Supreme Court of Kentucky

Case No. 2018-SC-000586
Kentucky Court of Appeals
Case No. 2017-CA-001252

On Appeal from Harlan Circuit Court
Civil Action No. 11-CI-00349

CRYSTAL LEE MOSLEY, individually and as Administratrix of the Estate of Rhett Lee Mosley, and RHETT MOSLEY, JR., MOVANTS,

v.

ARCH SPECIALITY FIRE INSURANCE COMPANY and NATIONAL UNION FIRE INSURANCE COMPANY, RESPONDENTS.

RESPONSE TO MOTION FOR DISCRETIONARY REVIEW

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CERTIFICATE OF SERVICE

It is certified that this Response to Motion for Discretionary Review was served via U.S. Mail on this 3d day of December, 2018, on: J. Dale Golden, Kellie Marie Collins, Golden Law Office, PLLC, 771 Corporate Dr., Suite 750, Lexington, KY 40503; Jeffrey Morgan, Jeffrey R. Morgan & Associates PLLC, 850 Morton Blvd, Hazard, KY 41702; Mindy G. Barfield, Dinsmore & Shohl LLP, Lexington Financial Center, 250 West Main St., Suite 1400, Lexington, KY 40507; Kenneth R. Friedman, 1126 Highland Ave., Bremerton, WA 98337; Harlan Circuit Court Clerk, Harlan County Justice Center, 129 S. First Street, Harlan, KY 40831; Hon. Jeffrey Thomas Burdette, Chief Regional Circuit Judge, Pulaski County Judicial Center, 50 Public Square, Somerset, KY 42501; and Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601.

Griffin Terry Sumner
Counsel for Respondent

STATEMENT OF POINTS AND AUTHORITIES

May it please the Court:

This appeal challenges the dismissal of third-party bad faith claims arising from two insurers' defense of their insureds in a wrongful death litigation. The Motion seeks discretionary review of the Court of Appeals' unanimous decision holding that the third-party bad faith claims failed as a matter of law because liability was disputed in the underlying claims against each of the insureds. The Court of Appeals correctly affirmed dismissal of the bad faith claims based on settled precedent. There are no special reasons for discretionary review and the Motion should therefore be denied. *Cf.* CR 76.20.

First, the Motion purports to raise a question about the proper standard for a third-party bad faith claim. But that standard is well settled under this Court's precedents: a bad faith claim cannot succeed where the insureds' liability is never "beyond dispute." The Motion actually argues that both the circuit court and the Court of Appeals incorrectly applied that long line of settled precedent. *Cf.* Motion at 7. The Court of Appeals, however, recognized that the record – including deposition testimony from the Movants' trial counsel – establishes that the underlying liability remained disputed for each of the insureds. The insurers' delay in settlement therefore could not constitute the egregious level of conduct required for bad faith claims under Kentucky law.

Second, the Motion also argues that the Court of Appeals' erred in finding the insurers' mediation conduct inadmissible to prove bad faith. *Cf.* Motion at 11. That decision was correct and is supported by precedent. But the issue also does not warrant discretionary review because it was not essential to the decision below.

The Court of Appeals did consider the insurers' mediation offers and determined that the conduct did not constitute bad faith under Kentucky law.

CLARIFICATION OF MATERIAL FACTS

Movants Crystal Mosley, individually and as administratrix of her husband's estate, and Rhett Mosley Jr. ("the Mosleys") brought bad faith claims against two insurers: Respondent National Union Fire Insurance Company and Respondent Arch Specialty Insurance Company. The Mosleys asserted that National Union acted in bad faith by defending its insureds, Rex Coal Company, Inc. and Dixie Fuel Company, LLC, where the insureds disputed liability with defenses of immunity, causation, the law of bailment, and comparative fault. Both the circuit court and the Court of Appeals correctly held that the insureds' disputed liability precluded any bad faith claim.

The underlying wrongful death claim.

These third-party bad faith claims arise out of a fatal accident at a surface coal mine near Harlan, Kentucky. Rhett Mosley was killed when he lost control while driving a service truck in the course of his employment at the mine with Regional Contracting.

The Mosleys initially sued Dixie Fuel, the owner of the truck Mr. Mosley was operating, and later added claims against Rex Coal, the owner of the surface mine where Mr. Mosley was working. Both Dixie Fuel and Rex Coal were insured by National Union, and National Union assumed their defense. The Mosleys also added claims against other parties not insured by National Union: Jean Coal Co., LLC, the actual surface mine operator and the bailee responsible for operation and maintenance of the Dixie Fuel truck; Regional Contracting, Mr. Mosley's employer;

and Terry Loving, the sole managing member of Jean Coal and Regional Contracting.

After four years of litigation, Rex Coal's and Dixie Fuel's liability for the death of Rhett Mosley remained in dispute.

The alleged liability of Rex Coal and Dixie Fuel (and the other defendants) was disputed over more than four years of litigation. Rex Coal was entitled to "up the ladder" immunity under the Workers' Compensation Act as a "contractor" of Mr. Mosley's employer. Dixie Fuel, as bailor of the truck, was not legally responsible for the bailee's (Jean Coal's) alleged negligent use or maintenance of a truck that it did not control or have any right to control. Events after the truck left Dixie Fuel's control more than a year before the accident – specifically, repairs by numerous mechanics and other individuals – also severed any chain of causation with respect to Dixie Fuel's alleged negligence.[1]

Apportionment to other entities and individuals was likely.

In addition to the legal issues of "up the ladder" immunity and bailment law that precluded liability for both Rex Coal and Dixie Fuel, liability for these parties was even further "beyond dispute" because a jury would have been able to apportion fault to other current and former parties, as well as to Mr. Mosley himself. For example, Jean Coal and Regional Contracting were exclusively responsible for maintaining the truck Mr. Mosley was driving. Third-party mechanics were also hired to adjust the truck's brakes after the Mine Safety and

[1] The Motion's assertion that Dixie Fuel's liability was clear – or that Dixie Fuel made "admissions" of liability after it stipulated ownership of the truck and that it was not entitled to up-the-ladder immunity – therefore misrepresents the record and ignores Dixie Fuel's other legal and factual defenses.

Health Administration (MSHA) found problems with the brakes the year before the accident. And a liability dispute existed about Rhett Mosley's comparative fault.[2] As the circuit court judge later stated: "How can liability be reasonably clear when the court is ordering an apportionment jury instruction and then denying summary judgment on both accounts, on both sides?" Hearing, VR 2/3/16: 11:03:30-11:03:39.

Appellants' bad faith and concert of action claims against National Union.

While dispositive motions were pending, two court-ordered mediations were held in June 2013 and in September 2013. After the second mediation, in an apparent attempt to force a settlement, the Mosleys added bad faith and concert of action claims against National Union, the insurer of Rex Coal and Dixie Fuel, and Arch, the insurer of Jean Coal and Terry Loving.

The Mosleys' bad faith allegations relate to the insurers' alleged conduct at the confidential mediation in September 2013. The Mosleys complain that a single attorney and a single adjuster attended the mediation and made "global" settlement offers on behalf of all defendants (Jean Coal and Terry Loving, insured by Arch, and Rex Coal and Dixie Fuel). But as the Mosleys knew, both Rex Coal and Dixie Fuel were indemnitees under Arch's policy and entitled to a defense from

[2] The circuit court "[felt] confident ... the record [would] support a comparative negligence instruction." Hearing, VR 1/5/15: 11:03:02-11:03:09. First, Mr. Mosley was not wearing a seatbelt at the time of the accident, which Plaintiffs' expert admitted would have prevented him from being thrown from the truck. Second, MSHA investigators confirmed that Mr. Mosley was operating the truck in neutral, instead of in gear, and that he therefore did not have the benefit of the Jacobs engine brake, an operational choice that Plaintiffs' expert described as "unsafe, period." Third, Mr. Mosley and others (including those in the preceding shift who operated the truck without any problem) had performed numerous pre-shift inspections on the truck in the days and weeks leading up to the accident, but never reported any issues with the brakes.

Arch, which provided that defense up until the point it tendered its $1 million policy limits.

Although the Mosleys never issued separate demands to Rex Coal and Dixie Fuel, the Mosleys nonetheless claim that National Union and Arch acted in bad faith by "forcing" global negotiations and refusing to delineate how a proposed settlement would be allocated among the defendants. But through four years of litigation and both of these mediations (and a subsequent one in 2014), the Mosleys never lowered their collective demand to Rex Coal and Dixie Fuel below National Union's policy limits of $6 million. And the Mosleys never made a separate demand to either Rex Coal or Dixie Fuel. Settlement negotiations thus consisted of Rex Coal and Dixie Fuel "bidding against themselves" by increasing their collective settlement offer without receiving a corresponding counter-demand. When the claims against Rex Coal and Dixie Fuel were later settled during the interlocutory appeal of Rex Coal's immunity claim, that settlement was for a fraction of the National Union policy limits demanded for years by the Mosleys.

The bad faith litigation.

The Mosleys then pursued the bad faith claims against the insurers. After National Union's initial motion to dismiss the bad faith claims was denied without prejudice, National Union timely responded to voluminous discovery requests: along with interrogatory responses, National Union produced over 4,300 pages of responsive documents, including unprivileged portions of its claims file, and a detailed privilege log describing the privileged documents withheld. For almost a year, the Mosleys did not complain about any alleged deficiencies in National

Union's discovery responses.

During that period of inaction by the Mosleys, National Union deposed Jeffrey Morgan, the Mosleys' primary counsel in the underlying case. Mr. Morgan's three days of deposition testimony confirmed that Appellants were fully aware of the weaknesses in the claims against Rex Coal and Dixie Fuel. Mr. Morgan acknowledged that fault could have been apportioned to other defendants and/or to Mr. Mosley himself and that there were legal barriers to the claims due to workers' compensation immunity.[3]

The circuit court properly granted summary judgment in favor of National Union.

The circuit court granted National Union's motion for summary judgment, finding that the Mosleys were unable to satisfy the elements of bad faith under Kentucky law and that the claims were improperly premised on litigation conduct. The court also expressly rejected the Mosleys' request for additional discovery, noting that the issues raised were "immaterial to the facts supporting National Union's Motion for Summary Judgment":

> 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.

Order, 7/11/17, at 14-15.

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[3] *See, e.g.*, Morgan Dep., 12/14/16, at 40 (acknowledging difficulties with workers' compensation defenses); *id.*, 12/15/16, at 29-30 (acknowledging discovery showed that a mechanic had adjusted the brakes in October 2010); *id.*, 12/14/16, at 70 (acknowledging that the circuit court's denial of plaintiffs' summary judgment motion meant that "a reasonable jury could find for Defendants"). Mr. Morgan further acknowledged that Dixie Fuel was the "main target" in the underlying litigation, "joking" that the reason was that it had higher insurance coverage limits than the other defendants. *Id.*, 12/14/16, at 108-09.

The Court of Appeals properly affirmed dismissal of the bad faith claims.

The Court of Appeals unanimously affirmed the dismissal of the bad faith claims against the insurers. Opinion at 30. Quoting this Court's recent *Hollaway* decision, the Court stated that Kentucky law "only requires insurers to negotiate reasonably" – not "to acquiesce to a third party's demands" -- and only where "liability is beyond dispute." Opinion at 29 (quoting *Hollaway v. Direct Gen. Ins. Co. of Miss., Inc.*, 497 S.W.3d 733, 739 (Ky. 2016)). The court recognized that "the disputed liability in this matter is quite complex." Opinion at 25.

> The issues include, among others, "up the ladder" immunity in workers compensation, Dixie Fuel's questionable duty to Rhett as a bailor of the truck without actual control of the truck for over one year, apportionment of liability among the Defendant/Appellees and other parties, the proof that Rex Coal or Dixie Fuel had knowledge about the truck's condition, and a comparative fault apportioned to Rhett for failure to wear a seatbelt.

Id.

The Court also affirmed the circuit court's decision that the Mosleys had a sufficient opportunity for discovery. *Id.* at 14-15. "First, Mosley had time to discover evidence related to the ostensible liability in the original case. Two dozen depositions were conducted, which included six expert depositions, and numerous filings were made about the varied and complex liability issues." *Id.* at 14. And the Mosleys had an additional 16 months for discovery in the bad faith claims. *Id.*

Additionally, the Court of Appeals held that the insurers' global mediation offers in this case did not constitute bad faith. Opinion at 18-19. And the court stated that, to protect the confidentiality of mediation, evidence of the insurers' mediation offers should not be admissible to prove bad faith. Opinion at 27.

REASONS FOR DENYING DISCRETIONARY REVIEW

Discretionary review is appropriate "only when there are special reasons for it." CR 76.20; *Beard v. Commonwealth ex rel. Shaw*, 891 S.W.2d 382 (Ky. 1994). Although the term "special reasons" escapes precise definition, it includes "a novel question of statewide significance, a legal proposition that requires reexamination, or a matter in which lower courts have conflicted." BALDWIN'S KENTUCKY LAWYER'S HANDBOOK, Civil Practice Vol. 1, 399 (Thomson Reuters) (June 2013); *see also* C. Theodore Miller, *Discretionary Review Practice in the Kentucky Supreme Court*, 76 BENCH & BAR, Jan. 2012, at 16; 19 Sheryl G. Snyder, et al., *Appellate Practice*, in KENTUCKY PRACTICE, 73-74 (Thompson-West 2006). Where – as here – the law is clear and supports the decision below, discretionary review is inappropriate. *See, e.g., Hall v. Coyle,* 240 S.W.3d 656, 657 (Ky. App. 2007).

The Court of Appeals correctly applied Kentucky precedent law and the Motion presents no "special reasons" warranting further review. The Motion should therefore be denied.

I. There is no special reason for discretionary review of the Court of Appeals' decision that well-settled precedent required dismissal of the bad faith claims.

The Court of Appeals affirmed the circuit court's judgment holding that the Mosleys cannot satisfy the elements of a bad faith claim under Kentucky law. Opinion at 19-21. The Court of Appeals correctly recognized that the second *Wittmer* prong could not be satisfied because Rex Coal's and Dixie Fuel's liability was never reasonably clear, and therefore National Union had no obligation to pay the underlying claims under the KUCSPA. To the contrary, National Union had

both a right and a duty to defend its insureds against an excess judgment exactly as it did.

Bad faith claims are governed by the long-settled criteria from *Wittmer v. Jones,* which established that "an insurer is ... entitled to challenge a claim and litigate it if the claim is debatable on the law or facts." *Lee v. Med. Protective Co.*, 904 F. Supp. 2d 648, 653-54 (E.D. Ky. 2012)(citing *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993)). A bad faith claim requires:

> (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.

Wittmer, 864 S.W.2d at 890; *Hollaway v. Direct Gen. Ins. Co. of Miss., Inc.*, 497 S.W.3d 733 (Ky. 2016). The failure to show any one of these elements eliminates a bad faith claim as a matter of law.

In the context of third-party bad faith claims, the KUCSPA 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." KRS 304.12-230(6). For liability to be "reasonably clear" it must be "beyond dispute." *See, e.g., Hollaway,* 497 S.W.3d at 736; *Coomer v. Phelps*, 172 S.W.3d 389, 395 (Ky. 2005). Whenever liability is not "beyond dispute," a "defendant ha[s] a right to litigate its case" and is under "no duty to make an offer" unless and until it becomes "beyond dispute." *Lee,* 904 F. Supp. 2d at 656.

This Court has recently – and repeatedly – reinforced the *Wittmer* standard and the "tall burden of proof on plaintiffs seeking to recover on a theory of bad

faith." *Hollaway*, 497 S.W.3d at 737. A "genuine dispute as to liability" renders a "bad faith claim a de facto nullity." *Id.* at 738; *see also Ind. Ins. Co. v. Demetre*, 527 S.W.3d 12, 31 (Ky. 2017) ("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[.]").

In the face of these settled precedents, the Motion argues that discretionary review is warranted because this Court's decision in the *Farmland* case stands for the proposition that a bad faith claim can proceed even where liability on the underlying claim was fairly debatable. Motion at 16-17 (citing *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368, 375 (Ky. 2001)). But *Farmland* did not eviscerate the requirement that liability be "beyond dispute." *Farmland* focused on misconduct by the insurance company; there was no liability dispute. The insurance company misrepresented the terms of the policy to its insured and proceeded to negotiate using the erroneous basis and using other "oppressive tactics" toward its insured. *Farmland*, 36 S.W.3d 368.

There is no suggestion those circumstances exist here. Both the Court of Appeals and the circuit court correctly recognized that liability was clearly disputed – the disputed nature of liability was even admitted by the Mosleys' counsel. The Motion does not identify when – or how or even if – the obligation to pay on behalf of Rex Coal arose. And, the suggestion that National Union's "obligation to pay" on behalf of Dixie Fuel arose when Dixie Fuel stipulated that it owned the truck at issue and that it was not entitled to up-the-ladder immunity ignores Dixie Fuel's other defenses based on the law of bailment, lack of control over the truck and the comparative fault of Mr. Mosley and others, including mechanics who had serviced

the brakes.

Under the well-settled *Wittmer* standards, National Union had no obligation to pay the Mosleys' claims. The claims against Dixie Fuel were not "beyond dispute" because of Dixie Fuel's undisputed lack of contact with the truck in the year preceding the accident, and based on evidence of the comparative fault of Jean Coal (as bailee of the truck), mechanics who performed repairs on the truck, and Mr. Mosley himself, who did not report any problems with the truck in the days and weeks before the accident. Rex Coal's liability was equally debatable in light of the substantial probability that it was entitled to up-the-ladder immunity as a "contractor" of Mr. Mosley's employer.[4]

And both lower courts correctly recognized that additional discovery could not have created a genuine issue of material fact concerning Rex Coal's and Dixie Fuel's liability for the underlying claims. The circuit court specifically found that "Plaintiffs have had ample opportunity to conduct discovery" during the four-plus years that the underlying case was pending. Order, 7/11/17, at 13-14. During that time, the Mosleys were unable to establish that liability was "reasonably clear." Indeed, the Mosleys' trial counsel for the underlying claims admitted that the Mosleys were fully aware of the weaknesses in the claims against Rex Coal and Dixie Fuel, that fault could have been apportioned to other defendants and/or to Mr. Mosley himself, and that they faced legal barriers to the claims due to workers'

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[4] The genuine liability dispute in the underlying case also precluded any finding that National Union "knew there was no reasonable basis for denying [Appellants'] claim or acted with reckless disregard for whether such a basis existed" under *Wittmer*'s third requirement. 864 S.W.2d at 890.

compensation immunity.[5] No additional discovery was going to change that.

Sixteen months of bad faith discovery were also conducted, and National Union produced more than 4,000 pages of documents, including unprivileged portions of its claim file related to the underlying dispute. After the Mosleys waited until a year had passed and a dispositive motion was pending to complain, the circuit court found that the Mosleys' "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 [did] not preclude summary judgment." Order, 7/11/17, at 14. The circuit court also found that the factual allegations Appellants raised in response to National Union's motion for summary judgment (and which were the subject of the underlying discovery dispute) did 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." *Id.* at 15.

The Court of Appeals' Opinion applied well-settled precedent to hold that the Mosleys' bad faith claims failed as a matter of law. No additional discovery would change that result. The Motion does not present any special reason for review and should therefore be denied.

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[5] Jeffery Morgan was deposed as part of discovery during the bad faith case. *See, e.g.*, Morgan Dep., 12/14/16, at 40 (acknowledging difficulties with workers' compensation defenses); *id.*, 12/15/16, at 29-30 (acknowledging discovery showed that a mechanic had adjusted the brakes in October 2010); *id.*, 12/14/16, at 70 (acknowledging that the circuit court's denial of plaintiffs' summary judgment motion meant that "a reasonable jury could find for Defendants").

II. There is no special reason for discretionary review of the Court of Appeals' decision that the insurers' mediation conduct should remain confidential.

The Court of Appeals' discussion of the admissibility of mediation conduct also does not warrant discretionary review. Consistent with precedent excluding evidence of an insurers' litigation conduct, the Court of Appeals correctly recognized that the insurers' refusal to negotiate settlement of claims against their insureds separately in a confidential mediation context should not be admissible to prove bad faith. Opinion at 25-27.

But that issue was not essential to the affirmance of judgment in favor of the insureds. The Court of Appeals analyzed the inadmissible mediation conduct and correctly found that the conduct did not violate Kentucky law. Opinion at 22-25. The discussion of mediation confidentiality therefore does not warrant additional judicial review by this Court.

Each insurer represented two of the defendants in the underlying case. The Mosleys' trial counsel from those claims, Jeffery Morgan, admitted in his deposition that trying to force one of the insureds into an excess verdict was part of the Mosleys' litigation strategy. But both insurers had a legal obligation to obtain a release for each of their insureds to avoid subjecting one to an excess verdict:

> If we read [the KUCSPA] as requiring payment of the policy limit without a settlement of claims against the insured, then an insurance company would be forced to watch both flanks. On one side, the company may be sued for unfair settlement practices by a claimant disgruntled by the company's failure to pay, and, on the other side, the company may be sued by an insured disgruntled by the company's payment of the policy limit without obtaining a release.

Shaheen v. Progressive Cas. Ins. Co., 114 F. Supp. 3d 444, 449-450 (W.D. Ky. 2015), *aff'd*, 673 F. App'x 481 (6th Cir. 2016).

The Court of Appeals correctly recognized that National Union's insistence on negotiating a settlement that involved a release of both Rex Coal and Dixie Fuel did not violate Kentucky law. Opinion at 22-25. Global offers on behalf of multiple insureds are in no way prohibited. The KUCSPA's prohibition on "leveraging" applies only to attempts to condition settlement under one portion of an insurance policy on settlement of another portion of an insurance policy on claims where liability has become reasonably clear. *See* KRS 304.12-230(13). The classic example is an insurer who tries to pressure a claimant to condition settlement of a property damage claim on settlement of a personal injury claim. But that is not this situation.

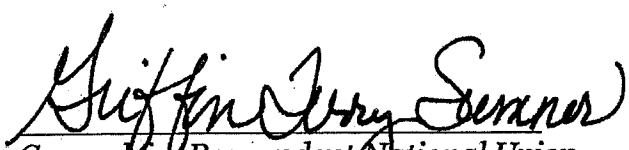
The Court of Appeals also correctly recognized that the insurers' negotiations in a confidential mediation should not be admissible as the basis for a bad faith claim. Opinion at 22-25. That decision is consistent with this Court's precedent holding that evidence of an insurer's litigation conduct should not be admissible in a bad faith action. *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512 (Ky. 2006). To hold otherwise would "impede insurers' access to the courts and right to defend, because it makes them reluctant to contest coverage of questionable claims." *Id.* at 521. This Court further cautioned of "the chilling effect that allowing introduction of evidence of litigation conduct would have on the exercise of an insurance company's legitimate litigation rights," finding that "any exception [making litigation conduct admissible] threatens to turn our adversarial system on its head." *Id.* at 522. The remedy for any alleged misconduct is under the civil rules, not the KUCSPA. *See id.*

The *Knotts* rationale is even more compelling when considering confidential mediation activity. The reason for KRE's prohibition on the use of settlement-related conduct to prove liability is to encourage "voluntary dispute resolution by protecting against the possibility that a compromise or offer of compromise might be used to the disadvantage of a party in subsequent litigation." *Green River Elec. Corp. v. Nantz*, 894 S.W.2d 643, 646 (Ky. App. 1995). Consistent with this rule, evidence of National Union's mediation strategy was inadmissible. The Opinion's discussion of mediation confidentiality – consistent with precedent and the rules of evidence – does not present any special reason for review.

CONCLUSION

Discretionary review should be denied. Both the Court of Appeals and the circuit court properly held that the Mosleys' bad faith claims failed as a matter of law. The Motion does not present any special reason for further review of that decision and should therefore be denied.

Respectfully submitted,



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