.12-230*. The jury found for the accident victims. The trial court, which denied the insurer's motions for a directed verdict and judgment notwithstanding the verdict, reduced the punitive damages award. The parties appealed.

Overview
One of the accident victims was injured when a vehicle that an employee of the insured was driving collided with the victim's vehicle. The accident victims made no attempt with the insurer to settle their underlying negligence action against the insured before filing their complaint against the insurer. On appeal, the court found that the trial court erred by denying the insurer's motion for a directed verdict that the attorney retained by the insurer to represent the insured was not the insurer's agent. The attorney began and maintained his representation of the insured as the insurer's independent contractor. Therefore, the general rule prevailed and the insurer was not vicariously liable for any of the attorney's actions undertaken in his representation of the insured. Additionally, the trial court erred by denying the insurer's motion for a directed verdict on the victims' claim of fraud because the victims failed to prove the elements of fraud. Finally, the trial court committed reversible error when it failed to direct a verdict in favor of the insurer on the claims that the insurer violated the UCSPA because the insurer had a reasonable basis for denying the victims' claims.

Outcome
The judgment was reversed. The insureds' cross-appeal was dismissed as moot.

LexisNexis® Headnotes

Civil Procedure > Discovery & Disclosure > Disclosure > Mandatory Disclosures

HN1 **Disclosure, Mandatory Disclosures**

See *Ky. R. Civ. P. 26.02(2)*.

Civil Procedure > Appeals > Standards of Review > Clearly Erroneous Review

Civil Procedure > Trials > Judgment as Matter of Law > Directed Verdicts

Civil Procedure > Trials > Judgment as Matter of Law > Judgment Notwithstanding Verdict

HN2 **Standards of Review, Clearly Erroneous Review**

A directed verdict or judgment notwithstanding the verdict is appropriate when, drawing all inferences in favor of the nonmoving party, a reasonable jury could only conclude that the moving party was entitled to a verdict. A reviewing court may not disturb a trial court's decision on a motion for directed verdict unless that decision is clearly erroneous. The denial of a directed verdict by a trial court should only be reversed on appeal when it is shown that the verdict was palpably or flagrantly against the evidence such that it indicates the jury reached the verdict as a result of passion or prejudice.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Conflicts of Interest

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Masters & Servants

Legal Ethics > Client Relations > Duties to Client > Effective Representation

HN3 **Types, Attorney & Client**

No man can serve two masters. It is axiomatic that a lawyer must serve his client dutifully and loyally.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Duties to Client > Effective Representation

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN4 **Types, Attorney & Client**

There is a fear that the entity paying an attorney, the insurer, and not the one to whom the attorney is obligated to defend, the insured, is controlling the legal representation. To quell that fear, the Supreme Court of Kentucky adheres to the view that it would be contrary to public policy to allow the insurer to control the litigation.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Duties to Client > Effective Representation

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN5 **Types, Attorney & Client**

Kentucky has consistently refused to allow an insurer any right to control an attorney's independent manner of representing its insured.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Duties to Client > Effective Representation

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters

& Servants > Independent Contractors

HN6[] **Types, Attorney & Client**

The general rule is the services of a professional man, such as a lawyer are rendered under an independent contract. That is, a lawyer is one who follows his employer's desires only as to results of work, and not as to means whereby it is to be accomplished. These same rules apply when an insurer selects and pays an attorney to represent its insured.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Duties to Client > Effective Representation

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN7[] **Types, Attorney & Client**

In the typical situation in which an insurer hires an attorney to defend an insured, the relationship of the insurer and its attorney is precisely that of principal to independent contractor. The attorney is engaged in the distinct occupation of practicing law, one in which the attorney possesses special skill and expertise. The attorney generally supplies his or her place of work and tools; the attorney is employed and paid only for the cases of individual insureds; and he or she alone, consistent with ethical obligations to ensure competence and diligence in the representation, determines the time to be devoted to each case. Finally, and obviously, the practice of law is not, nor could it be, part of the regular business of an insurer.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Duties to Client > Effective Representation

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN8[] **Types, Attorney & Client**

The factor most critical to an attorney's retention of his status as an independent contractor, vis-a-vis an insurer, is the attorney's retention of control over the means by which he accomplishes the insurer's desired result - defense of its insured. The relationship of an attorney hired to defend an insured relative to the insurer that hired him, at least initially, is that of independent contractor.

Torts > Vicarious Liability > Independent Contractors > General Overview

Torts > Vicarious Liability > Employers > General Overview

HN9[] **Vicarious Liability, Independent Contractors**

As a general rule, an employer is not liable for the torts of an independent contractor in the performance of his job.

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN10[] **Independent Contractors, Masters & Servants, Independent Contractors**

Kentucky recognizes that if a principal lacking the right of control nevertheless personally interferes with, undertakes to do, manage or control the work of an independent contractor, he thereby destroys the relationship of independent contractor. The independent contractor would thus convert to an employee or agent. Kentucky independent contractors, once possessed of the right to control their own work, are not inclined to relinquish that right to the employer.

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Masters & Servants

HN11[] **Independent Contractors, Masters & Servants, Independent Contractors**

The main dispositive criterion for determining whether a party is an independent contractor is whether it is understood that an alleged principal or master has the right to control the details of the work.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Conflicts of Interest

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

Legal Ethics > Client Relations > Duties to Client > Effective Representation

HN12 **Types, Attorney & Client**

Unlike other independent contractors, an attorney who relinquishes the right to control will perforce violate his duty under the *Ky. Sup. Ct. R. 1.8(f)(2)*, and clearly subject himself to severe discipline. An attorney's maintenance and protection of his independent contractor status is thus reinforced. Cases in which an insurer may be held liable under an agency theory when an attorney represents an insured will be rare indeed.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Conflicts of Interest

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

Legal Ethics > Client Relations > Duties to Client > Effective Representation

HN13 **Types, Attorney & Client**

The proper standard for determining whether an insurer has exercised actual control of an attorney, despite lacking the right to do so, is that such control must be invidious in that it affects the attorney's independent professional judgment, interferes with the attorney's unqualified duty of loyalty to the insured, or presents a reasonable possibility of advancing an interest that would differ from that of the insured.

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

Business & Corporate Law > ... > Establishment > Elements > Right to Control by Principal

HN14 **Independent Contractors, Masters & Servants, Independent Contractors**

Whereas independent contractor status is shown by the absence of a principal's control over the work to be performed, agency is shown by its presence. Just as with the independent contractor analysis, the right to control is considered the most critical element in determining whether an agency relationship exists.

Insurance Law > Remedies > Declaratory Judgments > General Overview

HN15 **Remedies, Declaratory Judgments**

A contract of liability insurance is simply an asset from which a liability may be satisfied. Accident victims assert claims against alleged tortfeasors, not directly against the tortfeasor's insurer. Nothing prevents a tortfeasor's satisfaction of a claim from his assets other than insurance. It is simply because use of an insurance asset has the least disruptive effect on the continued operation of a business that it is naturally the first asset a business considers when contemplating claims settlement. However, whether to actually utilize that asset first remains the option of the business. It is not the option of the accident victim or his attorney to demand that the claim be satisfied from a contract of insurance.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Insurance Law > Remedies > Declaratory Judgments > General Overview

HN16 **Types, Attorney & Client**

An insurer is better able than its insured to select legal counsel to represent that insured. Kentucky courts will not penalize a party because he prudently authorized his experienced insurer to select the right attorney to defend him.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Legal Ethics > Client Relations > Conflicts of Interest

Business & Corporate Law > ... > Establishment > Elements > Right to Control by Principal

Business & Corporate Law > Agency Relationships > Types > Insurance Agents & Insurance Companies

Legal Ethics > Client Relations > Duties to Client > Effective Representation

HN17 **Types, Attorney & Client**

The respective roles of an insured's attorney and the insurer's claims adjuster are entirely distinguishable. The adjuster's fundamental role is to settle the claim apart from litigation; the attorney's is to effectively conduct a defense in the litigation. The adjuster owes no independent loyalty to the insured apart from that owed by the insurer. The attorney's loyalty to his insured client is paramount. And, unlike the attorney whose conduct is controlled by his oath, the adjuster receives direction and authority from the insurer, which is why he has been deemed the insurer's agent. Furthermore, the adjuster and the claimant usually deal directly with one another. If their negotiations fail, the adjuster negotiates with plaintiff's counsel, and even after litigation is begun, the adjuster frequently deals directly with plaintiff's counsel.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

HN18 **Types, Attorney & Client**

An attorney is an agent of his client. Kentucky has always jealously guarded the attorney-client relationship, for while the relationship is generally that of principal and agent the attorney owes his client a higher duty than any ordinary agent owes his principal.

Business & Corporate Law > Agency Relationships > Types > Attorney & Client

Business & Corporate Law > ... > Agents Distinguished > Independent Contractors, Masters & Servants > Independent Contractors

HN19 **Types, Attorney & Client**

Where there is no evidence other than the fulfillment of those duties existing between the lawyer and the insured as his client, and the fulfillment of those duties existing between the insured and the insurer, there can be no finding of an agency relationship between the insurer and the attorney it hires to defend its insured. These duties exist and will be carried out in every case of this nature.

Civil Procedure > ... > Preclusion of Judgments > Estoppel > Judicial Estoppel

HN20 **Estoppel, Judicial Estoppel**

The judicial estoppel doctrine prevents a party from taking a position inconsistent with one successfully and unequivocally asserted by the same party in a prior proceeding.

Insurance Law > Remedies > Declaratory Judgments > General Overview

Torts > Negligence > Types of Negligence Actions > General Overview

HN21 **Remedies, Declaratory Judgments**

An automobile accident gives rise to a tort claim against the tortfeasor, but not any kind of claim against that tortfeasor's insurer (unless, of course, the claimant is also an insured under the same policy). The accident victim has no right, prior to obtaining a judgment against the tortfeasor, to assert a direct claim to insurance policy proceeds.

Evidence > Burdens of Proof > Allocation

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

Evidence > Burdens of Proof > Clear & Convincing Proof

HN22[] **Burdens of Proof, Allocation**

Common law fraudulent misrepresentation requires proof of six elements: (1) that the declarant made a material misrepresentation to the plaintiff, (2) that this misrepresentation was false, (3) that the declarant knew it was false or made it recklessly, (4) that the declarant induced the plaintiff to act upon the misrepresentation, (5) that the plaintiff relied upon the misrepresentation, and (6) that the misrepresentation caused injury to the plaintiff. There must be clear and convincing proof of each of these elements.

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

Torts > Business Torts > Fraud & Misrepresentation > General Overview

HN23[] **Actual Fraud, Elements**

The duty to disclose describes an element of the tort of fraudulent concealment requiring proof of substantially different elements from the tort of fraudulent misrepresentation.

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

HN24[] **Actual Fraud, Elements**

Blind reliance fails the fifth requirement of fraud - reasonable reliance upon the claimed fraudulent act.

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

HN25[] **Actual Fraud, Elements**

If the truth or falsehood of a representation might have been tested by ordinary vigilance and attention, it is a party's own folly if he has neglected to do so, and he is remediless.

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

HN26[] **Actual Fraud, Elements**

Where an ordinary attention would be sufficient to guard against imposition, the want of such attention is, to say the least, an inexcusable negligence. To one thus supinely inattentive to his own concerns, and improvidently and credulously confiding in the naked and interested assertions of another, the maxim vigilantibus non dormientibus jura subveniunt, emphatically applies, and opposes an insuperable objection to his obtaining the aid of the law.

Evidence > Burdens of Proof > Allocation

Torts > ... > Fraud & Misrepresentation > Actual Fraud > Elements

HN27[] **Burdens of Proof, Allocation**

The concept that a defendant cannot escape on the ground that the complaining party should not have trusted him applies only where the one claiming to be deceived is not shown to have at hand any reasonably available means of determining the truth of representations made to him.

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

HN28[] **Legislation, Statutory Remedies & Rights**

The fact that the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, is not specifically designed to accommodate third party claims makes trial nearly impossible and appellate review most difficult.

Business & Corporate Compliance > ... > Regulators > State Insurance Commissioners & Departments > National Association of Insurance Commissioners

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

Business & Corporate Compliance > ... > Regulators > State Insurance Commissioners & Departments > Rules & Regulations

HN29 State Insurance Commissioners & Departments, National Association of Insurance Commissioners

Ky. Rev. Stat. Ann. § 304.12-230 was never intended by its creators to establish any private right of action at all. The statute is an almost verbatim adoption of the 1971 version of the model act formulated by the National Association of Insurance Commissioners (NAIC). It was intended by its drafters only as regulatory measure to assist state insurance administrators. The NAIC emphasized the original intent of this model act when it issued this warning to legislatures: "A jurisdiction choosing to provide for a private cause of action should consider a different statutory scheme. This Act is inherently inconsistent with a private cause of action." As a consequence, Kentucky is in that distinct minority of states that recognizes a private right of action for violations of the Kentucky Unfair Claims Settlement Practices Act, Ky. Rev. Stat. Ann. § 304.12-230.

Evidence > Burdens of Proof > Allocation

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > Elements of Bad Faith

HN30 Burdens of Proof, Allocation

There is no such thing as a technical violation of the Kentucky Unfair Claims Settlement Practices Act, Ky. Rev. Stat. Ann. § 304.12-230, at least in the sense of establishing a private cause of action for tortious misconduct justifying a claim of bad faith. An insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed. An insurer is entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.

Civil Procedure > Sanctions > Baseless Filings > Bad Faith Motions

Governments > Courts > Authority to Adjudicate

Civil Procedure > Sanctions > Misconduct & Unethical Behavior > General Overview

Governments > Courts > Rule Application & Interpretation

HN31 Baseless Filings, Bad Faith Motions

Litigation conduct amounting to bad faith can be sanctioned by a trial court pursuant to the civil rules.

Torts > ... > Employers > Scope of Employment > Personal Activities

HN32 Scope of Employment, Personal Activities

For a frolic and detour an employer has no vicarious liability.

Civil Procedure > Trials > Jury Trials > Province of Court & Jury

Governments > Courts > Authority to Adjudicate

Torts > ... > Employers > Scope of Employment > Personal Activities

HN33 Jury Trials, Province of Court & Jury

Where deviation from the course of his employment by

a servant is slight and not unusual, a court may, as a matter of law, find that the servant was still executing his master's business. On the other hand, if the deviation is very marked and unusual the court may determine that the servant was not on the master's business at all but on his own. Cases falling between these extremes will be regarded as involving a question of fact for the determination of a jury.

Civil Procedure > Trials > Jury Trials > Province of Court & Jury

Governments > Courts > Authority to Adjudicate

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

Torts > ... > Types of Damages > Punitive Damages > Aggravating Circumstances

Governments > Legislation > Statutory Remedies & Rights

HN34 **Jury Trials, Province of Court & Jury**

Whether a tort has occurred under the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, is precisely what the caselaw requires a trial court, not the jury, to decide. The threshold problem is to determine whether the dispute is merely contractual or whether there are tortious elements justifying an award of punitive damages. To do that, the trial court must weigh in on the question of punitive damages by answering whether the proof is sufficient for the jury to conclude that there was conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others.

Evidence > Burdens of Proof > Allocation

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > Elements of Bad Faith

HN35 **Burdens of Proof, Allocation**

The evidentiary threshold for a claim predicated on bad faith by an insurer is high indeed. Evidence must demonstrate that an insurer has engaged in outrageous conduct toward its insured. Furthermore, the conduct must be driven by evil motives or by an indifference to its insureds' rights. Absent such evidence of egregious behavior, the tort claim predicated on bad faith may not proceed to a jury. There is no justification for lowering the standard for third-party claims deriving as they must from the first-party's contract of insurance. This approach has long been embraced in both first-party and third-party claims under the common law where it was recognized that bad faith determinations present troublesome, or even impossible, questions for a jury which is just not equipped to evaluate the issue of bad faith. The case law has simply extended to tort actions under the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, the same requirement still existing under the common law that the issue of bad faith should be decided by a trial court.

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > Elements of Bad Faith

Insurance Law > Liability & Performance Standards > Settlements > Policy Coverage

HN36 **Bad Faith & Extracontractual Liability, Elements of Bad Faith**

Ky. Rev. Stat. Ann. § 304.12-230(1) prohibits an insurer from misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue.

Insurance Law > Liability & Performance Standards > Settlements > Policy Coverage

HN37 **Settlements, Policy Coverage**

"Coverages" is a term that identifies the amount and extent of risk contractually assumed by an insurer. It is an abbreviated means by which a court will define what an insured has contracted for in exchange for his premium. "Coverages at issue" therefore refers to an insured's contractual dispute with his insurer, and not an accident victim's tort dispute with the insured-tortfeasor, or an accident victim's dispute with the insurer (unless as the assignee of the insured's rights under the contract he stood in the insured's shoes).

Insurance Law > Liability & Performance

Standards > Settlements > Policy Coverage

Insurance Law > Liability & Performance Standards > Settlements > Third Party Claims

Insurance Law > ... > Declaratory Judgments > Procedure > Relevant Parties

HN38 **Settlements, Policy Coverage**

For purposes of defining the class of persons protected by *Ky. Rev. Stat. Ann. § 304.12-230(1)*, coverages at issue would include both first-party insureds and third-party claimants to whom the insured assigned (as under common law) his claim against the insurer.

Insurance Law > Liability & Performance Standards > Settlements > Good Faith & Fair Dealing

Insurance Law > Liability & Performance Standards > Settlements > Reasonable Basis

Insurance Law > Liability & Performance Standards > Settlements > Third Party Claims

HN39 **Settlements, Good Faith & Fair Dealing**

Under *Ky. Rev. Stat. Ann. § 304.12-230(6)*, an insurer violates the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, by not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear. At least with regard to third-party claims, the bad faith standards under the caselaw encompass this provision.

Insurance Law > Liability & Performance Standards > Settlements > Good Faith & Fair Dealing

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > Payment Delays & Denials

Insurance Law > Liability & Performance Standards > Settlements > Reasonable Basis

HN40 **Settlements, Good Faith & Fair Dealing**

Although an insurer is under a duty to promptly investigate and pay claims where it has no reasonable grounds to resist in good faith, neither this duty nor any provision of the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, requires the insurer to assume responsibility to investigate the amount of the claimant's loss for the claimant. The insurer's legal responsibility is limited to payment upon proof of loss.

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Settlements > Reasonable Basis

HN41 **Legislation, Statutory Remedies & Rights**

Ky. Rev. Stat. Ann. § 304.12-230(13) of the Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, allows a private right of action against an insurer for failing to promptly settle claims, where liability has become reasonably clear, under one portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage.

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Settlements > Reasonable Basis

Insurance Law > Liability & Performance Standards > Settlements > Third Party Claims

HN42 **Legislation, Statutory Remedies & Rights**

Like *Ky. Rev. Stat. Ann. § 304.12-230(1)*, the class of persons protected by *Ky. Rev. Stat. Ann. § 304.12-230(13)* are first-party insureds and third-party assignees of the first-party's rights.

Governments > Legislation > Statutory Remedies & Rights

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > Payment Delays & Denials

Insurance Law > Liability & Performance Standards > Settlements > Reasonable Basis

HN43[] Legislation, Statutory Remedies & Rights

Ky. Rev. Stat. Ann. § 304.12-230(14) makes an insurer liable for failing to promptly provide a reasonable explanation of the basis in an insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement. This is a coverage issue that plainly refers to first-party claims.

Civil Procedure > Appeals > Standards of Review > General Overview

Civil Procedure > Trials > Jury Trials > Jury Deliberations

HN44[] Appeals, Standards of Review

The Court of Appeals of Kentucky will neither presume in any particular case, nor deny the proposition in general, that there is a prejudice which juries frequently apply against insurance companies. Kentucky courts have long been aware of this prejudice, as exemplified by the decisions in personal injury cases where the element of insurance has been improperly injected.

Evidence > ... > Preliminary Questions > Admissibility of Evidence > General Overview

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

HN45[] Preliminary Questions, Admissibility of Evidence

Post-litigation conduct by an insurance company can be the basis of a claim under the Kentucky Unfair Claims Settlement Practices Act, Ky. Rev. Stat. Ann. § 304.12-230. However, litigation conduct is held inadmissible.

Civil Procedure > Sanctions > General Overview

Evidence > ... > Preliminary Questions > Admissibility of Evidence > General Overview

Governments > Courts > Rule Application & Interpretation

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

Legal Ethics > Professional Conduct > Tribunals

HN46[] Civil Procedure, Sanctions

The remedies provided by the Kentucky Rules of Civil Procedure for any wrongdoing that may occur within the context of the litigation itself render unnecessary the introduction of evidence of litigation conduct. Attorneys, and even parties, are subject to direct sanction under the Civil Rules for any improper conduct. Though it goes without saying, attorneys have significant duties under the Kentucky Rules of Professional Responsibility, which allow for further sanctions for unethical behavior. Thus, the better approach is an absolute prohibition on the introduction of such evidence in actions brought under Ky. Rev. Stat. Ann. § 304.12-230.

Civil Procedure > Trials > Jury Trials > Jury Deliberations

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

Civil Procedure > Trials > Jury Trials > Province of Court & Jury

HN47[] Jury Trials, Jury Deliberations

It is calamity to permit a jury to pass judgment on a defense counsel's trial tactics and to premise a finding of bad faith on counsel's conduct. It places an unfair burden on the insurer's counsel, potentially inhibiting the defense of the insurer. In fact, given the chilling effect that allowing introduction of evidence of litigation conduct would have on the exercise of an insurance company's legitimate litigation rights, any exception threatens to turn the adversarial system on its head. The fear is that a jury, with the assistance of hindsight, and without the assistance of insight into litigation techniques, could second guess the defendant's rationales for taking a particular course.

Civil
Procedure > Remedies > Damages > Compensator y Damages

Torts > ... > Types of Losses > Lost Income > Award Calculations

Civil Procedure > Remedies > Damages > Monetary Damages

HN48[] **Damages, Compensatory Damages**

The test of whether there can be a recovery for loss of anticipated revenues or profits is whether the cause of the damage or injury can with reasonable certainty be attributed to the breach of duty or wrongful act of the defendant. But no recovery is allowed when resort to speculation or conjecture is necessary to determine whether the damage resulted from the unlawful act of which complaint is made or from other sources.

Evidence > ... > Examination > Cross-Examinations > Collateral Matters

Evidence > ... > Examination > Cross-Examinations > Scope

HN49[] **Cross-Examinations, Collateral Matters**

A connection must be established between the cross-examination proposed to be undertaken and the facts in evidence. A party is not at liberty to present unsupported theories in the guise of cross-examination and invite the jury to speculate as to some cause other than one supported by the evidence.

Insurance Law > Liability & Performance Standards > Bad Faith & Extracontractual Liability > General Overview

HN50[] **Liability & Performance Standards, Bad Faith & Extracontractual Liability**

Some attorneys exhibit a personal bias against insurance companies and in favor of using bad faith and Kentucky Unfair Claims Settlement Practices Act, *Ky. Rev. Stat. Ann. § 304.12-230*, allegations to extort payment of underlying claims from insurers.

Counsel: ORAL ARGUMENT AND BRIEFS FOR APPELLANT AND CROSS-APPELLEE: John T. Ballantine, Louisville, Kentucky; Ronald L. Green, Lexington, Kentucky.

BRIEFS FOR APPELLANT AND CROSS-APPELLEE: Michael D. Risley, Louisville, Kentucky.

ORAL ARGUMENT AND BRIEFS FOR APPELLEES AND CROSS-APPELLANTS: J. Dale Golden, Lexington, Kentucky.

AMICUS CURIAE BRIEF FOR THE KENTUCKY DEFENSE COUNSEL: Gregg E. Thornton, Luke A. Wingfield, Lexington, Kentucky.

Judges: BEFORE: ACREE AND KELLER, JUDGES; KNOPF, [1] SENIOR JUDGE. KNOPF, JUDGE, CONCURS. KELLER, JUDGE, CONCURS IN RESULT ONLY.

Opinion by: ACREE

Opinion

REVERSING APPEAL NO. 2004-CA-002296-MR AND DISMISSING AS MOOT APPEAL NO. 2004-CA-002362-MR

ACREE, JUDGE: This is the appeal and cross-appeal of a judgment entered in Scott Circuit Court after a jury found Cincinnati Insurance Company (CIC) liable to George and Kay Hofmeister for fraudulent misrepresentation and for violation of the Kentucky Unfair Claims **[*2]** Settlement Practices Act (UCSPA), *Kentucky Revised Statutes (KRS) 304.12-230*. CIC appeals the trial court's denial of its motions for summary judgment, motions for directed verdict and judgment notwithstanding the verdict, and entry of judgment awarding the Hofmeisters $ 10,000,000 in compensatory damages and $ 18,405,500 in punitive damages following a jury verdict. Prior to appeal, the trial court amended the judgment by reducing the punitive damages award to $ 10,000,000. The Hofmeisters filed a cross-appeal, challenging the reduction of the punitive damages award. We reverse the judgment and dismiss the Hofmeisters' cross-appeal as moot.

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[1] Senior Judge William L. Knopf sitting as Special Judge by assignment of the Chief Justice pursuant to Section 110(5)(b) of the Kentucky Constitution and Kentucky Revised Statute (KRS) 21.580.

This case requires examination of a myriad of relationships and duties, some created by contract, others by statute, and still others by common law. It requires examination of settlement negotiations and litigation strategy and tactics, nearly all of which was placed in the hands of a jury to assess. Understanding this case necessitates a detailed examination of a voluminous record which we will abbreviate wherever possible.

I. Facts and Procedure

The facts of the underlying automobile claim, which the jury found CIC settled unfairly, began at 10:00 **[*3]** a.m. on November 3, 1998. Eugene "Gene" Clark, a delivery driver for Dasher Express, Inc., had finished a workshift that exceeded ten hours. He returned his employer's vehicle to Dasher's offices in Lexington, Kentucky. He then drove home to Frankfort in his personal vehicle.

Clark was fatigued when he arrived home and discovered that he still had in his possession the company's credit card and the keys to his company's vehicle. He called Dasher's offices, informed the dispatcher of his mistake, and "indicated he was going to return the keys to Dasher." (Trial Court's Opinion and Order, September 13, 2002, p.2, quoting testimony of Dasher employee). Clark took a shower and changed clothes. Then he got back in his personal vehicle and left his Frankfort home. Ostensibly, his sole purpose was to return the Dasher vehicle keys and credit card.

George Hofmeister was driving his own vehicle and talking to his wife on a cell phone when he first saw Clark's vehicle approaching him from about a quarter-mile away. Clark's driving was erratic. In fact, Clark had fallen asleep despite having gone to a McDonald's restaurant for coffee. As the vehicles approached one another, Clark's vehicle crossed **[*4]** the centerline. Hofmeister slammed on his brakes but did not avoid the collision. Whether it was possible to have done so was never determined in the record. [2]

When Clark did not arrive at Dasher's offices after indicating he was going to return the keys, a Dasher employee called his telephone number and

> le[ft] a message for Gene, indicating whether or not he was returning the keys and when they or whomever [sic] was returning the keys would have them to Dasher. After that, we received a call that Gene had been in an accident and basically were waiting to see how he was and, you know, what the situation was.

(Trial Court's Opinion and Order, September 13, 2002, p.2, quoting testimony of Dasher employee).

The accident did not occur on the most direct route between Clark's home and Dasher's offices. Clark said the direct route he regularly took would have placed him on Interstate Highway 64 (I-64) all the way from Frankfort until he exited the highway southbound at the Newtown Pike exit in Lexington. But the accident site was on US 62 in Georgetown, Kentucky. **[*5]** This location necessarily required Clark to exit I-64 about halfway between his home and Dasher's offices, and to head away from his business destination. Clark was rendered unconscious by the accident, and said he did not recall exiting I-64 onto US 62 or why he did so.

Hofmeister's injuries were significant. He convalesced for a total of eight months, confined to a wheelchair for five of those months. During that time, Hofmeister engaged attorney Dale Golden to assist in recovering his damages.

Golden concentrated his settlement efforts on Clark and Clark's insurer, the Travelers Insurance Group. Travelers offered to pay Hofmeister its policy limits of $ 100,000. Pursuant to *KRS 304.39-320(3)*, Golden sent notice of Travelers' offer to Hofmeister's underinsured motorist (UIM) coverage insurer, Kentucky Farm Bureau Mutual Insurance Company, whose policy limits were also $ 100,000. Farm Bureau elected to preserve its subrogation rights against Clark and substituted its own payment of $ 100,000 to Hofmeister under the procedure outlined in *Coots v. Allstate Ins. Co., 853 S.W.2d 895 (Ky. 1983)*. Additionally, Farm Bureau paid $ 50,000 in personal injury protection (PIP) benefits to Hofmeister's **[*6]** medical providers. Hofmeister did not waive his right to file a civil action against Farm Bureau, and he subsequently did so.

The complaint first named Clark as a defendant. The second defendant identified was Farm Bureau. The claim against Farm Bureau sought to collect an additional $ 100,000 in UIM benefits available under any and all of the Hofmeisters' policies. Finally, the complaint named Dasher, asserting that Clark was acting within the scope of his employment at the time of the accident and, therefore, Dasher was vicariously liable.

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[2] Mr. Hofmeister testified in the bad faith trial, however, that there was no place for him to exit the road on which the accident occurred.

Service of the complaint was Dasher's first notice that the Hofmeisters were asserting any claim against the company. Consistent with duties created by its contract of insurance, Dasher notified CIC of the claim. CIC's duty under the same contract was to provide a defense at its cost. To satisfy that duty, CIC made financial arrangements with attorney Dan Murner to answer and defend Dasher against the Hofmeisters' claims.

Murner drafted and served Dasher's answer to the complaint on November 4, 1999, asserting, among other defenses, that Clark was not acting within the scope of his employment at the time of the accident, and that Hofmeister was comparatively **[*7]** negligent. Murner simultaneously served discovery requests upon Hofmeister seeking information substantiating the damages claimed and the basis of Dasher's alleged liability.

The Hofmeisters responded to Dasher's discovery requests four months later, on March 3, 2000. The responses provided scant information upon which Dasher could assess its exposure to liability. On the contrary, they show the Hofmeisters: (1) had not yet compiled a list of medical expenses; (2) had not yet decided what witnesses to call at trial; (3) did not know what documents they intended to introduce at trial; and (4) were not prepared to identify any expert, including one who would testify regarding Mr. Hofmeister's claim for economic losses, or otherwise. Furthermore, in response to Dasher's request pursuant to *Kentucky Rules of Civil Procedure (CR) 8.01(2)* that damages be specified, the Hofmeisters replied that "[a] total has not been calculated at this time."

The Hofmeisters, too, engaged in discovery. On February 1, 2000, they submitted interrogatories and requests for production of documents to Dasher. Consistent with a pattern repeated throughout this litigation, the Hofmeisters did not ask Dasher to produce **[*8]** insurance information in accordance with *CR 26.02(2)*. [3]

In the meantime, Dasher noticed Hofmeister's deposition to be taken on May 12, 2000. Mr. Hofmeister's deposition testimony was the first indication Dasher had that Hofmeister was claiming a loss of income equaling or exceeding $ 5 million. When questioned about substantiation for this loss, Hofmeister explained that the primary entity through which he conducted his business, American Commercial Holdings, Inc. (ACH), had paid him a $ 5-million bonus for the year of the accident, but did not pay him any bonus the next year. [4]

Hofmeister's deposition testimony showed that while he did receive a Form W-2, he was not a typical employee. He was a self-made entrepreneur. Through various business entities he had created, **[*10]** including ACH, Hofmeister made a career of purchasing troubled businesses, obtaining financing to keep the businesses afloat, and then reselling the businesses for a profit. Between 1995 and 1999, Hofmeister and ACH acquired approximately sixty (60) businesses. Hofmeister stated that he accomplished these acquisitions after obtaining bank financing to do so. At deposition, he testified that he had been turned down for a $ 25-million loan as a direct result of the accident and his injuries. Consequently, so he testified, he was unable to purchase more distressed businesses for resale. He had no documentation with him at the deposition that would have substantiated any of his prior acquisitions or sales, or any of his business activity at all. Nor could he document the denial of his $ 25-million loan application or the potential business acquisitions the loan would

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[3] *CR 26.02(2)* states:

> *HN1*[↑] A party may obtain discovery of the existence and contents of any insurance agreement under which any person carrying on an insurance business may be liable to satisfy part or all of a judgment which may be entered in the action or to indemnify or reimburse for payments made to satisfy the judgment.

[4] As the CEO of ACH, Mr. Hofmeister largely controlled his own income. He testified that his salary the year after the accident actually increased from $ 577,402 in 1998 (10 months of which preceded the accident) to $ 624,135 in 1999. The Hofmeisters' tax returns show that 1998 was a good year for **[*9]** Mr. Hofmeister to take a $ 5-million bonus because his capital losses and Schedule E losses (from other partnerships and subchapter S corporations including ACH) exceeded $ 8 million. When those losses were deducted from his total income, including the $ 5-million bonus, the Hofmeisters' adjusted gross income (AGI) was less than zero (-$ 443,102). Consequently, the Hofmeisters paid no taxes in 1998. In 1999, the year after the accident, the Hofmeisters' businesses netted substantial capital gains resulting in an AGI of more than $ 9.5 million, and a tax liability of more than $ 1.8 million. Awarding himself any bonus in 1999 would have yielded an even higher tax burden. In 2000, Mr. Hofmeister's salary was again above $ 500,000. Also in 2000, and in 2001 and 2002 as well, the Hofmeisters continued to earn substantial capital gains. Those gains, however, were offset by greater Schedule E losses from other partnerships and S corporations, including the Hofmeisters' interest in equine partnerships.

have facilitated. However, he agreed to later provide Dasher with that documentation through his own attorney.

Hofmeister's attorney, Golden, took the face-to-face opportunity immediately following Hofmeister's deposition to propose settlement. After the Hofmeisters departed, Golden sat down with Murner and Dasher's owners **[*11]** and verbally demanded $ 1,500,000 on behalf of his clients. [5] According to Murner's uncontradicted testimony, Golden said "[Y]ou don't want an excess verdict, you'd better settle this case." Once Golden had departed, Murner's clients asked him what was meant by an "excess verdict" and Murner explained it to them. What followed this meeting was a series of extrajudicial correspondence upon which much of the Hofmeisters' claim of fraud and bad faith rests.

On May 18, 2000, Murner wrote to Golden requesting further substantiation of Hofmeister's claim that his business losses were attributable to the accident and stating that such information was essential to a proper assessment of Golden's settlement demand. Murner also noted that the demand was "in excess of the policy limits provided by Dasher's insurance carrier[.]" He never stated what those policy limits were except to say that $ 1,500,000 exceeded them.

On May 22, 2000, Golden wrote to Murner "a little surprised that $ 1,500,000 is in excess of the policy limits of Dasher's insurance carrier." He declined Murner's **[*12]** request for additional support for Hofmeister's losses, stating, "The tax returns I have provided to you contain more than adequate information to show" Hofmeister's loss. He expressed his opinion that a "claim for punitive damages against Dasher alone could exceed $ 1,000,000." Nevertheless, based upon Murner's representation that $ 1,500,000 exceeded Dasher's liability policy limits, Golden agreed to recommend to Hofmeister "that he accept the amount of $ 1,000,000, *which I assume* from your correspondence is the policy limit." (Emphasis supplied).

Because Golden was unable to contact Mr. Hofmeister until early the next month, Golden agreed to extend the offer until June 9. Golden stated that if settlement was not accomplished by then, he would recommend that his client not accept less than $ 1,500,000. "In other words," Golden said, "assuming that Dasher has $ 1,000,000 in coverage, this is your one opportunity to resolve this matter within the limits of coverage."

The next day, May 23, 2000, Golden and Murner spoke by telephone. Based on that conversation, Golden wrote Murner again, agreeing to a short extension of the deadline for Dasher's response to his settlement demand. Golden **[*13]** also asked Murner to let him know "what additional information you will need and I will try to provide" it. He then reiterated that if Dasher did not agree to settle the claim for $ 1 million, "our demand will increase beyond the limits of Dasher's liability policy[.]"

One day later, May 24, 2000, Murner provided a list of information he needed to assess the claim and settlement demand, limiting the list to information Hofmeister already agreed in his deposition to provide through Golden. Among other things, this included: a list of Hofmeister's companies identifying those he purchased and sold in the previous five years, with the cost of acquisition and profit realized on resale; documentation relating to the denial of his $ 25-million loan application; quarterly earnings reports for three of Hofmeister's corporations; and an accounting of Hofmeister's 1999 income.

On May 26, 2000, while waiting for Golden's response, Murner sought to file a protective cross-claim against Clark. On behalf of Dasher, Murner continued to assert that Clark was not acting within the scope of his employment at the time of the accident, but claimed the right of indemnification from Clark should that issue **[*14]** be determined otherwise. The Hofmeisters initially objected to Dasher's motion to file the cross-claim, but soon after withdrew the objection.

On May 31, 2000, the Hofmeisters served upon Dasher a second set of interrogatories and requests for production of documents. Despite Golden's being "a little surprised" that the initial demand exceeded policy limits, the discovery still did not include a request to provide insurance information.

Also on May 31, 2000, Golden wrote to Murner again. He enclosed a copy of an amended complaint alleging that Dasher had violated federal Department of Transportation regulations prohibiting drivers to spend more than ten consecutive hours on the road without an eight-hour break. Based on that alleged violation, the proposed amended complaint demanded punitive damages be assessed against Dasher. Golden stated he would file the amended complaint if the case was not settled by June 22 for $ 1,000,000.

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[5] Though Golden informally stated he could establish damages of $ 20,000,000, no demand higher than $ 1,500,000 was ever made.

Golden's correspondence did not provide the documentation Murner requested, but did say that he had sought it from "Mr. Hofmeister and he will be providing that information to my office within the next few days." Golden also confirmed for Murner that Mr. Hofmeister **[*15]** agreed "to lower his demand to $ 1,000,000, which, according to you, is the policy limit of Dasher's insurance." Nothing in the record supports Golden's assertion that Murner had confirmed what Golden had previously assumed - that the limit of Dasher's automobile liability insurance policy was $ 1,000,000.

On the contrary, according to Murner's testimony, a telephone conversation took place around this time during which he conveyed to Golden the information regarding Dasher's policy of excess insurance coverage. Murner initially told Golden, as he had been told by Dasher, that those policy limits were $ 3 million. Later, Murner learned that the policy limits were not $ 3 million, but $ 5 million. Following a hearing on a procedural motion in Scott Circuit Court, Murner conveyed that corrected information to Golden. There is no evidence in the record that impugns Murner's testimony.

Back at CIC's offices, senior claims examiner Julie Sullivan was developing a sense of the claim against CIC's insured, Dasher. Her role was to evaluate the claim based on information provided by Dasher's counsel. On June 9, 2000, she created a "Reserve Increase Memorandum," introduced at trial as Plaintiffs' **[*16]** Exhibit 5, stating:

> Information is sketchy at this time. . . . The claimant, George Hofmeister, DOB unknown, was in a wheel chair for five months and he had physical therapy. He was unable to conduct his business [but] is back to work now. His attorneys say he will likely need to have a joint replacement of his knee and hip. . . . His meds total around $ 100,000.

Hofmeister's economic circumstances, as well as a settlement demand in excess of Dasher's insurance coverage through CIC, also concerned Sullivan.

> Mr. Hofmeister is literally "worth millions." We have his tax returns [showing he did not receive a $ 5M bonus] which plaintiff may attribute to this accident. Dan [Murner] will meet with an accountant to review all this documentation. . . .
>
> In mid May a settlement demand of $ 1.5 million was initially proposed in the presence of Dasher officials. They immediately became very concerned due to personal exposure. . . . At that time, the issue of accepting the demand and tendering our limit of $ 1M, limiting the personal exposure of the insured to half a million versus potentially exposing them to millions was problematic due to coverage issues involved.

The coverage issues to which she **[*17]** referred included the fact that "Clark's personal carrier, KY Farm Bureau, tendered their $ 100,000 limits [and] some question regarding KY Farm Bureau stacking their coverage up to $ 600,000." Sullivan noted that "while the insured [Dasher] has an umbrella policy, it is not through CIC." This is the earliest indication in the record that a policy of excess insurance coverage existed. Still, neither the carrier nor the policy limits was identified.

On the other hand, Sullivan noted that there was still a question of Dasher's liability. The case had not developed far enough to know "whether Mr. Clark was on or off the clock." At that time, legal focus was on whether the "actions of Mr. Clark occurred outside the time restrictions of his employment."

As it turned out, Hofmeister's representations of his impaired physical condition were overstated. According to his pretrial disclosures in the spring of 2004, Hofmeister's medical expenses never totaled more than $ 50,037.92, far from the $ 100,000 to which he had testified. Also, Hofmeister never needed subsequent surgery or any other substantial medical treatment for his injuries. His pretrial disclosures placed a zero-dollar value on future **[*18]** medical costs. Nevertheless, for a time at least, the parties proceeded on Hofmeister's erroneous representations.

Meanwhile, the Hofmeisters, through Golden, had provided to Murner some documentation of Hofmeister's finances. However, according to a June 16, 2000, letter from Murner to Golden, there was still much requested documentation that had yet to be provided. Notably, there was no documentation of the $ 25-million loan application or its denial. An accounting expert hired on behalf of Dasher reported to Murner that the information Hofmeister had thus far provided only supported the conclusion that his businesses were losing money even before the accident. From 1995 to 1999, the cost of acquiring the businesses exceeded the cash generated by all of Hofmeister's businesses by $ 150 million. Dasher's expert could not reconcile Hofmeister's claim that his economic loss was attributable to the accident without additional documentation. He specifically requested documentation to support Hofmeister's income calculations, as well as records of intercompany

loans and other subsidization of the losses shown to have been sustained by Hofmeister's equine-related and other businesses. Murner **[*19]** explained to Golden the reason such detailed information was necessary:

> As you know, this is not a W2 economic loss case. Your client derives his income from a myriad of sources, which we need to explore. If this cannot be accomplished by June 22 [Golden's settlement demand deadline], so be it. However, my client will not act on blind faith as you suggest. . . . [I]f you take out the economic claims and simply size this case up on medical expenses (past and future) and pain and suffering (past and future) the numbers do not come close to the limits of my client's insurance policy. For example, everything you have provided to us show [sic] medical expenses of approximately $ 50,000 rather than the $ 100,000 claimed by your client during deposition. . . . Your client is asking . . . me to assume without documentation that his economic losses make up the difference and exceed the policy limits . . . .
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> I, of course, will put all of this in a formal request for production of documents. However, the deadline for your response [to that discovery request] will fall after the deadline your client has arbitrarily imposed [to respond to the settlement offer].

Golden responded to Murner on June 20, **[*20]** 2000, that "Cincinnati Insurance Company has known about the claim since October 1999. . . . A cursory review of any of Mr. Hofmeister's tax returns for the past five years would reveal to the layman that he has a solid basis for his economic damages claim." Golden declined to send Murner any further medical records to support a claim for future medical costs stating simply that "Cincinnati Insurance Company is creating additional requests for information to serve as the basis for its refusal to settle this claim." [6] Furthermore, Golden charged CIC with failing to timely investigate and pay the claim, and with asking "for more information than the court would ever require Mr. Hofmeister to produce and that would take us several months to acquire." He then stated his intention "to hold Cincinnati Insurance Company responsible."

On June 21, 2000, Murner spoke by telephone with Golden and invited him to his office to discuss settlement. Golden declined the invitation. Murner therefore had a settlement proposal hand-delivered to Golden's office on June 22, 2000. There were several aspects to the **[*21]** settlement proposal.

First, because the issue of whether Clark was acting within the scope of his employment at the time of the accident had not been resolved, Murner pointed out the possibility that Dasher would have no liability whatsoever. Additionally, Murner's interpretation of the discovery produced thus far suggested some comparative liability on Mr. Hofmeister's part.

Second, because Hofmeister still had not provided the documentation Murner requested, both informally and through discovery, Hofmeister's claim for lost business earnings could not be properly assessed. Therefore, the settlement offer specifically reserved Hofmeister's right to pursue "any claim the Hofmeisters may have against Dasher for damages due to lost wages, or lost profits due to lost business opportunities[.]"

Third, Murner totaled "all of Mr. Hofmeister's medical expenses provided to Dasher by Plaintiffs' counsel to date," then subtracted "expenses previously paid for PIP [personal injury protection of $ 50,000]" by Hofmeister's own insurance. The balance was $ 9,275. [7] Dasher agreed to pay that sum and further agreed, having obtained CIC's consent, that CIC would "be responsible for negotiating any settlement **[*22]** for PIP, for expenses incurred as of the date of this settlement."

Fourth, Dasher agreed to pay Hofmeister $ 25,000 for future medical treatment despite the fact that "no medical evidence has been presented by the Hofmeisters' counsel regarding Mr. Hofmeister's need for future medical treatment[.]"

Fifth, recognizing Mrs. Hofmeister's "role in caring for Mr. Hofmeister[,]" Dasher agreed to pay her $ 25,000 on her loss of consortium claim.

Sixth, for Hofmeister's claim of past and future pain and suffering, Dasher agreed to add $ 50,000 to the $ 100,000 previously received from Clark's carrier making his pain and suffering claim about three times his medical expenses.

In effect, Dasher's total offer was $ 109,275, plus indemnification for the $ 150,000 previously paid by other insurers for a total of $ 259,275, plus the important reservation of Hofmeister's right to pursue his claim for

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[6] The record reflects that no such medical records existed and, therefore, none could be sent.

[7] These figures indicate that Murner continued to err in favor of Hofmelster regarding calculation of medical expenses since his estimate exceeds Hofmeister's pretrial disclosure by more than $ 9,200.

lost income.

Before the workday ended, Golden, on behalf of the Hofmeisters, wrote to Murner stating that the **[*23]** "proposed settlement offer is rejected and that we hereby withdraw our offer to settle this matter for the policy limits of $ 1 million." Golden gave no credence to Murner's asserted defense that Clark was not acting in the scope of employment for Dasher, stating, "I have already presented to your office the applicable case law that clearly indicates Mr. Clark was acting within the scope of his employment[,]" and insisting that taking a contrary position "is a clear violation of the Unfair Claims Settlement Practices Act because liability has become clear." Similarly, according to Golden, Murner's position that Hofmeister might bear some percentage of fault "constitutes a violation of the Unfair Claims Settlement Practices Act." Finally, and contrary to the offer to reserve the claim for lost profits, Golden claimed that while Murner acknowledged a "viable claim for lost wages, lost profits, and lost business opportunities, [he] did not offer a dime to settle that portion of our claim. This, too, is in violation of the Unfair Claims Settlement Practices Act."

Settlement negotiations were thus suspended. Negotiations would not resume in earnest until the issue of Dasher's vicarious liability **[*24]** was determined by the trial court. This did not occur until shortly before the final date set for the trial, October 14, 2002.

Between these two periods of settlement negotiation - the summer of 2000 and autumn of 2002 - substantial discovery took place as well as a variety of procedural and other motions. The following events, including extrajudicial events subsequently memorialized as part of the record, are relevant to our review.

On February 9, 2001, Golden wrote a peculiar letter [8] to Murner ostensibly attempting to settle one portion only of his clients' claims. The letter did not present any *offer* to settle. On the contrary, Golden was attempting to resurrect and accept one portion of Dasher's June 22, 2000, offer that Hofmeister rejected *in toto* eight months earlier. With still no proof of future medical expenses, Golden, on behalf of the Hofmeisters, wanted now to accept that portion of Dasher's previous offer. He wanted Murner to explain the "decision to withdraw the offer of settlement of $ 25,000[.]" He also wanted to know why Hofmeister could not accept one portion of the offer without accepting the other portions. In Golden's opinion, this violated Kentucky's UCSPA. Using **[*25]** the same wording as *KRS 304.12-230(13)*, Golden claimed this amounted to "failing to promptly settle a claim where liability has become reasonably clear under one portion of the insurance policy coverage in order to influence settlement under another portion of the coverage afforded by [CIC]."

Murner replied on February 15, 2001, documenting the history of Dasher's offer and Hofmeisters' rejection, and quoting Golden's June 2000 pronouncement that "[w]e will now proceed to trial and have the jury decide the issue of damages." Again, Murner insisted that liability was not as clear as Golden asserted and reminded Golden of the difficulty Dasher had in obtaining from Hofmeister sufficient information to assess his claim of lost profits. Finally, Murner stated, "I believe your allegations of bad faith that you have thrown about throughout this litigation are frivolous."

More than three years later, when Golden interrogated Murner at trial regarding this episode, Golden revealed that his **[*26]** February 9, 2001, letter was a calculated attempt to put Murner "on the spot." [9]

> Golden: You admitted you shouldn't have made that offer. You admitted it was a sham. . . . I put you on the spot on the $ 25,000 you offered in future medicals, to show that that was just a sham.
> Murner: I did not admit it was a sham. . . . You rejected the whole $ 109,000 . . . . And then six [sic] months later you said, oh well, I'll take the $ 25,000

[8] The oddity of Golden's letter surpasses the "curious letter" described in *Manchester Ins. & Indem. Co. v. Grundy, 531 S.W.2d 493, 495 (Ky. 1976)*, which is similar to some of Golden's other correspondence.

[9] On this point, Golden interrogated Murner, CIC representative Dan Walsh, and CIC's bad faith expert Carl Sumner. The essence of Golden's interrogation and argument is that: (1) the June 22, 2000, offer included $ 25,000 for future medical expenses; (2) there was no change in the medical proof between June 22, 2000, and February 9, 2001, when Golden "accepted" the offer, so the offer could not have become less justifiable; (3) despite this, CIC refused to pay over the $ 25,000; (4) Murner admitted that the $ 25,000-offer should not have been made; and (5) Murner's admission supported Golden's claim **[*27]** that it was a sham offer all along and, therefore, made in bad faith. This argument fails fundamentally since there was never any evidence of the need for future medical care. Murner's settlement recommendation to Dasher, and CIC's approval of the settlement offer for future medicals, was based on Golden's representation that he would eventually present such evidence. Golden attempts to make Murner and CIC the culprits because they relied on his representations in making the offer. The argument defies logic.

> that you were offering for medicals, and I said you already rejected the offer and you hadn't proved anything regarding future medicals, so why would I go there?

The Hofmeisters continued to engage in discovery between the summer of 2000 and autumn of 2002. They served additional requests for production of documents and a third and fourth set of interrogatories on Dasher in September 2000 and May 2001, respectively. Again, the Hofmeisters never took advantage of the discovery process to obtain information regarding Dasher's insurance coverage.

Dasher, too, continued efforts through discovery to obtain Hofmeister's financial records so it could assess whether there was a causal relationship between the accident and Hofmeister's business failures. The trial court permitted such discovery even over Golden's motion for a protective order. Even **[*28]** then, Dasher subsequently found it necessary to obtain the trial court's order compelling production of this documentation before Hofmeister would produce it.

On July 19, 2001, through Golden, the Hofmeisters moved to amend their complaint for a second time. They did not attach a copy of the proposed amended complaint to the motion, but stated their intent to assert a claim against CIC for violation of the UCSPA. Through Murner, Dasher moved the trial court pursuant to *CR 11* to strike the motion as frivolous, having been filed for the improper purpose of attempting to force settlement of the underlying claim. Primarily, Dasher noted that its liability was still fairly debatable since no decision had yet addressed the scope-of-employment issue. Dasher also asserted that the Hofmeisters had continuously thwarted its efforts to substantiate their economic losses. The trial court granted the Hofmeisters' motion to amend the complaint and deferred a ruling on Dasher's *CR 11* motion.

The second amended complaint listed a variety of grievances against CIC, each of which the Hofmeisters contended constituted a violation of the UCSPA. Shortly thereafter, the Hofmeisters amended the complaint again, **[*29]** adding an additional UCSPA claim against CIC. Now itself a defendant, CIC answered the two amended complaints and denied each of the substantive allegations in both.

In September 2001, the trial court agreed with CIC that the case against it for bad faith should be bifurcated from the underlying tort claim and entered an order to that effect. Attorney Michael Risley entered his appearance on behalf of CIC. The underlying tort claim went forward.

On March 15, 2002, Dasher took the deposition of a representative of the bank where Hofmeister had applied for and had been denied the $ 25-million loan. The bank representative acknowledged that he recommended Hofmeister's loan application to his superiors, but stated they ultimately denied the loan. He said that Hofmeister's medical condition following the accident did not affect either his recommendation or his superiors' denial of the application for credit. He testified, "I don't recall it being woven into the credit presentation as an issue we had to deal with[.]" Instead, "the final decision" to reject was based on "economic issues with his businesses, his horse business and other businesses, that he had that brought in risk factors that **[*30]** the bank [was] not willing to accept[.]" Nothing in the record indicates that the accident had any effect on the bank's denial of Hofmeister's application for a $ 25-million loan.

Trial was scheduled for the spring of 2002. Both the Hofmeisters and Dasher submitted proposed jury instructions that left the issues of Dasher's vicarious liability and Hofmeister's comparative negligence for resolution by the jury. For reasons which the Hofmeisters opposed but are not otherwise pertinent here, the trial was continued and eventually rescheduled for October 14, 2002.

The critical issue of whether Clark was acting in the scope of his employment was still not resolved when, between August 30 and September 4, 2002, the Hofmeisters, Clark and Dasher each filed motions on this issue. On September 13, 2002, the trial court entered an order finding that Clark was acting in the scope of his employment with Dasher.

There was conflicting evidence as to whether Dasher's dispatcher *ordered* Clark to return the keys and credit card himself that morning, or whether Clark, knowing the keys had to be returned, felt compelled to voluntarily undertake the task. The Hofmeisters argued that this specific question **[*31]** is irrelevant. The trial court seemed to agree, focusing instead on the facts that: (1) Dasher "indicated the keys had to be returned;" (2) return of the keys was for Dasher's benefit; (3) Dasher's dispatcher authorized the return of the keys; and (4) returning the keys was "incidental" to Clark's employment. The trial court noted and discounted the fact that Clark made two separate stops for coffee and fuel, stating those stops were "not evidence of any

independent pursuit or deviation [but] merely in furtherance of Clark's primary mission[.]" The trial court did not address the facts that: (1) Clark was not on a direct route between his home and Dasher's offices when the accident occurred; (2) Clark did not recall why he deviated from the direct route to Dasher's offices; (3) Clark himself had created the circumstances necessitating a return of the keys and credit card; or (4) when asked in a pre-litigation interview whether he was on company or personal business, Clark himself responded, "[T]hat's debatable."

On October 3, 2002, rather than challenging the trial court's ruling, Dasher stipulated liability [10] and simultaneously presented the Hofmeisters with an offer of judgment, **[*32]** pursuant to *CR 68*, in the amount of $ 175,000. [11] Eight days later, on October 11, the offer increased to $ 300,000. On the day of trial, October 14, Dasher offered $ 500,000. Before trial started, Dasher offered the $ 1,000,000-limits of its policy of automobile liability insurance. On behalf of the Hofmeisters, Golden accepted, but conditioned that acceptance upon certain concessions from some of the other defendants.

Because this occurred on the day trial was to commence, and because terms of the settlement were unclear, **[*33]** the parties agreed to go on the record with the trial court, as "the way to consummate this settlement[,]" to use Golden's words. Golden and Murner were present on behalf of their respective clients. [12] Also present, either in person or by telephone conferencing, were representatives of Clark's personal insurer and the attorney for Farm Bureau Insurance. As the case against CIC for statutory bad faith had been bifurcated and all such claims were to be addressed later, attorney Risley was not present on behalf of CIC.

Golden initiated the discussion by representing he could "blackboard over $ 20 million in damages and that will expose Eugene Clark to that excess judgment[.]" Only moments into the hearing, a reference was made to the "excess policy with Dasher of $ 10 million[.]" Murner corrected the speaker and clarified that Dasher's excess policy was only $ 5 million. Owing to telecommunications glitches, Murner had to repeat three times that the amount of Dasher's excess insurance coverage was $ 5 million.

Before the negotiations ended, eleven separate references were made to the existence of Dasher's policy of excess insurance. In addition, the excess insurer was identified as Fireman's Fund three separate times. And the excess policy limits of $ 5 million were stated a total of four times. Nothing in the transcript indicates that anyone, including Golden, was surprised by or unaware of the existence of Dasher's policy of excess insurance.

The sticking point in settlement, however, was the relatively smaller amount of $ 100,000. This is one of the sums of insurance Golden collected for the Hofmeisters before initiating litigation. Before the **[*35]** parties could reach a settlement, one question had to be resolved: which party or insurance company would ultimately be responsible for that amount? The attorneys for the Hofmeisters and Dasher and Clark were attempting to convince the representatives of the insurance companies to waive the right to recover the sum from any of them.

Golden pointed out that he could easily prove more than $ 100,000 in damages and, if the trial went forward, the obstinacy of Clark's personal liability insurer "will expose Eugene Clark to that excess judgment." This prompted Clark's insurer to ask, "Isn't Mr. Clark an insured under the excess policy, also?" To this, Murner responded that he "had no authority from the excess carrier. A million dollars is what we're offering here." Golden proposed a simple solution: "[I]f [Clark's personal liability insurer] pays the hundred [thousand dollars] that it already

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[10] Murner testified this was a tactical decision "to refocus the Issues to the damages, which is what we always wanted to address in this case." On cross-examination, Golden attempted unsuccessfully to have Murner admit the stipulation indicated CIC knew Dasher was liable all along "because nothing had changed in the case" from the date of Dasher's original offer, June 22, 2000, until liability was conceded.

[11] The Hofmeisters have argued throughout the litigation, and now in this appeal, that the net value of this $ 175,000-offer was $ 25,000 because of "liens" in favor of Travelers and Farm Bureau. There is nothing in the record supporting the existence of such liens.

[12] At this point in the litigation, Murner was representing Dasher and Clark. Before the trial court determined that Clark was acting within the scope of his employment with Dasher, Clark had separate counsel. He had never requested coverage from CIC. Once the scope-of-employment issue was decided, CIC provided Clark's defense. Still, on the heels of the jury verdict in the case *sub judice,* Clark filed a civil action over this issue claiming CIC violated the UCSPA. *Clark v. Cincinnati Ins. Co., No. 2005-CA-000356-MR, 2006 WL 1044461 (Ky.App. April 21, 2006)*. This Court in *Clark* affirmed the Fayette Circuit Court's dismissal of Clark's claim. In an example of *litigation* making **[*34]** strange bedfellows, Clark's attorney was Dale Golden.

committed to pay earlier, then we're all done and it's over with, we can all go home."

Clark's insurer balked. So, Golden announced he was prepared "to proceed against Eugene Clark, and if we ring him up, then we're going to take his personal assets . . . and our position is going to be that [Clark's **[*36]** personal liability insurer] has acted unreasonably and violated the Unfair Claims Settlement Practices Act[.]" Eventually, the representatives of the affected insurers agreed to brief and argue this particular issue among themselves, leaving the remaining parties out of that particular fray and free to settle their claims.

On the points of settlement, Murner was very clear that the settlement for the limits of Dasher's automobile liability policy embraced a universal release of liability relative to the underlying tort claim.

> Mr. Murner: Okay, Your Honor, my position is--and if I'm wrong, somebody tell me now. Cincinnati, excess carrier, Dasher and Clark are protected, and free and clear from--
>
> The Court: I don't know what anybody else thinks, but I am clear on that, for whatever it is worth.
>
> . . . .
>
> Mr. Murner: What I want to make sure is that this is a complete release. I mean, this is the standard complete release with the exception of [the remaining issues among the insurers regarding subrogation issues apart from the parties].
>
> Mr. Golden: I agree.

In accordance with this agreement, Murner drafted a settlement agreement and release. [13] The Hofmeisters' right was reserved to continue pursuing **[*37]** the bad faith and UCSPA claims against CIC and Fireman's Fund. Otherwise, the Hofmeisters released Dasher, Clark, CIC and Fireman's Fund for all claims arising directly from the automobile accident only.

There was a delay in obtaining approval from the Hofmeisters' insurer and Clark's personal insurer relative to the subrogation issue. This delayed execution of settlement documents and disbursement of proceeds. Attempting to encourage movement on the issue, Golden filed a motion to enforce the settlement on behalf of the Hofmeisters, followed by a motion on his own behalf, based on his own lien, for immediate disbursement of his attorney fees and costs expended.

In his motions, Golden claimed that he never agreed to include CIC and Fireman's Fund in the release of the underlying tort action. Blaming Murner, Golden insisted that the trial court "stop the wrongful conduct of withholding the **[*38]** settlement proceeds in exchange for additional releases that were never bargained for[.]" Golden insisted the delay was to pressure the Hofmeisters into dismissing their bad faith claims.

On behalf of Dasher and Clark, Murner responded that he had

> never included a provision in any proposed settlement agreement providing for protection against allegations of violation of the Unfair Claims Settlement Practices Act [or] in any correspondence that any release must contain protection from any potential bad faith allegations[.] Thus, any claim by Plaintiffs' counsel that settlement proceeds are being withheld to solicit a release of bad faith claims on behalf of Cincinnati Insurance and/or Fireman's Fund Insurance Company are simply unsupported by the correspondence between counsel and the proposed settlement release.

Murner's position is easily verified by the language of the settlement agreement itself. Furthermore, nothing in the record contradicts Murner's position on this issue, nor does the record support Golden's suggestion otherwise.

Eventually, all of the issues were resolved by the attorneys without the need for the trial court to rule. However, the delay was long enough that it allowed **[*39]** Allied Capital Corporation, one of George Hofmeister's judgment creditors, to intervene in this action and garnish the settlement proceeds before the Hofmeisters received them.

In May 2003, the Hofmeisters sought leave to file another amended complaint. In essence, this amendment added two counts. First, the Hofmeisters alleged that CIC's rapid increase in offers between October 3 and October 14, 2002, from $ 175,000 to $ 1,000,000, violated Kentucky's UCSPA. Second, they alleged that CIC intentionally prolonged settlement to purposefully take advantage of the Hofmeisters' worsening financial circumstances. The motion was granted and the amended complaint ordered filed on June 5, 2003.

In August 2003, ten months after the settlement

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[13] Golden actually made the first attempt at drafting the agreement. However, that draft was incomplete in that it did not include the release of CIC and Fireman's Fund as to the underlying tort claim and it left unresolved the subrogation dispute between the Hofmeisters' insurer and Clark's insurer.

negotiations were recorded before the trial court, it occurred to the Hofmeisters that they had an opportunity to file yet another amended complaint. Here, they alleged that CIC "misrepresented pertinent facts regarding the amount of insurance that was available" and "failed to disclose the existence of an excess insurance policy." The motion was granted and the amended complaint ordered filed on September 15, 2003.

In February 2004, the Hofmeisters sought **[*40]** leave to file what became their final amended complaint. Seemingly aware of this Court's nonfinal opinion in *Knotts v. Zurich Ins. Co., 2002-CA-001846, 2004 Ky. App. LEXIS 22 (Feb. 6, 2004)* that no post-litigation conduct by an insurance company can be the basis of a UCSPA claim, the Hofmeisters' "Fifth Amended Complaint" [14] alleged that all of CIC's actions also supported a claim for common law fraud and intentional infliction of emotional distress. It appears from the record that this tactical decision was intended to avoid the potential that *Knotts,* once final, would totally defeat the Hofmeisters' claims under the UCSPA. The motion was granted and the amended complaint ordered filed on May 17, 2004, three days before trial.

Before trial commenced on May 20, 2004, CIC moved for a continuance because the amended complaint had been filed so close in time to the commencement of trial. The motion was denied because there were no additional factual allegations, only additional legal theories. The trial judge also addressed numerous procedural and evidentiary motions, **[*41]** filed by both sides. Over CIC's objection, the trial court ruled that Murner was CIC's agent for purposes of settlement negotiation. *See, infra,* Section II.C.

Both sides tendered proposed jury instructions. The parties announced ready and the trial proceeded. At the close of evidence, each party moved for directed verdicts. As to the issues now before this Court, those motions were denied. The jury was instructed in preparation for its deliberations.

The trial court took the parties' respective proposed jury instructions into consideration but crafted its own. The court incorporated its previous holding that Murner was CIC's agent into Instruction No. 2, addressing violations of the UCSPA, and Instruction No. 3, addressing fraudulent misrepresentation. Therefore, the jury was entitled to attribute Murner's conduct to CIC for liability purposes. The jury received no instruction regarding fraud by omission, i.e., the Hofmeisters' allegation that CIC failed to disclose the existence of the policy of excess insurance coverage. Further details of the jury instructions will be discussed as necessary in the context of the parties' various arguments. The case was turned over to the jury which **[*42]** found for the Hofmeisters on both Instruction No. 2 and Instruction No. 3, though not unanimously on either.

CIC filed motions for judgment notwithstanding the verdict; for a new trial; and to alter, amend or vacate the judgment. To the extent the bases for these motions are relevant to this appeal, they will be discussed *infra.* It is sufficient now to note only that all post-judgment motions were denied with the exception of the motion to reduce the punitive damages award. These appeals followed.

II. *Cincinnati Insurance Company v. Hofmeister,* 2004-CA-002296

CIC presents a plethora of arguments on appeal. Many of these arguments center on one central question: What legal relationship exists between an insurer and legal counsel hired to defend its insured? Surprisingly, Kentucky has never addressed this question squarely, but the answer is crucial to resolution of this case. After addressing this question generally, we will apply the law to the facts of this case, and then address CIC's additional arguments *seriatim.*

We further preface our discussion by noting two factors that will distinguish this case from many others. First, the underlying litigation was a negligence action brought **[*43]** by a claimant seeking restitution from a tortfeasor. It was not a contract action brought either by the first-party insured, by a third-party beneficiary of an insurance contract, or a third party who stood in the shoes of the insured as a result of an assignment. Second, the Hofmeisters made no attempt to settle the case with Dasher prior to the filing of the complaint. Consequently, whether the concepts discussed here have equal application to pre-litigation conduct will depend on circumstances not present in this case.

A. Standard of Review

Many of the issues addressed here were preserved in more ways than one. The issues which are dispositive of this case involve the denial of CIC's motions for

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[14] While this was the fifth amendment of the complaint after CIC was named as a defendant, it was the sixth time the original complaint was amended.

directed verdict and for judgment notwithstanding the verdict. The same standard applies to both. Prichard v. Bank Josephine, 723 S.W.2d 883, 885 (Ky.App. 1987). HN2[↑] A directed verdict or judgment notwithstanding the verdict is appropriate when, drawing all inferences in favor of the nonmoving party, a reasonable jury could only conclude that the moving party was entitled to a verdict. Buchholtz v. Dugan, 977 S.W.2d 24, 26, 45 11 Ky. L. Summary 7 (Ky.App. 1998); see also, Bierman v. Klapheke, 967 S.W.2d 16, 18, 45 5 Ky. L. Summary 18 (Ky. 1998). **[*44]** A reviewing court may not disturb a trial court's decision on a motion for directed verdict unless that decision is clearly erroneous. Bierman at 18. The denial of a directed verdict by a trial court should only be reversed on appeal when it is shown that the verdict was palpably or flagrantly against the evidence such that it indicates the jury reached the verdict as a result of passion or prejudice. Id. at 18-19.

B. Relationship of Attorney Defending Insured and Insurer - Generally

In Kentucky, the relationship of the insurer to the attorney hired to defend the insured has been discussed primarily in caselaw interpreting the Rules of Professional Conduct, Supreme Court Rule (SCR) 3.130. While the trial court was not inclined to consider these cases because Murner's professional responsibility was not directly in issue, we believe they are illuminating.

In American Ins. Ass'n v. Kentucky Bar Ass'n, 917 S.W.2d 568 (Ky. 1996), the insurance industry sought permission for its insurer members to use in-house lawyers to defend their insureds, or at least to engage outside counsel on a "set fee" or retainer basis to handle all litigation. Both requests were denied.

Reaffirming the sanctity **[*45]** of the relationship between the insured and the attorney hired to defend him, our Supreme Court reemphasized that HN3[↑] "[n]o man can serve two masters[.]" American Ins. Ass'n at 571, quoting Kentucky State Fair Bd. v. Fowler, 310 Ky. 607, 615, 221 S.W.2d 435, 439 (1949). It is axiomatic that a lawyer must serve his client dutifully and loyally. Building upon that axiom, the Supreme Court recognized that granting the industry's request would move the attorney closer to certain "inherent pitfalls and conflicts" that would interfere with his duty and loyalty to the client. Id. at 571.

> Inherent in all of these potential conflicts is HN4[↑] the fear that the entity paying the attorney, the insurer, and not the one to whom the attorney is obligated to defend, the insured, is *controlling* the legal representation.

American Ins. Ass'n at 573 (emphasis supplied). To quell that "fear," "[w]e continue to adhere to the view that it would be contrary to public policy to allow the insurer to control the litigation[.]" Wheeler v. Creekmore, 469 S.W.2d 559, 563 (Ky. 1971).

American Ins. Ass'n was not the first time we rejected a "rule [that] would be inimical to the preservation of traditional and longstanding concepts **[*46]** associated with attorney-client relationship, as recognized by Kentucky law." American Continental Ins. Co. v. Weber & Rose, P.S.C., 997 S.W.2d 12, 13, 45 13 Ky. L. Summary 18 (Ky.App. 1998) (rejecting excess insurer's claim of right to sue its insured's attorney for malpractice). Our courts simply cannot ignore HN5[↑] Kentucky's consistent refusal to allow the insurer any right to control the attorney's independent manner of representing its insured. That independence has a long history.

In New Independent Tobacco Warehouse, No. 3 v. Latham, 282 S.W.2d 846 (Ky. 1955), our highest court said that HN6[↑] the "general rule is the services of a professional man, such as a lawyer . . . are rendered under an independent contract[.]" Id. at 848. That is, a lawyer is one "who follows [his] employer's desires only as to results of work, and not as to means whereby it is to be accomplished." Romero v. Administrative Office of Courts, 157 S.W.3d 638, 642 (Ky. 2005), quoting BLACK'S LAW DICTIONARY 770 (6th ed.1990). These same rules apply when an insurer selects and pays an attorney to represent its insured. The Tennessee Supreme Court accurately described the relationship:

> HN7[↑] In the typical situation in which an insurer hires an attorney **[*47]** to defend an insured, the relationship of the insurer and its attorney is precisely that of principal to independent contractor. [T]he attorney is engaged in the distinct occupation of practicing law . . . one in which the attorney possesses special skill and expertise. [T]he attorney generally supplies his or her place of work and tools; the attorney is employed and paid only for the cases of individual insureds; and he or she alone, consistent with ethical obligations to ensure competence and diligence in the representation, determines the time to be devoted to each case. Finally, and obviously, the practice of law is not, nor

could it be, part of the regular business of an insurer.

Givens v. Mullikin ex rel. Estate of McElwaney, 75 S.W.3d 383, 393-94 (Tenn. 2002); *see also, Sam Horne Motor & Implement Co. v. Gregg, 279 S.W.2d 755, 756-57 (Ky. 1955)*(factors for determining independent contractor status); *see also, Vires v. Dawkins Log & Mill Co., 240 Ky. 550, 42 S.W.2d 721, 722 (Ky. 1931)*("independent contractor is . . . independent of his employer in the execution of his work, and may labor at the times and in the manner he prefers.").

HN8[↑] Clearly, the factor most critical to the attorney's **[*48]** retention of his status as an independent contractor, *vis-a-vis* the insurer, is the attorney's retention of control over the means by which he accomplishes the insurer's desired result - defense of its insured. *Home Ins. Co. v. Henderson Lodge, No. 732, Loyal Order of Moose, 201 Ky. 522, 257 S.W. 422, 423 (Ky. 1923)*("If [one] is merely subject to the control or direction of the [employer] as to the result to be obtained, he is [still] an independent contractor. If [one] is subject to the control of the employer as to the means, he is not an independent contractor.")(quotation marks and citation omitted). We conclude that the relationship of an attorney hired to defend an insured relative to the insurer that hired him, at least initially, is that of independent contractor. [15]

HN9[↑] As a general rule, an employer is not liable for the torts of an independent contractor in the performance of his job. *Miles Farm Supply v. Ellis, 878 S.W.2d 803, 804 (Ky.App. 1994)*. While general rules often have philosophical or logical origins, their exceptions typically are born of practical realities. Therefore, we cannot ignore the practical reality that an insurer may seek to exercise actual control of an attorney's work, even though lacking the right to do so. Our common law embraces that possibility.

Long ago, ***HN10***[↑] Kentucky recognized that if a principal lacking the right of control nevertheless "personally interferes with, undertakes to do, manage or control the work of the independent contractor, he thereby destroys the relationship of independent contractor." *Madisonville, H. & E.R. Co. v. Owen, 147 Ky. 1, 143 S.W. 421, 424 (Ky. 1912)*. The independent contractor would thus convert to an employee or agent. Our review of authority reveals that Kentucky independent contractors, **[*50]** once possessed of the right to control their own work, are not inclined to relinquish that right to the employer. In fact, we failed to discover any case in which that has occurred. [16]

However low the rate at which typical independent contractors relinquish the *right* to control their own work, logic compels the conclusion that the rate would be even lower when that right is coupled with a *duty*. ***HN12***[↑] Unlike other independent contractors, the attorney who relinquishes the right to control will perforce violate his duty under the Rules of Professional Conduct, Rule 1.8(f)(2), and "clearly subject himself to severe discipline." *Summit v. Mudd, 679 S.W.2d 225, 226 (Ky. 1984)*. An attorney's maintenance and protection of his independent contractor status is thus additionally **[*51]** reinforced. We therefore agree with our sister court that "cases in which an insurer may be held liable under an agency theory will be rare indeed." *Givens at 395*.

We also believe *Givens* indicates ***HN13***[↑] the proper standard for determining whether the insurer has exercised actual control of the attorney despite lacking the right to do so. Such control must be invidious in that it "affect[s] the attorney's independent professional judgment . . . interfere[s] with the attorney's unqualified duty of loyalty to the insured, or . . . present[s] a reasonable possibility of advancing an interest that would differ from that of the insured." *Givens at 395*.

We now apply these criteria to the facts of this case.

C. Whether the Trial Court Erred in Failing to Direct

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[15] This same conclusion has been reached by many of our sister states. *See, Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co., 439 Mass. 387, 788 N.E.2d 522, 539-41 (Mass. 2003)*(Where lawyer "controls the strategy, conduct, and daily details of the defense . . . an insurer cannot be vicariously liable for the lawyer's negligence."), *and cases cited therein, and, Ingersoll-Rand Equip. Corp. v. Transportation Ins. Co., 963 F.Supp. 452, 454-55 (M.D.Pa. 1997)*("The **[*49]** attorney's ethical obligations to his or her client, the insured, prevent the insurer from exercising the degree of control necessary to justify the imposition of vicarious liability"), *and cases cited therein.*

[16] Several cases, notably *United Engineers & Constructors, Inc. v. Branham, 550 S.W.2d 540 (Ky. 1977)*, reaffirm the longstanding rule that ***HN11***[↑] "the main dispositive criterion is whether it is understood that the alleged principal or master has the *right* to control the details of the work." *Id. at 543* (emphasis supplied). Here we are speaking of a different concept - the principal's exercise of control despite having no right to do so.

a Verdict That Murner Was Not CIC's Agent

The trial court concluded that Murner was CIC's agent for purposes of settlement negotiations. CIC claims that ruling was error. We agree.

The trial court did not engage in the analysis indicated above, but instead applied the reciprocal analysis of whether Murner was CIC's agent. ***HN14***[↑] Whereas independent contractor status is shown by the *absence* of the principal's control over the work to be performed, agency **[*52]** is shown by its *presence.* Just as with the independent contractor analysis, "the right to control is considered the most critical element in determining whether an agency relationship exists." *Phelps v. Louisville Water Co., 103 S.W.3d 46, 50 (Ky. 2003)*(citation and quotation marks omitted). Therefore, the trial court's analytical approach was effectively the same as ours.

During oral argument of the issue, the trial court stated, "[I]t's pretty clear to me that Mr. Murner was *controlled and guided* by Cincinnati Insurance Company in terms of settling this case." (Emphasis supplied). The trial court determined that CIC exercised sufficient control over Murner to make him CIC's agent based on the following three facts alone:

(1) "Murner was hired by Defendant [CIC] to represent Dasher;"

(2) "Murner was required to report to [CIC];" and

(3) CIC "would have to approve any settlement offers [recommended by Murner]."

Having examined the record and finding no additional facts that would reinforce this list, we conclude that CIC was entitled to a directed verdict that Murner was not CIC's agent.

Respectfully, we believe the learned trial judge erred by not considering closely enough just what caused **[*53]** these three facts to occur. The trial court concluded they occurred because an agency relationship existed between Murner and CIC. But the record reveals that none of these three facts was intended as a means by which CIC would exercise control over Murner as its agent. Instead, each fact relates directly to a specific duty created by the insurance contract between CIC and Dasher. The contract and these duties existed well before CIC engaged Murner as Dasher's legal counsel.

The insurance contract created specific reciprocal duties that CIC and Dasher were required to satisfy when certain claims of Dasher's liability were asserted. CIC's duty was to defend such claims and to satisfy the legitimate ones. These duties were conditioned upon Dasher's satisfaction of its own duty to cooperate with CIC "in the investigation, settlement or defense of the claim[.]" To be entitled to the benefits of its bargain with CIC, Dasher had to obtain CIC's approval of any settlement it expected CIC to pay. At the same time, however, the contract did not prohibit Dasher from paying a claim without CIC's approval and outside the contract - that is, by utilizing any other Dasher asset to settle the Hofmeisters' **[*54]** demands - but such a payment would be, according to the insurance contract, "at the 'insured's' own cost." [17]

CIC performed its duty to defend Dasher by selecting and agreeing to pay Murner to serve as Dasher's legal counsel. Experience tells us that ***HN16***[↑] an insurer is better able than its insured to select **[*55]** legal counsel to represent that insured. *State Farm Mut. Auto. Ins. Co. v. Marcum, 420 S.W.2d 113, 120 (Ky. 1967)*(insurer is "a professional defender of law suits[.]"), *overruled on other grounds, Manchester Ins. & Indem. Co. v. Grundy, 531 S.W.2d 493 (Ky. 1975)*. Our courts will not penalize a party because he prudently authorized his experienced insurer to select the right attorney to defend him. *Asbury v. Beerbower, 589 S.W.2d 216, 217 (Ky. 1979)*(An insured who "has paid an insurance company to exercise that choice for him . . . should not be penalized for his prudence in that respect."). We are not surprised that such prudence was exercised in this case. When Dasher paid its premium, it purchased CIC's expertise in selecting an attorney and, when a claim was asserted, CIC performed. It simply makes no sense to conclude that CIC's performance of its duty to select Dasher's attorney also supports a finding that the attorney thereby became CIC's agent. Absent evidence that there was more to such selection and compensation than satisfaction of a duty to Dasher, we

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[17] We should not forget that ***HN15***[↑] a contract of liability insurance is simply an asset from which a liability may be satisfied. *See, Hillman v. American Mut. Liability Ins. Co., 631 S.W.2d 848, 848 (Ky. 1982)*(liability insurance policy was tortfeasor's "only asset[.]"). Accident victims assert claims against alleged tortfeasors, not directly against the tortfeasor's insurer. Nothing prevents a tortfeasor's satisfaction of a claim from his assets other than insurance. It is simply because use of an insurance asset has the least disruptive effect on the continued operation of a business that it is naturally the first asset a business considers when contemplating claims settlement. However, whether to actually utilize that asset first remains the option of the business. It is not the option of the accident victim or his attorney to demand that the claim be satisfied from a contract of insurance.

cannot conclude that this fact supports a finding that CIC controlled Murner.

The trial court and the Hofmeisters next place **[*56]** much reliance upon Murner's cooperation with CIC and the acknowledgment that he routinely obtained CIC's approval before offering settlement to the Hofmeisters. This reliance is misplaced.

As Dasher's agent, Murner had a duty to follow Dasher's instructions. If Murner's cooperation with CIC had been contrary to Dasher's instructions, that would support an argument for Murner's role as CIC's agent. But nothing in the record suggests such a thing occurred. Murner's cooperation with CIC was consistent with the duty he owed to his client, Dasher; it was consistent with Dasher's duty to CIC; it was consistent with Murner's relationship to CIC as an independent contractor. *See, Latham, supra, 282 S.W.2d at 848* (Fact that employer and independent contractor engaged in "daily conferences merely represented the [employer's] right to see that the work was progressing . . . and does not militate against the idea Latham was an independent contractor.").

The same can be said for Murner's act of obtaining CIC's approval before settlement was offered. Murner was, again, simply carrying out the contractual duty his client owed CIC.

It is also clear that Murner was not functioning as CIC's claims adjuster. **[*57]** ***HN17***[↑] The respective roles of the insured's attorney and the insurer's claims adjuster are entirely distinguishable. The adjuster's fundamental role is to settle the claim *apart from* litigation; the attorney's is to effectively conduct a defense in the litigation. The adjuster owes no independent loyalty to the insured apart from that owed by the insurer. The attorney's loyalty to his insured client is paramount. And, unlike the attorney whose conduct is controlled by his oath, the adjuster receives direction and authority from the insurer, which is why he has been deemed the insurer's agent. *Fidelity & Guaranty Ins. Underwriters, Inc. v. Gregory, 387 S.W.2d 287, 289 (Ky. 1965)*. Furthermore,

> the adjuster and the claimant usually deal directly with one another. If their negotiations fail, the adjuster negotiates with plaintiff's counsel, and even after litigation is begun, the adjuster frequently deals directly with plaintiff's counsel.

Gailor v. Alsabi, 990 S.W.2d 597, 608, 46 3 Ky. L. Summary 16 (Ky. 1999)(Lambert, C.J., dissenting).

Our conclusion that CIC did not control Murner is also strengthened by the undeniable fact that Murner and Dasher enjoyed an attorney-client relationship. When Murner undertook Dasher's **[*58]** legal representation, he became Dasher's agent, not CIC's. *Douthitt v. Guardian Life Ins. Co. of America, 235 Ky. 328, 31 S.W.2d 377, 379 (1930)*(***HN18***[↑] "an attorney is an agent of his client"). Kentucky has always jealously guarded the attorney-client relationship, for while "[t]he relationship is generally that of principal and agent . . . the attorney [owes his client] a higher duty than any ordinary agent owes his principal." *Daugherty v. Runner, 581 S.W.2d 12, 16 (Ky.App. 1978)*. As described *supra,* Murner's relinquishment of control to CIC would have required that he abdicate his professional responsibility, abandon his true principal, and jeopardize his career.

We conclude that ***HN19***[↑] where there is no evidence other than the fulfillment of those duties existing between the lawyer and the insured as his client, and the fulfillment of those duties existing between the insured and the insurer, there can be no finding of an agency relationship between the insurer and the attorney it hires to defend its insured. These duties exist and will be carried out in every case of this nature. If we held that these facts alone would support a finding that the insurer controlled the attorney, not only would **[*59]** we have to conclude that the attorney is *always* the insurer's agent, we would be inviting, if not requiring, the very conflicts our caselaw and ethical rules seek to avoid. *See, e.g., American Ins. Ass'n, supra;* Kentucky Rules of Professional Conduct, (SCR) 3.130(1.7) and (1.8).

For their part, the Hofmeisters assert that additional evidence does exist. They claim Murner became directly involved in deciding whether CIC's policy covered his client's employee. Examination of the record does not support more than their attorney's argument to that effect, and the unrefuted evidence of record contradicts the assertion. In his testimony, Murner made the point, and we believe correctly, that the scope-of-employment issue (critical to his client's common law liability to Hofmeister) and the coverage issue (critical to CIC's contractual liability to Clark as a third-party beneficiary) were independent considerations, and that his focus was on the former. Murner's opinion regarding scope of employment may have affected CIC's decisions regarding coverage, but that alone will not support an agency relationship between CIC and Murner.

The Hofmeisters also believe that CIC should be judicially estopped **[*60]** from denying the agency

relationship because of a prior assertion in this same proceeding that CIC's communications with Murner were privileged. We disagree. ***HN20***[↑] "The judicial estoppel doctrine . . . prevent[s] a party from taking a position inconsistent with one successfully and unequivocally asserted by the same party *in a prior proceeding*." *Colston Investment Co. v. Home Supply Co., 74 S.W.3d 759, 763 (Ky.App. 2001)*(emphasis supplied). Even if we were to expand the doctrine to include inconsistent positions within the same proceeding, we certainly could not do so selectively. We would have to apply the doctrine equally to the Hofmeisters who sought to avoid the attorney-client privilege by arguing below that Murner was not CIC's attorney. To use the Hofmeisters' attorney's words, "As this Court is well aware, an attorney can only represent the insured."

The Hofmeisters next argue that Murner had either actual or apparent authority to bind CIC in settlement negotiations. Though the brief makes virtually no reference to the record on this point, our examination does not disclose evidence to justify such a conclusion. Until the complaint was amended in mid-August 2001, there was no claim **[*61]** against CIC to be settled. After that point, attorney Risley was hired to represent CIC. We find it difficult to understand this argument under these circumstances. Evidence that Murner sought a release that would include CIC, and even evidence that Murner conveyed information to Golden that CIC would be responsible for negotiating Hofmeister's PIP settlement, is not inconsistent with Murner's independent contractor status *vis-a-vis* CIC.

However, the trial court, citing *Clark v. Burden, 917 S.W.2d 574 (Ky. 1996)*, appears to have accepted this last argument. We believe that case is inapposite. The attorney with settlement authority at the center of *Clark* represented the tort claimant. *Id. at 575*. The only other attorney involved represented the joint tortfeasors and not either of their insurers. *Id.* In fact, no insurer is mentioned at all. *Clark* simply stands for the proposition that, under proper circumstances, an attorney can bind his client. CIC was not Murner's client. Excluding a sort of circular argument, we simply cannot see how *Clark* supports the finding the CIC exercised the kind of control over Murner that would have made Murner its agent.

The Hofmeisters' argument that Murner **[*62]** could bind CIC in settlement reveals a fundamental confusion about the nature of the underlying claim. ***HN21***[↑] An automobile accident gives rise to a tort claim against the tortfeasor, but not any kind of claim against that tortfeasor's insurer (unless, of course, the claimant is also an insured under the same policy). The accident victim has no right, prior to obtaining a judgment against the tortfeasor, to assert a direct claim to insurance policy proceeds. *Central Mut. Ins. Co. v. Pippen, 271 Ky. 280, 111 S.W.2d 425, 426 (Ky. 1937)*; *cf., Wheeler v. Creekmore, 469 S.W.2d 559, 564 (Ky. 1971)*(where one jurist lamented the fact that an insurance contract is not "viewed as one vesting in the injured third party a direct cause of action;" Osborne, J., concurring). Consequently, CIC had no liability in the underlying tort action that would have required negotiation or compromise. If there had been evidence that Murner had authority to bind CIC, it would have been, at best, merely incidental to his duty to defend Dasher.

The record is devoid of any evidence that CIC exercised any actual control, invidious or otherwise, over the means by which Murner accomplished his representation of Dasher, including **[*63]** his efforts toward settlement of the tort claim. These settlement efforts are best characterized as an appropriate attempt by Dasher's attorney, utilizing a Dasher asset (the contract of insurance), in accordance with contract terms requiring Dasher's cooperation and CIC's approval, to settle a tort claim against his client. [18]

We therefore agree with CIC that the trial court erred by denying its motion for directed verdict that Murner was not CIC's agent. Murner began and maintained his representation of Dasher as CIC's independent contractor. Consequently, the general rule prevails and CIC is not vicariously liable for **[*64]** any of Murner's actions undertaken in the performance of his representation of Dasher. *Miles Farm Supply v. Ellis, 878 S.W.2d 803, 804 (Ky.App. 1994)*.

D. Whether the Trial Court Erred in Failing to Direct a Verdict in Favor of CIC on the Claim of Fraudulent Misrepresentation

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[18] In view of our holding, we need not rely on the alternative basis for reversal that the record is completely devoid of evidence sufficient to constitute the required mutual "manifestation of consent" that Murner serve as CIC's agent. *Phelps v. Louisville Water Co., 103 S.W.3d 46, 50 (Ky. 2003)*. Without contradiction, Murner testified that he never consented to have either his litigation conduct or his settlement conduct controlled by CIC, and that his loyalty to his client was never compromised by any obedience to CIC inconsistent with his duty as Dasher's attorney.

CIC asserts the trial court erred by denying its motion for directed verdict on the Hofmeisters' claim of fraudulent misrepresentation. We agree.

HN22[↑] Common law fraudulent misrepresentation requires proof of six elements: "(1) that the declarant made a material misrepresentation to the plaintiff, (2) that this misrepresentation was false, (3) that the declarant knew it was false or made it recklessly, (4) that the declarant induced the plaintiff to act upon the misrepresentation, (5) that the plaintiff relied upon the misrepresentation, and (6) that the misrepresentation caused injury to the plaintiff." *Radioshack Corp. v. ComSmart, Inc., 222 S.W.3d 256, 262 (Ky.App. 2007)*. There must be clear and convincing proof of each of these elements. With regard to at least three of these elements, the proof was entirely lacking. Therefore, the trial court's denial of a directed verdict and judgment notwithstanding the verdict **[*65]** was clearly erroneous.

The trial court adopted the Hofmeisters' proposed fraud instruction language which misidentified the misrepresentation as "that there was only one (1) million dollars in insurance coverage[.]" [19] They claimed Murner made this statement as CIC's agent in his letter to Golden dated May 18, 2000. We have already determined that Murner was not an agent of CIC, but its independent contractor. Thus CIC is not vicariously liable for that statement. It is not debatable that no other CIC representative made such a statement. CIC cannot be the declarant of the alleged actionable representation. Therefore, no evidence supports the first element of fraudulent misrepresentation - that CIC made a material misrepresentation.

The Hofmeisters respond by arguing that even if Murner was an independent contractor, CIC can still be liable for fraudulent misrepresentation on its own account. Arguing for what might be termed reverse engineering of the tort, they urge us to conclude that the jury inferred fraudulent misrepresentation from CIC's breach of its duty to disclose that Dasher had another asset to satisfy their claim, i.e., the excess policy. This presumes a duty to disclose. However, ***HN23***[↑] the duty to disclose describes an element of the different tort of fraudulent concealment requiring proof of "substantially different elements." *Rivermont Inn, Inc. v. Bass Hotels & Resorts, Inc., 113 S.W.3d 636, 641 (Ky.App. 2003)*.

Disregarding, *arguendo,* that the jury was not instructed as to the tort of fraudulent concealment, and further *equating* fraudulent concealment with fraudulent representation, *cf., Bankers Bond Co. v. Cox, 263 Ky. 481, 92 S.W.2d 790, 792 (1936)*("such concealment was in fact a false representation"), **[*67]** we do not find merit in either of the Hofmeisters' arguments that CIC owed them such a duty.

The Hofmeisters quote *Williams v. Kentucky Dept. of Educ., 113 S.W.3d 145 (Ky. 2003)*, for the proposition that "when the principal is under a duty to provide protection for . . . others and confides the performance of that duty to a servant . . . who causes harm to them by failing to perform that duty, vicarious liability attaches even if the agent or subagent is not a servant, *i.e.,* is an independent contractor" such as Murner. *Id. at 151*. We believe *Williams* is not helpful. While an accurate quote, this is not an accurate reflection of the holding.

In *Williams,* two students skipped school and were involved in an automobile accident resulting in the death of one student. The student's estate sought relief against the Kentucky Department of Education (DOE) claiming negligent supervision. The principal issue in *Williams* was DOE's defense that

> local boards of education are not agents of the DOE but are separate and distinct agencies of the Commonwealth assigned to perform separate and distinct functions, i.e., they are co-agents; and, thus, the DOE is not vicariously liable for the failures of employees **[*68]** of local boards[.]

Id. at 152. The principal holding in *Williams* was a rejection of that argument.

> From the language and structure of this statutory scheme, we conclude that the legislative intent was to vest the overall management, operation, and control of the common schools in the DOE, with the local boards of education *functioning as agents* of the DOE . . . . Thus viewed, the statutory relationship between the DOE and the local board was more *akin to that of principal-agent* than to that

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[19] There is a technical difference between the instruction's wording and the actual language the Hofmeisters alleged misled them - that their $ 1.5-million demand was "in excess of the policy limits provided by Dasher's insurance carrier[.]" The October 14, 2002, settlement conference is the first time the record reflects that either Murner or CIC represent that the limits of the policy CIC wrote for Dasher were $ 1,000,000. CIC proposed more generally that **[*66]** the instruction simply ask the jury to determine whether CIC had misrepresented "pertinent facts" regarding insurance coverage. Jury instructions identifying the alleged representation must portray it with accuracy.

of co-agents.

Id. at 154 (emphasis supplied). The issues had nothing to do with independent contractors. The language upon which the Hofmeisters rely is mere *dicta*.

Furthermore, we believe the Hofmeisters misinterpret these *dicta*. They argue this language supports a holding that CIC owed a duty to "provide protection" to them by disclosing the existence of a potential source of recovery for a liability they had yet to establish. We believe no such duty exists. *Cf., National Sur. Corp. v. Hartford Cas. Ins. Co., 493 F.3d 752, 760-61 (6th Cir. 2007)*(a slightly different concept; "no Kentucky court has recognized a duty" nor is there "any reason why the Kentucky Supreme Court would impose a duty on an **[*69]** insurance company [even] to investigate whether its insured has other insurance coverage."). Support for our view can be found by reading *Williams* more closely.

The *Williams* quote, referencing a duty to provide protection for others, is based on *RESTATEMENT (SECOND) OF AGENCY § 251* (1958). Contrary to the Hofmeisters' suggestion, that section does not describe a manner in which vicarious liability may be *created* absent an agency relationship. As even the caption to § 251 illustrates, the kind of liability being described presumes the agency relationship *already exists*. RESTATEMENT (SECOND) OF AGENCY, *supra*, § 251 ("Liability For Physical Harm *Caused By A[n] Agent;*" emphasis supplied). [20]

The Hofmeisters argue that there is an alternate source for CIC's duty. Citing *Smith v. General Motors Corp., 979 S.W.2d 127, 45 13 Ky. L. Summary 9 (Ky.App. 1998)*, the Hofmeisters claim CIC's **[*70]** duty arose "from a *partial disclosure* of information, [or] from particular circumstances such as where one party to a contract has *superior knowledge* and is relied upon to disclose same." *Smith at 129* (emphasis supplied). Neither argument has merit.

Taking the latter first, the "superior knowledge" argument requires that the "defrauder" and the "defraudee" be parties to the same contract. We should not have to point out that the Hofmeisters and CIC were not in privity.

The "partial disclosure" argument also fails. The Hofmeisters maintain that Murner's letter constitutes a disclosure about insurance coverage that, because it was only partially true, was a false representation of the *whole* truth. *See, Dennis v. Thomson, 240 Ky. 727, 43 S.W.2d 18, 23 (1931)*. Therefore, goes their argument, CIC had a duty to supplement Murner's information with a disclosure of the excess policy. The problem with this argument, whether under a theory of fraudulent concealment or fraudulent misrepresentation, is that the Hofmeisters' reliance on the information conveyed must be reasonable.

The reliance element contained in Jury Instruction No. 3(f) carried with it the implicit requirement that the reliance **[*71]** be reasonable. *Harralson v. Monger, 206 S.W.3d 336, 341 (Ky.2006)*(***HN24***[↑] "*[B]lind* reliance . . . fails the fifth requirement of fraud - *reasonable* reliance upon the claimed fraudulent act."). (Emphasis supplied). Based on the record before us, the Hofmeisters' reliance on their own or their attorney's impression of Murner's letter was unreasonable for several reasons.

Murner testified that when he learned Dasher had an excess policy, he told Golden about it, not once but twice. Golden did not take the stand to refute Murner, nor did the Hofmeisters present any other evidence contradicting Murner's testimony. Even if the jury chose to disregard Murner's testimony entirely, we are left with the transcript of the settlement negotiations, conducted on October 14, 2002, and attended by Golden, showing that the excess policy was referenced one-and-a-half dozen times. These references occurred before the conditions Golden placed on settlement were met and, therefore, before the Hofmeisters were legally committed to accept Dasher's settlement offer. In fact, after October 14, 2002, substantial issues remained and the Hofmeisters had to move the trial court to decide one of the issues remaining between **[*72]** the Hofmeisters' and Clark's insurers. The settlement agreement itself was not finalized until December 2002.

Most significantly, it is well established that ***HN25***[↑] "[i]f the truth or falsehood of the representation might have been tested by ordinary vigilance and attention, it is the party's own folly if he neglected to do so, and he is remediless." *Bassett v. National Collegiate Athletic Ass'n., 428 F.Supp.2d 675, 684 (E.D.Ky. 2006), quoting Mayo Arcade Corp. v. Bonded Floors Co., 240 Ky. 212, 41 S.W.2d 1104, 1109 (1931)*. The case cited most frequently in Kentucky for this point of law is one of our

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[20] Generally, *RESTATEMENT (SECOND) OF AGENCY § 251* describes the liability of a party who, once owing a non-delegable duty of protection to a third person, cannot avoid liability on agency law grounds for the injury to that third person resulting from the negligence of an agent, regardless of whether the agent is a servant or a non-servant.

earliest. In *Moore v. Turbeville, 2 Bibb 602, 5 Ky. 602, 1812 WL 644, 5 Am.Dec. 642 (Ky. 1812)*, our high court said:

> [W]here ***HN26***[↑] an ordinary attention would be sufficient to guard against imposition, the want of such attention is, to say the least, an inexcusable negligence. To one thus supinely inattentive to his own concerns, and improvidently and credulously confiding in the naked and interested assertions of another, the maxim "*vigilantibus non dormientibus jura subveniunt,*" emphatically applies, and opposes an insuperable objection to his obtaining the aid of the law.

Moore, 5 Ky. at 604.

In the **[*73]** two and one-half years of substantial discovery that occurred in this case, the Hofmeisters elected never to seek discovery of the extent of Dasher's insurance as authorized by *CR 26.02(2)*. We believe use of *CR 26.02(2)* perfectly illustrates the kind of "ordinary vigilance and attention" expected by this rule of law. On May 22, 2000, the Hofmeisters' attorney was "a little surprised" by Murner's representation of insurance. [21] This uneasiness could have been eliminated if only the Hofmeisters had asked for insurance information when they prepared and served discovery requests nine days later on May 31, 2000. [22] Failing to exercise that ordinary diligence at any time throughout the litigation, the Hofmeisters can claim no more than that theirs was the kind of "blind reliance" deemed unsatisfactory in *Harralson, supra.*

In response, the Hofmeisters cite *Meyers v. Monroe, 312 Ky. 110, 226 S.W.2d 782 (1950)*, **[*74]** for the proposition that ***HN27***[↑] CIC "cannot escape on the ground that the complaining party should not have trusted him[.]" *Id. at 785*. They fail to note that *Bankers Bond Co. v. Cox, 263 Ky. 481, 92 S.W.2d 790 (1936)*, relied upon as authority in *Meyers,* applies this concept only "where the one claiming to be deceived is not shown to have at hand any reasonably available means of determining the truth of representations made to him[.]" *Id. at 792*. Clearly, the Hofmeisters do not fall in the category of claimants contemplated by *Meyers.* Proof of the fifth element of fraudulent misrepresentation - reasonable reliance - is therefore entirely lacking.

There is yet a third element of fraudulent misrepresentation that entirely lacks proof in this case. There is no evidence that Murner knew the statement to be false when made on May 18, 2000. The Hofmeisters offered no evidence at all to refute Murner's testimony that he did not know of the existence of the excess insurance until later. [23] The earliest documentary evidence of the excess policy is dated June 9, 2000. Therefore, no evidence supports the third element of fraudulent misrepresentation.

While CIC presents arguments regarding each of the six elements of fraudulent misrepresentation, our examination is sufficient to convince us that the Hofmeisters could not and did not establish that claim. The trial court erred by denying CIC's motion for a directed verdict on the Hofmeisters' claim of fraud.

E. Whether the Trial Court Erred in Failing to Direct a Verdict in Favor of CIC on the Claim of Violations of the UCSPA

The Hofmeisters alleged violations of several sections of the UCSPA. Although the jury was instructed on four of those sections, the allegations boil down to a claim that CIC did not promptly offer to pay the Hofmeisters what their **[*76]** claims were reasonably worth. *See, Motorists Mut. Ins. Co. v. Glass, 996 S.W.2d 437, 454, 44 12 Ky. L. Summary 28, 46 3 Ky. L. Summary 25 (Ky. 1997)*.

This case exemplifies one of our Supreme Court's warnings about UCSPA claims - ***HN28***[↑] the fact "that the statute is not specifically designed to accommodate third party claims [24] . . . makes trial nearly impossible

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[21] Mr. Hofmeister testified that he too was surprised and, in response to Golden's examination at trial said, "I asked you to ask them about that [excess coverage] because I was surprised that they didn't have more insurance."

[22] They ignored the same opportunity when they served discovery requests in September 2000 and May 2001.

[23] The Hofmeisters argue in their brief that Murner **[*75]** admitted that he kept the excess carrier "in the loop the entire time." They suggest this statement means Murner knew of the excess policy from the time he was engaged as Dasher's attorney. But this general statement, made as it was in a general context (and, in fact, denied by the excess carrier), is entirely consistent with Murner's specific testimony on this specific question. The general statement certainly is not clear and convincing evidence that would convince a reasonable person that Murner's specific testimony was a fabrication.

[24] In fact, ***HN29***[↑] *KRS 304.12-230* was never intended by its

and appellate review most difficult." *Glass at 460* (Lambert, C.J., dissenting). However, we have some clear guidance in *Wittmer v. Jones, 864 S.W.2d 885 (Ky. 1993)* - "the leading case on 'bad faith' in Kentucky." *Davidson v. American Freightways, Inc., 25 S.W.3d 94, 99 (Ky. 2000)*. Applying *Wittmer,* we have no difficulty concluding that the trial court erred in failing to grant a directed verdict in favor of CIC.

Justice Leibson's opinion in *Wittmer* was "the culmination of the development of 'bad faith' liability in our jurisprudence." *Id.* Writing for a unanimous Court, "Justice Leibson gathered all of the bad faith liability theories under one roof and established a test applicable to all bad faith actions, whether brought by a first-party **[*78]** claimant or a third-party claimant, and whether premised upon common law theory or a statutory violation." *Id. at 100*.

> We start with the proposition that ***HN30***[↑] there is no such thing as a "technical violation" of the UCSPA, at least in the sense of establishing a private cause of action for tortious misconduct justifying a claim of bad faith:
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> > [A]n insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.... [A]n insurer is ... entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.
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> *Wittmer at 890* (quotation marks and citation omitted).

As it is the centerpiece of CIC's argument, we focus on the second element - the lack of a reasonable legal or factual basis for denying the claim. Considering all of the evidence in a light most favorable to **[*79]** the Hofmeisters, we conclude that CIC did have a reasonable basis for denying the Hofmeisters' claims. Those claims could not go forward against Dasher without establishing that Dasher was vicariously liable for Clark's acknowledged negligence. Vicarious liability depended upon whether Clark was acting in the scope of his employment at the time of the accident. Despite the Hofmeisters' insistence otherwise, the answer to that question was not clear.

Until the Hofmeisters filed their complaint nearly a year after the accident, no one exhibited any conviction that Clark was acting in the scope of his employment with Dasher. He had completed his work and gone home. He was in his own vehicle, not Dasher's. The Hofmeisters' entire focus was on Clark and *his* automobile liability insurer. Not even Clark was sure he was working for Dasher at the time of the accident. The record before us does not reflect that he ever filed a workers' compensation claim. And when the adjuster for Hofmeister's insurer asked Clark, "Were you working on the job at the time [of the accident] or were you just on personal business?" Clark responded, "That's uh . . . that's debatable."

After the Hofmeisters filed suit **[*80]** naming Dasher as a co-defendant, their attorney insisted Dasher's liability was clear and it was bad faith to deny it. However, it took two years before Dasher, Clark and the Hofmeisters each filed summary judgment motions asking the trial court to determine vicarious liability. Dasher's motion, and Dasher's opposition to the Hofmeisters' and Clark's separate motions, presented legal and factual argument that Clark was not acting in the scope of his employment. [25]

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creators to establish any private right of action at all. The statute "is an almost verbatim adoption of the 1971 version of the model act formulated by the National Association of Insurance Commissioners (NAIC)[.]" *Davidson v. American Freightways, Inc., 25 S.W.3d 94, 96 (Ky. 2000)*. It was intended by its drafters only as regulatory measure to assist state insurance administrators. NAIC emphasized the "original intent" of **[*77]** this model act when it issued this warning to legislatures: "A jurisdiction choosing to provide for a private cause of action should consider a different statutory scheme. This Act is inherently inconsistent with a private cause of action." NAIC Model Law, Regulations and Guidelines, Unfair Claims Settlement Practices Act, NAIC 900-1, Section 1. Purpose, Drafting Note (January 2008); *see also* NAIC 900-9 (January 2008), citing Proceedings of the NAIC, 1989 Proc. II 204. As a consequence, Kentucky is in that distinct minority of states that recognizes a private right of action for violations of the UCSPA. *See Hovet v. Allstate Ins. Co., 2004 NMSC 10, 135 N.M. 397, 89 P.3d 69, 76-77 (2004)*(allowing private right of action but requiring first that "there has been a judicial determination of the insured's fault and the amount of damages awarded in the underlying negligence action.").

[25] Dasher's filing of these pleadings is litigation conduct. ***HN31***[↑] Litigation conduct amounting to bad faith can be

Although the trial court eventually concluded that Clark was acting within the scope of his employment, Clark never accounted for, nor did the trial court appear to consider, the fact that, in a geographic context, the accident occurred at a point that took Clark substantially away from the purported purpose for the trip - to return Dasher's keys. [26] In the language of the early common law, this is an **[*81]** example of a "frolic and detour." *See, e.g.,* Faragher v. City of Boca Raton, 524 U.S. 775, 776, 118 S.Ct. 2275, 2278, 141 L.Ed.2d 662 (1998)(**HN32**[↑] referring to "the classic 'frolic and detour' for which an employer has no vicarious liability").

Accepting the trial court's determination that Clark left his home in pursuit of Dasher's business, the law is clear that to remain in the scope of employment, he must not have deviated from its pursuit. Sharp v. Faulkner, 292 Ky. 179, 166 S.W.2d 62, 63 (1942). But because Clark turned off that direct route and headed in the opposite direction, toward Georgetown where the accident occurred, there is a genuine question whether he was still on his employer's business at the time of the accident. In Dennes v. Jefferson Meat Market, 228 Ky. 164, 14 S.W.2d 408 (1929), our highest court considered such deviation in the context of the employee's use of his employer's vehicle. Where the employee is using his own vehicle, we believe Dennes must apply at least equally so.

> **HN33**[↑] Where deviation from the course of his employment by the servant **[*82]** is slight and not unusual, the court may, as a matter of law, find that the servant was still executing his master's business. On the other hand, if the deviation is very marked and unusual the court may determine that the servant was not on the master's business at all but on his own. Cases falling between these extremes will be regarded as involving a question of fact for the determination of the jury.

Dennes at 409; *see also,* Wyatt v. Hodson, 210 Ky. 47, 275 S.W. 15, 16 (1925)(master not liable for employee's auto accident where employee deviated 4-1/2 blocks from direct route of master's business). As our high court said in *Wyatt,* this "is a case of going beyond the route required in the service of the master, and in doing this he was acting for himself and not in the course of his employment." *Id.; see also,* Winslow v. Emerson, 221 Ky. 430, 298 S.W. 1084, 1085 (1927). As held in Model Laundry v. Collins, 241 Ky. 191, 43 S.W.2d 693 (1931), Clark's personal venture would not have terminated nor would his service for Dasher have resumed until he returned to the point of departure from the business route - Interstate 64 - a point he never reached. *Id. at 693.*

Because the underlying **[*83]** accident case was settled, the trial court's decision regarding scope of employment was never challenged. However, whether the trial judge was correct is not the issue - the issue is whether Dasher's defense was "debatable on the law or the facts." Wittmer at 890. We are satisfied that the "defense was not only fairly debatable, it had substantial merit." Bentley v. Bentley, 172 S.W.3d 375, 378 (Ky. 2005)(citation omitted). Since we conclude Dasher's defense was fairly debatable, we must also conclude that CIC's denial of the Hofmeisters' claim was reasonable. Therefore, under Wittmer's second element, there can be no UCSPA violation.

With regard to allegations that four individual sections of the UCSPA were violated, CIC specifically argues that the trial court should not have let the case go to the jury. We agree that the trial court turned the case over to the jury for resolution of an issue that was uniquely the trial court's alone to make.

HN34[↑] Whether a tort has occurred under KRS 304.12-230 is precisely what Wittmer requires the trial court, not the jury, to decide. The "threshold problem" is to determine "whether the dispute is merely contractual or whether there are tortious elements **[*84]** justifying an award of punitive damages[.]" Wittmer at 890. To do that, the trial court *must* weigh in on the question of punitive damages by answering "whether the proof is sufficient for the jury to conclude that there was conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others." *Id.* (internal quotation marks omitted). The order denying the Hofmeisters' summary judgment motion shows the trial court did not make such a finding.

The Hofmeisters specifically sought the trial court's determination that CIC had violated four sections of KRS 304.12-230. The court declined

> to find that the conduct of Defendant [CIC] was "outrageous because of the defendant's evil motive

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sanctioned by the trial court pursuant to the civil rules. See the discussion, *infra* at Section II.F.1., of Knotts v. Zurich Ins. Co., 197 S.W.3d 512 (Ky. 2006) distinguishing litigation conduct and settlement conduct.

[26] We set aside the substantial factual dispute whether Dasher "ordered" Clark to return the keys, or whether he did so voluntarily.

> or his reckless indifference to the rights of others." *Wittmer v. Jones, 864 S.W.2d 885, 890 (1993)*. Such a determination of evil intent or indifference . . . is within the province of the jury, but not within the province of this Court on a motion for summary judgment.

Trial Court's Opinion and Order, May 17, 2004. [27] The trial court's mistaken belief that this question was for the jury does not take away from the fact that, when presented with the question, it **[*85]** declined to find evidence of tortious conduct, outrageous behavior, evil motive or reckless indifference to the Hofmeisters' rights. Considering the threshold, this is not surprising.

> ***HN35***[↑] The evidentiary threshold is high indeed. Evidence must demonstrate that an insurer has engaged in outrageous conduct toward its insured. Furthermore, the conduct must be driven by evil motives or by an indifference to its insureds' rights. Absent such evidence of egregious behavior, the tort claim predicated on bad faith may not proceed to a jury.

United Services Auto. Ass'n v. Bult, 183 S.W.3d 181, 186 (Ky.App. 2003). While *Bult* is a first-party case, there is no justification for lowering the standard for third-party claims deriving as they must from the first-party's contract of insurance. Our Supreme Court has long embraced this approach in both first-party and third-party claims under the common law where it was recognized that bad faith determinations present "*troublesome, or even impossible, question[s] for the jury* [which] is just not equipped to evaluate [t]he issue of 'bad faith'[.]" *Manchester Ins. & Indem. Co. v. Grundy, 531 S.W.2d 493, 499-500 (Ky. 1976)*(emphasis in original). We believe *Wittmer* **[*86]** simply extended to tort actions under *KRS 304.12-230* the same requirement still existing under the common law that "[t]he issue of 'bad faith' should be decided by the trial court." *Id. at 500*; *see, Ruby Lumber Co. v. K.V. Johnson Co., 299 Ky. 811, 187 S.W.2d 449 (1945)*("until repealed or altered by the Legislature . . . [w]e are not at liberty to ignore the common law totally [and] the intention to abrogate the common law is not presumed.").

A **[*87]** review of the evidence presented reveals a complete absence of the type of conduct required to clear the evidentiary threshold to send this case to a jury on a claim that CIC violated the UCSPA. The trial court's May 17, 2004, Opinion and Order implicitly supports this conclusion.

Our opinion is not changed, but bolstered, by our examination of the individual sections of the UCSPA upon which the jury was instructed - *KRS 304.12-230(1)*, *(6)*, *(13)*, and *(14)*.

HN36[↑] Section (1) prohibits an insurer from "[m]isrepresenting pertinent facts or insurance policy provisions relating to coverages at issue." All previous discussion regarding the Hofmeisters' claim of fraudulent misrepresentation applies as well to this claim. In addition, this section addresses "coverages" - a term used through the Insurance Code, KRS Chapter 304. Though not defined by statute or Kentucky caselaw, ***HN37***[↑] "coverages" is a term that identifies "the amount and extent of risk *contractually* assumed by an insurer." *Illinois Farmers Ins. Co. v. Tabor, 267 Ill. App. 3d 245, 642 N.E.2d 159, 163, 204 Ill. Dec. 697 (Ill.App.1994)*, *citing* BLACK'S LAW DICTIONARY 365 (6th ed. 1990)(emphasis supplied). It is an abbreviated means by which we define what the insured has contracted **[*88]** for in exchange for his premium. "Coverages at issue" therefore refers to an insured's [28] contractual dispute with his insurer, and not an accident victim's tort dispute with the insured-tortfeasor, or an accident victim's dispute with the insurer (unless as the assignee of the insured's rights under the contract he stood in the insured's shoes).

HN39[↑] Under section (6), an insurer violates the

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[27] However, in its Opinion and Order denying CIC's post-trial motions, the trial court stated that "regarding the claim of statutory bad faith there was sufficient evidence of bad faith to present the question of punitive damages to the jury." Opinion and Order, October 25, 2004, p.6. Much of that evidence, however, was of litigation conduct admitted over CIC's objection and contrary to the subsequent holding in *Knotts v. Zurich Ins. Co., 197 S.W.3d 512, 522 (Ky. 2006)*.

[28] Of course, ***HN38***[↑] for purposes of defining the class of persons protected by the *KRS 304.12-230(1)*, this would include both first-party insureds and third-party claimants to whom the insured assigned (as under common law) his claim against the insurer. A close reading of *State Farm Mut. Auto. Ins. Co. v. Reeder, 763 S.W.2d 116 (Ky. 1988)* indicates that, consistent with common law bad faith, Reeder was an assignee of the insureds' (the Hamptons') contractual rights. This is the only explanation for the Supreme Court's statement that the case involved "a *contractual* dispute over the amount of damages[.]" *Id. at 118* (emphasis supplied). Unless the Hamptons assigned their contractual rights to Reeder, Reeder could have had no contractual right at all *vis-a-vis* the insurer.

UCSPA by "[n]ot attempting in good **[*89]** faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear[.]" At least with regard to third-party claims, we believe the *Wittmer* standards encompass this provision. As we just described, *supra,* the requirement that liability be reasonably clear was not met. Furthermore, we have yet to mention Golden's unreasonable demand that Dasher, and CIC, should need nothing more as proof of Mr. Hofmeister's $ 5,000,000-loss than his partially self-determined tax returns. Again, we turn to *Wittmer,* with some modifications applicable to this case.

> *HN40*[↑] Although an insurer is under a duty to promptly investigate and pay claims where it has no reasonable grounds to resist in good faith, neither this duty nor any provision of the UCSPA requires the insurer to assume responsibility to investigate the amount of the claimant's loss for the claimant. The insurer'[s] legal responsibility is limited to payment upon proof of loss. The only proofs presented to [CIC] were the [largely] unsubstantiated amounts stated in the demand letter from [Hofmeister's] counsel. This letter provided neither supporting documents nor reference to reliable sources.

Wittmer at 891-92. **[*90]** Under these circumstances, the June 22, 2000, settlement offer can only be rationally viewed as a good faith offer. Despite a reasonable belief that Dasher may have no liability whatsoever, CIC authorized Dasher's use of the equivalent of $ 259,000 of its $ 1,000,000-policy to settle all but the lost income portion of the Hofmeisters' demands. That offer was rejected. Most significantly, the Hofmeisters withdrew their $ 1,000,000-offer, never to present it again. Instead, they chose to litigate, making no further settlement demands. [29] We cannot find in the record any evidence that would have justified the trial court in allowing the jury to consider whether CIC violated *KRS 304.12-230(6)*.

HN41[↑] Section (13) of the UCSPA allows a private right of action against an insurer for "[f]ailing to promptly settle claims, where liability has become reasonably clear, under one (1) portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage[.]" Again, liability was not clear. Even if it had **[*91]** been, the Hofmeisters' claims were not claims under multiple portions of Dasher's insurance policy; they all arose under the same portion - Section II, Liability Coverage. *HN42*[↑] Like *KRS 304.12-230(1)*, the class of persons protected by this section are first-party insureds and third-party assignees of the first-party's rights.

HN43[↑] Section (14) makes an insurer liable for "[f]ailing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement[.]" This is clearly another coverage issue that plainly refers to first-party claims. Still, logic requires that it fail for additional reasons. The Hofmeisters' underlying tort claim was not against CIC but against Dasher. The bases for denial of that tort claim for vicarious liability were fully set out in Dasher's answer and discovery responses. Any duty we can possibly read into section (14) would have required CIC to simply repeat Dasher's defenses. The law will not require such a useless exercise. *Blackerby v. Monarch Equipment, 259 S.W.2d 683, 686 (Ky. 1953)*. But if somehow we concluded CIC did breach this section, we fail **[*92]** to see how the breach could cause any injury. It would be a mere "technical violation" for which no relief will be granted. *Wittmer at 890*.

For all of the foregoing reasons, we believe the trial court committed reversible error when it failed to direct a verdict in favor of CIC on the claims that it violated the UCSPA.

F. CIC's Remaining Arguments for Reversing the Verdict and Judgment

Consideration of the remaining claims of error is not necessary to determine CIC's liability. However, to understand the role of passion or prejudice in this jury's verdict, additional consideration is appropriate.

In particular, our consideration of three of CIC's arguments reveals aspects of that role. First, the trial court's denial of CIC's motion to exclude evidence of litigation conduct resulted in the jury's consideration of evidence deemed inadmissible both by *Knotts v. Zurich Ins. Co., 197 S.W.3d 512 (Ky. 2006)*, and the Court of Appeals opinion it reversed. Second, the conduct of the Hofmeisters' attorney was considered "improper" by the trial court, but not so improper as to justify a new trial. That conduct, however, appears calculated to, and we believe did, have the effect of arousing the passion **[*93]** or prejudice of the jury. Third, while proof of the

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[29] The Hofmeisters' February 2001 attempt to accept a portion of Dasher's earlier offer (which they had rejected) was not a demand for settlement.

Hofmeisters' substantial reversal of economic fortune is undeniable, our examination of the record reveals nothing more than bold speculation that the reversal of fortune was caused by CIC's conduct.

HN44[↑] We neither presume in any particular case, nor deny the proposition in general, that there is "a prejudice which juries frequently apply against insurance companies. Our courts have long been aware of this prejudice, as exemplified by our decisions in personal injury cases where the element of insurance has been improperly injected." *Aetna Freight Lines, Inc. v. R. C. Tway Co., 298 S.W.2d 293, 296 (Ky. 1957)*. We cannot quantify such prejudice in any case. But, in any degree, such an atmosphere combined with the other factors present in this case is entirely conducive to the creation of a "perfect storm" - a verdict and judgment so palpably and flagrantly against the evidence as to indicate it was the product of passion or prejudice.

1. Whether Litigation Conduct Is Actionable Under the UCSPA

Following the Supreme Court's rendition of *Knotts v. Zurich Ins. Co., 197 S.W.3d 512 (Ky. 2006)*, both parties supplemented their briefs with additional **[*94]** authority. [30] *Knotts* reversed the Court of Appeals opinion in *Knotts v. Zurich Ins. Co., 2002-CA-001846, 2004 Ky. App. LEXIS 22 (Feb. 6, 2004)*, that no *HN45*[↑] post-litigation conduct by an insurance company can be the basis of a UCSPA claim. However, in reversing the Court of Appeals, the Supreme Court reopened the door only in the slightest degree. Litigation conduct was held inadmissible by both courts.

The Supreme Court identified "a distinguishing factor between the insurer's settlement behavior during litigation and its other litigation conduct." *Id. at 523*.

> *HN46*[↑] We are confident that the remedies provided by the Rules of Civil Procedure for any wrongdoing that may occur within the context of the litigation itself render unnecessary the introduction of evidence of litigation conduct.

Id. at 522. Attorneys, and even parties,

> are subject to direct sanction under the Civil Rules for any improper conduct. Though it goes without saying, we also note that those attorneys have significant duties under the Rules of Professional Responsibility, which allow for further **[*95]** sanctions for unethical behavior. Thus, we think the better approach is an absolute prohibition on the introduction of such evidence in actions brought under *KRS 304.12-230*.

Id. This has been referred to as "*Knotts's* . . . litmus test for inadmissible litigation conduct[.]" *Rawe v. Liberty Mut. Fire Ins. Co., 462 F.3d 521, 535 (6th Cir.2006)*("bad litigation conduct that the Rules of Civil Procedure adequately remedy [is] inadmissible to prove bad faith.")(applying Kentucky law).

The trial court below did not have the benefit of *Knotts's* specific analysis but did have CIC's general argument and objection substantially to the same effect. Nevertheless, over CIC's objection, Golden was permitted to admit evidence and to argue the propriety of litigation tactics, including but not limited to: the timing and sequence of discovery; whether it was proper to file a third-party complaint against Clark before taking his deposition; the assertion of subrogation and indemnification rights; the decision not to file a declaration of rights action to determine whether the insurance policy covered Clark; and whether Murner should have subpoenaed documents from the Hofmeisters rather than using other **[*96]** more traditional means of obtaining information from adverse parties.

In *Knotts,* the Supreme Court considered *HN47*[↑] it calamity to "permit the jury to pass judgment on the defense counsel's trial tactics and to premise a finding of bad faith on counsel's conduct" stating that it "places an unfair burden on the insurer's counsel, potentially inhibiting the defense of the insurer." *Id. at 523*. In fact, "given the chilling effect that allowing introduction of evidence of litigation conduct would have on the exercise of an insurance company's legitimate litigation rights, any exception threatens to turn our adversarial system on its head." *Id. at 522*. *Knotts* expresses the fear that a jury, "with the assistance of hindsight, and without the assistance of insight into litigation techniques, could second guess the defendant's rationales for taking a particular course." *Id. at 520-21*. The case before us represents the coming to fruition of that fear.

2. Whether Conduct of Hofmeisters' Counsel

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[30] CIC referred us to Knotts while the Hofmeisters cited a case interpreting *Knotts, Hamilton Mut. Ins. Co. of Cincinnati v. Buttery, 220 S.W.3d 287 (Ky.App. 2007)*.

Required a New Trial

CIC moved the trial court for a new trial based on the misconduct of the Hofmeisters' counsel. *See, CR 59.01(d)*. The trial court "agree[d] that Plaintiffs' attorney engaged in some improper **[*97]** behavior" but held that its admonition of both attorney and jury was sufficient to cure the impropriety.

Because Golden was a witness to much of CIC's alleged actionable conduct, his role as advocate was complicated, albeit by his own choosing. Often when Golden was cross-examining Murner regarding oral communications to which only they were privy, the challenging tone of the question itself bore the implicit counter-testimony to Murner's response. Golden's interrogation of Murner regarding his first disclosure of the excess coverage is an example.

> Golden: [T]he first time the excess carrier was brought up was back there when Melissa Wilson was on the phone [at the October 14, 2002, transcribed settlement conference] isn't that true?
> Murner: No, sir.

Of course, only Murner's answer is admissible evidence, but without taking the witness stand, Golden effectively represented to the jury that he knew nothing of the excess policy until that moment. [31]

We need not question the trial court's ruling on Golden's conduct. However, we cannot escape the belief that the jury's verdict was affected by the cumulative effect of his "improper behavior."

3. Whether the Hofmeisters Proved Any Economic Loss Was Caused by CIC

CIC's argument that there was no proof of a causal connection between its conduct and the Hofmeisters' economic woes is based on *Roadway Exp., Inc. v. Don Stohlman & Associates, Inc., 436 S.W.2d 63 (Ky. 1968)*.

> *HN48*[] The test of whether there can be a recovery for loss of anticipated revenues or profits is . . . whether the cause of the damage or injury can with reasonable certainty be attributed to the breach of duty or wrongful act of the defendant. . . . But no recovery is allowed when resort to speculation or conjecture is necessary to determine whether the damage resulted from the unlawful act of which complaint is made or from other sources.

Id. at 65.

The **[*99]** Hofmeisters claim the causal connection is obvious and readily revealed in their theory of damages. Their theory is as follows:

> (1) CIC misrepresented that Dasher had only $ 1,000,000 in insurance coverage;
> (2) In fact, the CIC and Fireman's Fund policies combined for a total of $ 6,000,000 in coverage;
> (3) If both insurers had tendered policy limits in June 2000, the Hofmeisters would have netted $ 4,000,000 after attorney fees;
> (4) Mr. Hofmeister testified that if he had received a net $ 4,000,000 in June 2000, "it would have made a huge difference" that would have allowed him "to work out plans with different companies . . . to go out and buy a whole series of those bonds because they were trading on the open market at a huge discount" and he could have made "[r]oughly a hundred million dollars."

The Hofmeisters, not having their own expert, claim CIC's economic expert, James O. King, Jr., supported this theory and the testimony. Our examination of the actual exchange between Golden and Mr. King makes us dubious.

> Golden: And you can't tell this jury, Mr. King, that if George Hofmeister was paid $ 4 million in cash in June of 2000, that it wouldn't have made a difference.
>
> King: $ 4 million. **[*100]** I mean, I don't know, that's a sizeable amount of money and it might have enabled someone to keep a business going for a while, I don't know.
> Golden: All right, the fact is you don't know, do you?
> King. No.

In the final analysis, the theory is both factually and logically flawed.

The Hofmeisters never demanded $ 6,000,000 (or even the net figure of $ 4,000,000) in June 2000 or at any

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[31] There are several instances of Golden stating a fact in his question of Murner for which Golden presented no evidence, each of which Murner denied: "Mr. Risley . . . talked about me withdrawing our demand for a million. I reinstated that demand **[*98]** right after that;" "I could have gotten a hundred million dollar verdict against those two young men [Dasher's principals];" "[Y]ou and I went back to that jury room right there, you said you were going to pay a million and I accepted;" and "[I] never agreed to release Fireman's Fund."

time. [32] To suggest they were entitled to have CIC and Fireman's Fund write checks to the Hofmeisters totaling $ 6,000,000 based on Golden's unsubstantiated demand of only $ 1,500,000 is both factually unsupported and completely illogical.

Mr. Hofmeister's **[*101]** testimony that he could have turned $ 4,000,000 in "stake" money into $ 100,000,000 is the unadulterated epitome of speculation. Furthermore, there is reason to question the veracity of that testimony as the record shows Hofmeister borrowed $ 6,000,000 in January 2000 from a friend and business associate, Richard Burkhart, and Hofmeister's businesses still failed.

Nothing more than speculation supports the allegation that CIC's conduct caused the Hofmeisters' economic losses.

Our Supreme Court has recognized that ***HN50***[] some attorneys exhibit a "personal bias against insurance companies and in favor of using bad faith and UCSPA allegations to extort payment of underlying claims from insurers." *Motorists Mut. Ins. Co. v. Glass, 996 S.W.2d 437, 447, 44 12 Ky. L. Summary 28, 46 3 Ky. L. Summary 25 (Ky. 1997)*. The manner in which Mr. Golden zealously represented the Hofmeisters would not exclude him from this class of attorneys. Regardless, we have identified sufficient factors to convince us that the jury's verdict was the product either of passion or prejudice or a combination of both. For the several reasons set forth above, the judgment against CIC must be reversed.

III. *Hofmeister v. Cincinnati Insurance Company,* No. 2004-CA-002362-MR

The **[*102]** Hofmeisters' appeal challenges only the trial court's reduction of the punitive damages award from $ 18,405,500 to $ 10,000,000. In view of our decision that CIC was entitled to directed verdicts on the fraudulent misrepresentation claim and the claim of violation of the UCSPA, Appeal Number 2004-CA-002362-MR must be dismissed as moot.

IV. Conclusion

Considering the law as applied to the undisputed facts, we must conclude that the Scott Circuit Court's denial of Cincinnati Insurance Company's motions for directed verdict and for judgment notwithstanding the verdict as to the claim of fraudulent misrepresentation and as to the claim that it violated *KRS 304.12-230* was clearly erroneous. For the foregoing reasons, the judgment of the Scott Circuit Court in Appeal Number 2004-CA-002296-MR is reversed.

KNOPF, JUDGE, CONCURS.

KELLER, JUDGE, CONCURS IN RESULT ONLY.

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[32] Though it went without objection, Golden's question to King impermissibly assumed this fact was in evidence. Our Supreme Court held that ***HN49***[] "a connection must be established between the cross-examination proposed to be undertaken and the facts in evidence. A [party] is not at liberty to present unsupported theories in the guise of cross-examination and invite the jury to speculate as to some cause other than one supported by the evidence." *Commonwealth v. Maddox, 955 S.W.2d 718, 721, 44 12 Ky. L. Summary 24 (Ky. 1997)*(in a criminal context but citing *Kentucky Rule of Evidence 403*).

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United States District Court,
E.D. Kentucky.

Steve TENNANT, Individually, and
Jaclyn Tennant, Individually, Plaintiffs,
v.
ALLSTATE INSURANCE COMPANY, Defendant.

No. Civ.A. 04-54.
|
Feb. 10, 2006.

Attorneys and Law Firms

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OPINION AND ORDER

CALDWELL, J.

*1 This matter is before the Court on the Motion to Alter, Amend or Vacate Order (Rec. No. 30) filed by the Defendant, Allstate Insurance Co. ("Allstate"). For the following reasons, the Court DENIES the motion.

I. FACTS.

The Plaintiffs, Steve and Jaclyn Tennant (the "Tennants"), filed this Complaint on December 30, 2003. (Rec. No. 1, Notice of Removal, Complaint). They allege that they contracted with Allstate to insure their home and its contents. The limits of liability were $39,705 for the dwelling; $3,971 for other structures; and $19,853 for personal property protection and additional living expenses related to loss of use. *Id.* at ¶ 6. The policy was in effect on December 1, 2002 when the Tennants' house caught fire resulting in a total loss of the dwelling and all of its contents. *Id.* at ¶ 7. The Tennants filed a claim with Allstate on January 3, 2003 for $78,776. *Id.* at ¶ 8.

The Tennants allege that, on April 11, 2003, Allstate informed them that it had completed its investigation. *Id.* at ¶ 9. On August 11, 2003, Allstate informed the Tennants that it had rejected their claim except to pay their mortgagee in exchange for its release and assignment of interest in an amount less than the policy limits on the dwelling. *Id.* at ¶ 10. The Tennants assert that, by rejecting the claim, Allstate breached its obligations under the policy. *Id.* at ¶ 11.

In their Complaint, the Tennants assert tortious and contractual bad faith claims against Allstate. *Id.* at ¶¶ 12-13. The Tennants also assert statutory bad faith claims under the Kentucky Unfair Claims Settlement Practice Act ("KUCSPA"), KRS § 304.12-230, and the Kentucky Consumer Protection Act ("KCPA"), KRS § 367.170. *Id.* at ¶¶ 14-22. [1] Allstate moved for summary judgment (Rec. No. 14) charging that the Tennants' Complaint is barred by the limitation clause contained in the policy.

The policy provides that "[a]ny suit or action must be brought within one year after the inception of loss or damage." (Rec. No. 15, Mem. Supp. Mot. for Summ. J., Exhibit B, Policy, pp. 24-25, ¶ 12). In its Motion for Summary Judgment, Allstate argued that the fire loss occurred on December 1, 2002 and that the Tennants' Complaint was filed on December 30, 2003. Because the filing of the Complaint occurred more than one year after the date of loss, Allstate argued, the Complaint is barred by the one-year limitation clause contained in the policy.

In their response, the Tennants argued that the policy's one-year limitation clause as applied to their statutory and common law bad faith claims violates KRS § 304.14-370 [2] which provides the following:

> No conditions, stipulations or agreements in a contract of insurance shall deprive the courts of this state of jurisdiction of actions against foreign insurers, or limit the time for commencing actions against such insurers to a period less than one (1) year from the time when the cause of action accrues.

*2 Both sides agreed that the issue before the Court on the Motion for Summary Judgment was when the Tennants' causes of action accrued. (Rec. No. 20, Allstate's Reply at 3). The Tennants argued that their causes of action for bad faith could not have accrued until Allstate denied their claim. Therefore, they argue, under KRS § 304.14-370, they have at least one year from the denial of their claim to file a bad faith action.

Allstate argued that the Tennants' bad faith claim accrued at the time of the loss rather than upon denial of the insurance claim. Accordingly, Allstate contends that the limitation clause, which permits suit to be filed for one year after a cause of action accrues, does not violate KRS § 304.14-370.

In an Opinion and Order dated October 4, 2005, this Court ruled that, because a cause of action accrues when the last event necessary to create the cause of action occurs, a bad faith cause of action in which the allegation is that the insurance company *wrongfully denied* an insured's claim cannot accrue until denial of the claim. *See Combs v. International Ins. Co.,* 163 F.Supp.2d 686, 696 (E.D.Ky.2001), *aff'd, Combs v. International Ins. Co.,* 354 F.3d 568 (6th Cir.2004). Accordingly, the Court ruled that KRS § 304.14-370 prohibits an insurer from limiting the time for commencing such a bad faith action to a period of less than one year from the time a claim is denied. Thus, when applied to the Tennants' bad faith claims, the one year limitation provision in the insurance policy is inconsistent with KRS § 304.14-370. Accordingly, the Court then denied Allstate's Motion for Summary Judgment which relied solely on the argument that any action against Allstate was time-barred.

Allstate then filed this Motion to Alter, Amend or Vacate the Order pursuant to Federal Rule of Civil Procedure 59(e). In their current motion, Allstate argues that the Court erred 1) in construing Allstate's Motion for Summary Judgment as pertaining only to the Tennants' statutory and tortious bad faith claims and not a claim that Allstate breached the express provisions of the contract; 2) in denying Allstate's Motion for Summary Judgment on the bad faith claims because such claims are time-barred pursuant to *Smith v. Allstate Insurance Co.,* 403 F.3d 401 (6th Cir.2005); 3) in denying Allstate's Motion for Summary Judgment on the bad faith claims because it cannot be liable for bad faith since any claim that Allstate breached the express provisions of the contract is time-barred; and 4) in denying Allstate's Motion for Summary Judgment on the bad faith claim because the Tennants' claim is "fairly debatable."

II. STANDARD ON RULE 59 MOTION.

Federal Rule of Civil Procedure 59(e) provides for a motion to alter or amend a judgment. Rule 59(e) motions serve a limited purpose and should be granted for one of three reasons: (1) because of an intervening change in controlling law; (2) because evidence not previously available has become available; or (3) because it is necessary to correct a clear error of law or prevent manifest injustice. *Javetz. Board of Control, Grand Valley St. Univ.,* 903 F.Supp. 1181, 1190 (W.D.Mich.1995).

III. ANALYSIS.

A. The Breach of Contract Claim.

1) The Tennants Assert a Contractual Bad Faith Claim.

***3** In their Complaint, the Tennants asserted the following claims against Allstate: 1) a claim that Allstate breached the implied covenant of good faith and fair dealing in the homeowner's policy (Rec. No. 1, Notice of Removal, Complaint ¶ 12); 2) a tortious bad faith claim (Rec. No. 1, Notice of Removal, Complaint ¶ 13); statutory bad faith claims under KUCSPA, (Rec. No. 1, Notice of Removal, Complaint ¶¶ 14-16), and the KCPA (Rec. No. 1, Notice of Removal, Complaint ¶¶ 17-22); and a state law fraud claim (Rec. No. 1, Notice of Removal, Complaint ¶¶ 23-26).

Thus, in their Complaint, the Tennants assert a claim that Allstate breached the implied covenant of good faith and fair dealing but do not assert a claim that Allstate breached the express terms of the policy. Any such claim would be time-barred pursuant to *Smith v. Allstate Insurance Co.,* 403 F.3d 401 (6th Cir.2005). As will be explained further below, in *Smith,* the Sixth Circuit determined that a contractual limitations provision like the one at issue here was valid as applied to a claim that an insurance company breached the express terms of the policy.

2) The Contractual Bad Faith Claim Accrued at Denial.

As to the Tennants' claim that Allstate breached the implied covenant of good faith and fair dealing contained in the policy, this claim is rooted in the principle codified under Kentucky law that, within every contract, exists "an obligation of good faith in its performance or enforcement." KRS § 355.1-203. This implied covenant "imposes a duty to act in a 'bona fide' manner, defined by Kentucky law as being in or with good faith, honesty, openly and sincerely; without deceit or fraud....Truly;

actually; without simulation or pretense. Innocently; in the attitude of trust and confidence; without notice of fraud, etc. Real, actual, genuine and not feigned." *Combs,* 163 F.Supp.2d at 696 (quotations and citations omitted).

In its October 4, 2005 Opinion and Order (Rec. No. 28) on Allstate's Motion for Summary Judgment, the Court held that the bad faith claims accrued at denial and not at the loss. This is because a claim cannot accrue until the last even necessary to create the cause of action occurs. *Combs v. International Ins. Co.,* 354 F.3d 568, 591 (6th Cir.2004). Obviously, with a bad faith claim such as the Tennants' in which the allegation is that the insurance company *wrongfully denied* an insured's claim, the claim cannot accrue until the denial.

To the extent that Allstate argues in its Rule 59 motion that this Court should have analyzed the contractual bad faith claim differently than the Tennants' tortious or statutory bad faith claims for purposes of determining if the contractual limitations provision is valid, there is no basis in law for such a distinction. Under Kentucky law, a breach of the covenant of good faith and fair dealing gives rise to a contract action and, at least where a special relationship exists between the parties such as that between an insurer and an insured, a tort action for bad faith. *See Ennes v. H & R Block E.Tax Servs.,* 2002 WL 226345 at *2-3 (W.D.Ky.2002); *Davidson v. American Freightways, Inc.,* 25 S.W.3d 94, 102 (Ky.2000).

***4** The crucial difference between contractual and tortious bad faith claims is the remedy. *Curry v. Fireman's Fund Insurance Co.,* 784 S.W.2d 176, 178 (Ky.1989). Under Kentucky law, punitive damages cannot be awarded in a contract action and the plaintiff is limited to recovering the amounts agreed to be paid under the policy. KRS § 411.184(4); *Deaton v. Allstate Insurance Co.,* 548 S.W.2d 162, 164 (Ky.App.1977). Where a special relationship exists between the parties, however, permitting a bad faith tort action, the plaintiff may be awarded both punitive and compensatory damages. *Estate of Riddle ex rel. Riddle v. Southern Farm Bureau Life Ins. Co.,* 421 F.3d 400, 410 (6th Cir.2005)(citing *Curry v. Fireman's Fund Ins. Co.,* 784 S.W.2d 176, 178 (Ky.1989)).

As to when the various bad faith claims accrued, however, the Tennants' contractual, statutory and bad faith claims all arise from Allstate's denial of the Tennants' claim for insurance coverage. In fact, though Allstate has not asked for such relief, it would appear that the contractual bad faith claim should be dismissed as redundant to the tortious or statutory bad faith claim. Regardless, however, for the reasons stated here and in the Court's October 4, 2005 Opinion and Order, a bad faith claim based upon Allstate's denial of the Tennants' claim-whether contractual, statutory or tortious-could not have accrued until Allstate denied the claims. Thus, the limitations provision at issue here is invalid under KRS § 304.14-370 as applied to all of the Tennants' bad faith claims.

B. *Smith v. Allstate Insurance Company.*

In its Rule 59 motion, Allstate argues that the Court should have found that the Tennants' bad faith claim is time barred pursuant to *Smith v. Allstate Insurance Co.,* 403 F.3d 401 (6th Cir.2005). Allstate argues that, pursuant to *Smith,* this Court should have found that the Tennants' bad faith claims accrue at the loss instead of at denial.

In *Smith,* the plaintiffs (the "Smiths") purchased homeowner's and landlord's insurance policies covering their residence and adjacent rental property. *Id.* at 402-03. The policies were issued by Allstate. *Id.* at 403. The policies required that the insureds take the following steps after a loss:

1) give Allstate prompt notice, produce all records reasonably requested by Allstate and submit to an examination under oath if requested; and

2) within 60 days after the loss, submit a proof-of-loss statement.

Id.

The policy prohibited any suit against Allstate, "unless there has been full compliance with all policy terms." *Id.* The policy also required that any suit be brought "within one year after the inception of loss or damage." *Id.*

The Smiths' insured properties were damaged by a fire on April 17, 2000. *Id.* The Smiths notified Allstate as required under the policy. Allstate requested the proof-of-loss form by July 13, 2000, a date almost four weeks after the form was required under the policies. The parties also agreed that the Smiths would be examined on that date. *Id.* For various reasons, the Smiths did not give their proof-of-

loss statements to Allstate until September 15, 2000 and the examinations of the Smiths were not completed until December 26, 2000. *Id.* Allstate denied the Smith's claim in September, 2001. *Id.* at 404.

*5 The Smiths filed a complaint against Allstate on January 22, 2002. This was more than one year and nine months after the loss. *Id.* The Smiths asserted 1) a breach of contract claim on the basis that Allstate had not paid the claim in full; and 2) a bad faith claim. *Id.* The Sixth Circuit specifically noted that, while the Smith's complaint had alleged that the basis of their bad faith claim was the denial of the claim, at a hearing on Allstate's motion for summary judgment, the Smiths explained that the basis for their bad faith claim was that it was "impossible to comply with the policy provisions within the one-year limitations period for filing suit." *Id.* at 404 n. 1.

The district court granted Allstate summary judgment on the Smiths' claim that the company breached the contract by not paying the claims in full, finding that the one-year limitations provision was valid. *Id.* at 404. In a separate order, the district court granted summary judgment to Allstate on the bad faith claim, finding that it would have been possible for the Smiths to comply with all of the prerequisites for suit and still bring their action within one year of the loss. Thus, the district court concluded, Allstate's invocation of the limitations provision did not constitute bad faith. *Id.*

The Sixth Circuit agreed that the limitations provisions in the policies were valid under Kentucky law and were enforceable against the Smiths "*in the circumstances presented here.*" *Id.* at 402 (emphasis added). In reaching this decision, the Court recognized that the logic of KRS § 304.14-370 "would seem to be that Allstate's one-year limitation period is not valid unless, as a matter of law, an insured's cause of action accrues on the date of his or her loss." *Id.* at 404-05. The Court then cited to a "long line of Kentucky cases" holding that a "cause of action does not accrue until the plaintiff has the right to institute and maintain a suit." *Id.* at 405.

Next, however, the Sixth Circuit cited to *Ashland Finance Co. v. Hartford Accident & Indemnity Co.*, 474 S.W.2d 364 (Ky.1971)); *Edmonson v. Pennsylvania National Mutual Casualty Ins. Co.*, 781 S.W.2d 753 (Ky.1989); *Hale v. Blue Cross & Blue Shield of Kentucky*, 862 S.W.2d 905 (Ky.App.1993); and *Webb v. Kentucky Farm Bureau Insurance Co.*, 577 S.W.2d 17 (Ky.App.1978) as support for the proposition that, "a cause of action on an insurance policy can accrue, under Kentucky law, before maturation of the insured's right to sue," *Id.* at 405 & n. 3; and that "a cause of action for breach of an insurance contract may 'accrue,' in some sense, before the claimant is entitled to sue." *Id.* at 405.

After citing to these four Kentucky cases, the Sixth Circuit stated, "[w]e conclude that the limitations provision requiring the Smiths to sue Allstate within one year of their loss, while prohibiting suit during a portion of that year, is not inconsistent with [KRS § 304.14-370]." *Id.*

*6 *Ashland Finance, Webb, Edmonson* and *Hale* certainly make clear that-leaving aside the prohibition applicable to foreign insurers contained in KRS § 304.14-370-an insurance company can require that an insured sue within 12 months of a loss even though, under the common law, the cause of action would not accrue until after the loss. The critical issue before this Court, however, is whether such a provision is valid under KRS § 304.14-370. Neither *Ashland Finance, Webb, Edmonson* nor *Hale* addresses this issue. [3]

In their Rule 59 Motion, Allstate argues that, in ruling on the Motion for Summary Judgment, this Court "placed great importance upon the theory that a bad faith claim does not accrue until an insurance company denies a claim." (Rec. No. 31, Rule 59 Motion at 9). The Court's focus on when a bad faith cause of action accrues, however, is necessitated by the language of KRS § 304.14-370 which prohibits a limitations provision of less than one year "from the time when the cause of action accrues." Hence, both this Court and Allstate agreed that the crucial issue on Allstate's Motion for Summary Judgment was when the bad faith cause of action accrued. (Rec. No. 20, Reply at 3).

In its Rule 59 motion, however, Allstate appears to argue that this Court should no longer focus on when the bad faith cause of action accrues. Allstate recognizes that, "under principles of general contract law, a claim for breach of contract on an insurance policy also does not accrue until a claim for payment is denied, as a cause of action for breach cannot accrue until the contract is actually breached ... Thus, presumably in *Smith*, the insureds' cause of action for breach of contract did not accrue until their claim was denied in September, 2001,

and thus their lawsuit would have been timely filed." (Rec. No. 31, Mem. at 9). Nevertheless, Allstate argues, "the *Smith* Court had no difficulty finding that a cause of action for breach of contract accrued on the date of loss. This is so, even though the insureds, as of the day of loss, had not yet even submitted a claim for payment to their insurer." (Rec. No. 31, Mem. at 9).

The problem, however, is that it is unclear to this Court how the Sixth Circuit arrived at the conclusion that the limitation provision in that case did not violate KRS § 304.14-370 as applied to the breach contract claim at issue. The Sixth Circuit may have reasoned that the claim accrued at the loss instead of the breach. This, however, would be contrary to the principles of general contract law that Allstate recognizes in its pleadings. Further, the Sixth Circuit does not explicitly state this. Moreover, such a holding would not resolve the issue before this Court which is when a bad faith cause of action accrues.

Alternatively, the Sixth Circuit may have determined that, with the limitations provision, the parties implicitly altered when the breach of contract cause of action at issue accrued. The policy at issue in that case, however, did not explicitly state this. Moreover, the Sixth Circuit does not explicitly state this holding. No Kentucky state court has held that, in order to comply with KRS § 304.14-370, the parties may simply agree to alter when a cause of action accrues under the common law.

***7** Further, as explained, none of the Kentucky cases the Sixth Circuit cites to in arriving at its conclusion deals with the issue of whether a limitations provision is valid under KRS § 304.14-370. Accordingly, neither *Smith* nor the Kentucky cases it relies upon provide this Court with a rationale for finding that the limitations provision is valid under KRS § 304.14-370 as applied to a bad faith claim.

The language of KRS § 304.14-370 is clear and unambiguous. It prevents a foreign insurer from limiting the time for filing an against it to a period of less than one year after the cause of action accrues. It is equally clear that a bad faith action such as the one at issue here that is based on the insurer's denial of a claim, cannot accrue until the time of denial. Accordingly, pursuant to the plain language of KRS § 304.14-370, a foreign insurer cannot limit the time for filing a bad faith action to a period of less than one year after the denial of the claim. Thus, the contractual limitations provision at issue here is invalid under KRS § 304.14-370 as applied to the Tennants' statutory, contractual and tortious bad faith claims.[4]

C. Whether a Bad Faith Claim fails where Breach of Contract Claim is Time-Barred.

Next, Allstate argues that the bad faith claim must fail because it requires proof that the insurer was obligated to pay the claim under the terms of the policy. Because the breach of contract claim is time-barred under *Smith,* Allstate argues, the Tennants' claim for bad faith must fail. The Court notes that Allstate did not make this argument in their Motion for Summary Judgment and makes this argument for the first time in its Rule 59 motion. Accordingly, this argument must fail as improper in a Rule 59 motion. Further, as a matter of law, this argument fails on its merits.

Allstate cites to *Davidson v. American Freightways, Inc.,* 25 S.W.3d 94 (Ky.2000) in which the Kentucky Supreme Court stated that, absent a contractual obligation, there is no bad faith cause of action, either at common law or by statute. *Id.* at 100. Here, however, there has been no determination that Allstate was not contractually obligated to pay the Tennants' claim. Instead, there has only been a determination that any claim that Allstate breached its express contractual obligation to pay for the Tennants' loss is time-barred pursuant to *Smith.*

In *Davidson,* the plaintiffs asserted a bad faith claim against the defendant who was not the insurance company and had not entered into any contract at all with the plaintiffs. *Id.* at 100. Thus, it was clear that the defendant never had any contractual obligation to pay the plaintiffs and the Kentucky Supreme Court ruled that any bad faith claim against the defendant must therefore fail. *Id.* at 102.

More recently, in *Kentucky National Insurance Co. v. Shaffer,* 155 S.W.3d 738 (Ky.App.2004), the plaintiffs asserted a bad faith claim against an insurance company and, as the Court of Appeals expressly noted, "all parties and experts in this matter agree that an exclusion applied" in the insurance policy and that "there was never any actual coverage under the policy" for the automobile accident at issue. *Id.* at 741.

***8** Thus, in *Davidson* and *Kentucky National,* it would have been impossible for the plaintiffs to establish the

first element of a bad faith claim: that the insurer was obligated to pay the claim under the terms of the policy. *Davidson,* 25 S.W.3d at 100. Here, in contrast, there is an insurance policy and there has been no finding that Allstate was not obligated to pay the Tennants' claim under the express provisions of the policy. A finding that the claim is now time barred does not preclude the Tennants from arguing that Allstate indeed 1) had an obligation to pay the claims under the terms of the policy; 2) denied the claim without a reasonable basis; and 3) either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed. *Davidson,* 25 S.W.3d at 100. *See The Frog, Switch & Manufacturing Co. v. The Travelers Insurance Co.,* 193 F.3d 742, 751 n. 9 (3rd Cir.1999).

D. Whether the Tennants' Bad Faith Claim should be Dismissed because their Policy Claim is "Fairly Debatable."

Finally, in their Rule 59 motion, the Tennants argue that the Court should dismiss the Tennants' bad faith claim because the claim is "fairly debatable." Again, Allstate makes this argument for the first time in its Rule 59 motion. This argument was never presented in Allstate's pleadings on its Motion for Summary Judgment. Further, the argument depends upon the resolution of factual issues that the Tennants have not addressed as they were not raised on the Motion for Summary Judgment. Accordingly, this argument must fail as improper in a Rule 59 motion.

IV. CONCLUSION.

For all the above reasons, Allstate's Motion to Alter, Amend or Vacate (Rec. No. 30) the Court's Opinion and Order dated October 4, 2005 denying Allstate's Motion for Summary Judgment is DENIED.

All Citations

Not Reported in F.Supp.2d, 2006 WL 319046

Footnotes

1 *See, e.g., Davidson v. American Freightways, Inc.,* 25 S.W.3d 94, 99 (Ky.2000)(explaining that Kentucky recognizes two statutory bad faith causes of action premised upon violations of the KCPA and the KUCSPA).

2 The Tennants have not argued that their bad faith claims are not subject to the one-year limitation period contained in the policy and the Court did not address that issue in ruling on the Motion for Summary Judgment. *See, e.g., Thomas v. Allstate Ins. Co.,* 974 F.2d 706, 711 (6th Cir.1992)(stating that, under Ohio law, a bad faith tort claim is independent of the insurance contract and not subject to the limitation period contained in the policy).

3 In *Ashland Finance Co. v. Hartford Accident & Indemnity Co.,* 474 S.W.2d 364 (Ky.1971), the limitations provision at issue provided that suit had to be brought within one year of discovery of the loss. Under the policy, the insured could not file suit until three months after furnishing the proof of loss. The issue was whether the one-year limitations provision should be construed as running from the expiration of the three-month "no-suit period" or from the discovery of the loss. *Id.* at 365. The court held that the plain language of the limitation provision should control. *Id.* at 366. The conduct at issue in *Ashland* occurred before KRS § 304.14-370 became effective and neither the statute nor the validity of the limitations provision under the statute is discussed.

In *Webb v. Kentucky Farm Bureau Insurance Co.,* 577 S.W.2d 17 (Ky.App.1978), the court held that contractual limitations periods are valid. The issue was whether a contractual limitations provision that conflicts with the statutory limitations period is valid. *Id.* at 17. Because the defendant was a Kentucky corporation, KRS § 304.14-370 did not apply and was only mentioned as evidence that Kentucky statues permit contractual limitations provisions, the Court noting that the statute permits "foreign insurers to limit actions against them to one year." *Id.* at 18. Thus, again, this case does not discuss the issue before this Court of whether a limitations provision is valid under KRS § 304.14-370

In *Edmonson v. Pennsylvania National Mutual Casualty Ins. Co.,* 781 S.W.2d 753 (Ky.1989), the policy provision again required than any suit commence within one year after the loss. The court stated that, under Kentucky law, contractual limitations periods are valid and, thus, "there is no question in this case as to the validity of the limitation provided in the conditions of the policy...." *Id.* at 756. The issue there was whether under the principles of waiver or estoppel the insurer was precluded from asserting the contractual limitation period. *Id* at 755. Again, that case did not discuss KRS § 304.14-370 or the validity of the limitations provision under that statute.

Finally, in *Hale v. Blue Cross & Blue Shield of Kentucky, Inc.*, 862 S.W.2d 905 (Ky.App.1993), the limitations provision required that any action be brought within one year of the time the claim was filed. The plaintiff argued that the one-year limitation period was impermissibly short. As with *Webb*, in *Hale*, the defendant insurance company was a Kentucky corporation. Accordingly, KRS § 304.14-370 did not apply. The statute was mentioned only as evidence that a one-year contractual limitations provision is reasonable, the court noting that the statute permits foreign insurers to limit actions against them to one year. *Id.* at 907. Thus, again, this case against does not deal with the issue before this Court of whether a particular contractual limitations provision violates KRS § 304.14-370

4 For their statutory bad faith cause of action under UCSPA, the Tennants assert that Allstate (1) failed to deny coverage within a reasonable time after proof of loss statements were completed; (2) failed in good faith to settle the claims after liability became reasonably clear; (3) failed to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies; (4) refused to pay the claim without a reasonable and impartial investigation; (5) failed to acknowledge and act reasonably promptly upon communications regarding the claim; (6) compelled the plaintiffs to initiate litigation to recover amounts due under the policy; (7) attempted to settle for less than a reasonable amount; and (8) failed to provide a reasonable explanation of the basis for denial of the plaintiff's claims. Whether or not all of these claims accrued at denial, they necessarily accrued some time after the loss.

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NOT TO BE PUBLISHED
Court of Appeals of Kentucky.

Carrie C. Nelson, Appellant
v.
Jefferson County Board of Education; Sheldon Berman; Vicki Duckworth Lete; and Bonnie Cabell, Appellees

NO. 2015–CA–000467–MR
|
RENDERED: FEBRUARY 3, 2017; 10:00 A.M.

APPEAL FROM JEFFERSON CIRCUIT COURT, HONORABLE ANGELA MCCORMICK BISIG, JUDGE, ACTION NO. 13–CI–003027

Attorneys and Law Firms

BRIEF FOR APPELLANT: Brian Gary Abell, Louisville, Kentucky

BRIEF FOR APPELLEES JEFFERSON COUNTY BOARD OF EDUCATION; SHELDON BERMAN; VICKI DUCKWORTH LETE; AND BONNIE CABELL: C. Tyson Gorman Louisville, Kentucky

BEFORE: DIXON, JONES, AND J. LAMBERT, JUDGES.

OPINION

JONES, JUDGE:

I. FACTUAL AND PROCEDURAL BACKGROUND

*1 The Appellant, Carrie C. Nelson, appeals an order dismissing her claims against the Jefferson County Board of Education and Vicki Lete, the principal of the school where Nelson was previously employed as a teacher. Having reviewed the record, we vacate and remand.

Nelson was a middle school teacher at Moore Traditional School ("Moore") from August 2007 to June 2011. She primarily taught 8th grade Language Arts during her time at Moore; in January 2011, she began working as a Reading Specialist. For the entirety of her time at Moore, Nelson was a nontenured teacher employed on a year-to-year basis pursuant to Limited Contracts of Employment, which expressly stated a duration "for one year." At Lete's recommendation, Nelson's contract was not renewed after the 2010–2011 school year.

After filing an unsuccessful disability discrimination charge with the Equal Employment Opportunity Commission, Nelson initiated this lawsuit against the Board in June of 2013. In her complaint, Nelson alleged that the Board discriminated against her on the basis of disability in violation of KRS [1] 344.040. Discovery commenced. In April 2014, the Board moved for summary judgment. Nelson requested the trial court to hold the summary judgment motion in abeyance until discovery was complete. The court agreed with Nelson, but ruled that the Board could renew its motion in sixty days. It did so. Nelson then sought another abeyance and requested to amend her complaint. Nelson's requests were granted by the trial court.

Lete and others were added as defendants in July of 2014 along with several additional claims. In August of 2014, Nelson served additional discovery requests on Lete and the other defendants. Nelson voluntarily agreed to a response extension up to and including November 3, 2014. The defendants responded on that day. Along with their discovery responses, the defendants filed a motion for summary judgment. Nelson found the discovery responses inadequate. Accordingly, she moved to compel the defendants to answer her requests and asked the trial court to hold the defendants' motion for summary judgment in abeyance until such time as discovery was complete. The trial court declined to rule on Nelson's motion to compel before addressing summary judgment. On February 3, 2015, the trial court granted summary judgment in favor of all defendants on all counts. Nelson then filed a motion to vacate, which the trial court denied on March 4, 2015.

II. ANALYSIS

Nelson argues that the trial court prematurely rendered summary judgment against her when it did not at least consider her motion to compel prior to taking up the summary judgment motion. We agree with Nelson.

"Whether a summary judgment was prematurely granted must be determined within the context of the individual case." *Suter v. Mazyck*, 226 S.W.3d 837, 842 (Ky. App. 2007). While there is no exact limitation on the time parties have to complete discovery absent a pretrial order, for the sake of judicial efficiency this time is not indefinite. *Id.* at 844. On appeal, if the issue of failure to allow for discovery is raised, "a reviewing court must ... consider whether the trial court gave the party opposing the motion an ample opportunity to respond and complete discovery before the court entered its ruling." *Blankenship v. Collier*, 302 S.W.3d 665, 668 (Ky. 2010). A trial court's determination that a sufficient amount of time has passed for discovery is reviewed for an abuse of discretion. *Id.*

***2** The trial court determined that Nelson had adequate time to take discovery prior to summary judgment. Accordingly, it decided that it would not address Nelson's pending motion to compel until after it decided summary judgment. While Nelson's case as a whole had been pending since early 2013, Lete and many of the additional claims had just been added a few months prior to the summary judgment motion. After obtaining leave to amend, Nelson promptly served discovery requests. Those requests were not answered by Lete and the other defendants until November 3, 2014, the same day the summary judgment motion was filed. After reviewing the responses, Nelson filed a motion to compel in which she complained about defendants' failure to address a number of her requests. Nelson argued that several of her requests were directed towards issues relevant to the summary judgment. However, the trial court ruled that Nelson had already had an adequate amount of time to take discovery, and therefore, it would not consider the motion to compel until after ruling on the pending summary judgment motion.

Certainly, Nelson's case does not appear to be an overly strong one. Nelson's record at Moore is anything but spotless. This does not mean, however, that Nelson was not entitled to seek discovery from the defendants on claims that the trial court allowed her to add by amendment. It is also important to recognize that Nelson requested the discovery before the defendants filed for summary judgment. She was not requesting additional discovery. She was asking the trial court to compel the defendants to answer the discovery she had already requested. Moreover, Nelson did not delay in making her motion to compel.

These factors cause us concern. A defendant should not be able to escape its obligation to answer discovery requests that have already been propounded by the plaintiff by moving for summary judgment. If the defendant believes he or she should not have to answer, a motion for protective order is the appropriate remedy. In the absence of a protective order, Nelson was entitled to have the trial court consider her motion to compel before taking up summary judgment. This is especially so where there was no pretrial order in place that required Nelson to complete discovery by any specific date.

Accordingly, we vacate the summary judgment and remand for further proceedings consistent with this opinion. On remand, the trial court should decide Nelson's motion to compel before addressing the summary judgment motion. Should the trial court determine that Nelson is entitled to some additional discovery, it can set proper timelines and schedules to guide the parties in completing that discovery in a timely manner such that all parties have an adequate opportunity to supplement the record prior to any renewed motion for summary judgment.

To be clear, we are not holding that Nelson is entitled to conduct wholesale discovery into perpetuity. We simply believe that Nelson was entitled to have the trial court rule on her motion to compel answers to discovery requests she propounded before defendants moved for summary judgment, or at least make a determination that the additional discovery she sought in those requests would not impact its determination on summary judgment.

ALL CONCUR.

All Citations

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Footnotes

1 Kentucky Revised Statutes.

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