SUPREME COURT OF KENTUCKY
NO. 2014-SC-000354-D
~~NO. 2014-SC-000357-D~~



PHILADELPHIA INDEMNITY
INSURANCE COMPANY, INC.,
ET AL. APPELLANTS

**REPLY BRIEF FOR APPELLANT PHILADELPHIA INDEMNITY INSURANCE COMPANY**

v.

RICHARD TRYON APPELLEE

Submitted by:

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CERTIFICATE OF SERVICE

It is hereby certified that a true and correct copy of this Brief for Appellant was this 9th day of July 2015 mailed to the following: Ms. Susan Stokley, Clerk of the Supreme Court of Kentucky, 209 Capitol Building, 700 Capital Avenue, Frankfort, KY 40601; Mr. Samuel Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601; Honorable Charles Cunningham, Jefferson Circuit Court; Judicial Center, 700 West Jefferson Street, 7th Floor, Louisville, Kentucky. 40202; Mr. A. Thomas Johnson, 304 West Liberty Street, Louisville, KY 40202; Mr. William B. Orberson and Ms. Patricia C. Le Meur, Phillips Parker Orberson & Barnett, PLLC, 716 West Main Street, Suite 300, Louisville, KY 40202 and Mr Eric A. Hamilton, Coleman Lochmiller & Bond, P. O. Box 1177, Elizabethtown, KY 42702-1177. It is further certified, pursuant to CR 76.12(6), that the record on appeal was not withdrawn from the Clerk of the Jefferson Circuit Court by the appellant.

COUNSEL FOR APPELLANT

## I. STATEMENT OF POINTS AND AUTHORITIES

## I. ARGUMENT

### A. KENTUCKY CASE LAW COULD NOT AND DID NOT GIVE TRYON A REASONABLE EXPECTATION OF UIM COVERAGE.

Tryon argues that Kentucky case law, particularly *Chaffin v. Ky. Farm Bureau* and *Hamilton Mutual Ins. Co. v. USF&G*, gave him a reasonable expectation of Underinsured Motorists (UIM) coverage from Philadelphia. For at least two reasons, he is mistaken.

First, case law plays no part in the reasonable-expectations doctrine.[1] The doctrine is a rule of policy construction.[2] Under the doctrine, if a coverage exclusion is plain, it defeats a reasonable expectation of coverage. It's as simple as that. Case law is irrelevant. As the Court explained in *Motorists Mutual v. Glass*:

> The gist of the [reasonable-expectations] doctrine is that the insured is entitled to all the coverage he may reasonably expect to be provided under the policy. Only an unequivocally conspicuous, plain and clear manifestation of the company's intent to exclude coverage will defeat that expectation.
>
> The doctrine of reasonable expectations is used in conjunction with the principle that ambiguities should be resolved against the drafter in order to circumvent the technical, legalistic and complex contract terms which limit benefits to the insured.[3]

As the *Glass* Court explained, what matters under the reasonable-expectations doctrine is the clarity of exclusionary language. If an exclusion manifests a clear intent to exclude coverage, it defeats a reasonable expectation of that coverage.[4]

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1 *Motorists Mutual v. Glass*, 996 S.W.2d 437, 450 (Ky. 1997).

2 *Id.*

3 *Id.* (quoting *Simon v. Continental Ins.*, 724 S.W.2d 201, 212 (Ky. 1986)).

4 *Id.*

The rule recognizes the inherent logic that an insured can't hold a reasonable expectation of coverage in the face of an unambiguous exclusion that excludes the coverage.

The exclusion at issue here is Philadelphia's owned-but-not-scheduled exclusion. It provides:

> A. We do not provide Uninsured Motorists Coverage for "bodily injury" sustained:
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> 1. By an "insured" while "occupying," or when struck by, any motor vehicle owned by that "insured" which is not insured for this coverage under this policy. This includes a trailer of any type used with that vehicle.[5]

This exclusion is plain. Even Tryon concedes that. The exclusion excluded UIM coverage when Tryon was occupying a motor vehicle that he owned but didn't insure under his Philadelphia policy. In light of the exclusion, Tryon could not have had a reasonable expectation of UIM coverage from Philadelphia at the time of his accident because he was occupying a motor vehicle that he owned but didn't insure with Philadelphia. Tryon's argument that Kentucky case law gave him a reasonable expectation of UIM coverage is misplaced. He cites no authority to support his contention that case law plays a role in the reasonable-expectations doctrine. Furthermore, Tryon's argument assumes that he was aware of cases like *Chaffin* and *Hamilton Mutual* and relied on them in purchasing his Philadelphia policy. There's no record evidence to that effect. And the argument is contrary to common experience.

The second reason that Tryon's reasonable-expectations argument fails is that it's based on the premise that Kentucky courts have uniformly refused to enforce

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5 Collector Vehicle Policy, page 6 of 13 (attached to our original brief as Appendix Item 3).

UIM exclusions like Philadelphia's owned-but-not-scheduled exclusion. That's simply not true. As the dissent in *Chaffin v. Ky. Farm Bureau Ins. Co.* pointed out, the Court regularly enforced owned-but-not-scheduled exclusions prior to *Chaffin*.[6]

> This court has ruled on the [owned-but-not-scheduled exclusion] in three cases since 1977, and on all three occasions has upheld the exclusion.
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> In those cases, this court unanimously held:
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> . . . that a clause in an automobile policy excluding from uninsured motorist coverage accidents arising out of the use of vehicles owned by an insured other than the automobile described in the liability portion of the policy was a reasonable exclusion and precluded the insured's recovery from the insurer for injuries sustained while occupying an automobile that was not described in the liability portion of the policy.
>
> The majority opinion overrules these cases out of hand and without explaining, other than the change of personnel on the court, why this has suddenly become an unreasonable exclusion.[7]

The Kentucky Court of Appeals has also pointed out the incongruity between *Chaffin* and pre-*Chaffin* case law when it comes to enforcing owned-but-not-scheduled exclusions.[8] One of the first cases in which the court of appeals did so was *Hamilton Mutual Ins. Co. v. USF&G*. The *Hamilton Mutual* court questioned *Chaffin*'s reasoning and invited insurers to challenge *Chaffin*. Here's the relevant language:

> Unfortunately, given the logic and reasoning thus espoused [in *Chaffin*], we are unable to conclude that the instant case

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6 789 S.W.2d 754, 758 (Ky. 1990) (Gant, J. dissenting).

7 *Id.* (Gant, J. dissenting).

8 *Hamilton Mutual Ins. Co. v. USF&G*, 926 S.W.2d 466 (Ky. App. 1996).

> presents a distinction with a difference. If a different result is to come . . . , our Supreme Court must direct it.[9]

In addition to the doubt cast upon *Chaffin* by the dissent in the case and by *Hamilton Mutual*, Kentucky case law since *Chaffin* and *Hamilton Mutual* has remained inconsistent. One example of that is *Motorists Mutual Ins. Co. v. Hartley*.[10] We discussed *Hartley* in our opening brief. The case enforces an owned-but-not-scheduled exclusion under facts nearly identical to those here. Accordingly, it undermines Tryon's argument that he reasonably relied on Kentucky case law to form a reasonable expectation of UIM coverage from Philadelphia. The truth is that, as a whole, Kentucky case law is irreconcilable when it comes to the enforceability of UIM exclusions like the owned-but-not-scheduled exclusions at issue here. Accordingly, the case law (assuming that Tryon actually read and understood it before buying his policy) could not have given Tryon a reasonable expectation of coverage from Philadelphia.

### B. *CHAFFIN* AND *STATE FARM V. HODGKISS-WARRICK* ARE IRRECONCILABLE. THUS, THE COURT WILL HAVE TO CHOOSE BETWEEN THE TWO.

As we've discussed, the *Chaffin* Court used the reasonable-expectations doctrine to invalidate an unambiguous owned-but-not-scheduled exclusion on public-policy grounds.[11] That was error. Unfortunately, it was error that set precedent. The *Hamilton Mutual* court recognized *Chaffin*'s error but could do nothing about it.[12] After

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9 *Id.* at 469.

10 2011 Ky. App. Unpub. LEXIS 938 (attached to our original brief as Appendix Item 4).

11 *Chaffin*, 789 S.W.2d at 757-58.

12 *Hamilton Mutual*, 926 S.W.2d at 469.

*Hamilton Mutual*, the court of appeals nibbled around the edges of *Chaffin* with distinguishing decisions like *Motorists Mutual Ins. Co. v. Hartley*. But the court of appeals could not overturn *Chaffin*.

In 2013, this Court decided *State Farm v. Hodgkiss-Warrick*.[13] We discussed *Hodgkiss-Warrick* in our original brief. We believe the case controls here. Tryon disagrees. He asserts that *Hodgkiss-Warrick* doesn't apply here because the UIM exclusion at issue in the case was a regular-use exclusion, not an owned-but-not-scheduled exclusion. Tryon is missing the forest by focusing on the trees with this argument. The critical aspect of *Hodgkiss-Warrick* is that the Court refused to "disregard the plain terms of a contract between private parties on public policy grounds absent a clear and certain statement of strong public policy in controlling laws or judicial precedent."[14] The Court emphasized that "public policy, . . . is not simply something courts establish from general considerations of supposed public interest, but rather something that must be found clearly expressed in the applicable law."[15]

Having established that an insurance contract cannot be abrogated on public-policy grounds without a clear expression of public policy in the applicable law, the *Hodgkiss-Warrick* Court turned to the specific argument before it, which was that State Farm's regular-use exclusion violated the Kentucky Motor Vehicle Reparations Act's policy of fully compensating accident victims. The Court disagreed. It held that the

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13 413 S.W.3d 875 (Ky. 2013).

14 *Id.* at 880.

15 *Id.*

MVRA's plain language and related case law proved otherwise.[16] The Court explained that the flaw in Hodgkiss-Warrick's public-policy argument stemmed from the optional nature of UIM coverage.[17] Kentucky insurers have to make UIM coverage available, but insureds are not obligated to purchase it.[18] "Thus, while the [UIM] statute serves the remedial purpose of protecting auto-accident victims from underinsured motorists who cannot adequately compensate them for their injuries, that purpose has not been raised to the level of a public policy overriding other purposes of the MVRA, such as guaranteeing the continued availability of affordable motor vehicle insurance, or overriding all other considerations of contract construction."[19]

To emphasize its point that the purpose of optional UIM coverage isn't strong enough to override the other purposes of the MVRA, the *Hodgkiss-Warrick* Court cited *Preferred Risk Mut. Ins. Co. v. Oliver* and *Motorists Mutual v. Glass*.[20] In *Oliver*, the Court enforced a motorcycle exclusion that limited optional UM coverage.[21] In *Glass*, the Court enforced a regular-use exclusion that limited optional UIM coverage.[22] The purpose of these two optional coverages wasn't enough to override the reasonable UM and UIM exclusions in *Oliver* and *Glass*.

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16 *Id.* at 881.

17 *Id.*

18 *Id.*

19 *Id.*

20 *Id.* (citing *Preferred Risk Mut. Ins. Co. v. Oliver*, 551 S.W.2d 574 (Ky. 1977); *Glass*, 996 S.W.2d at 450).

21 *Id.* (citing *Oliver*, 551 S.W.2d at 574).

22 *Id.* (citing *Glass*, 996 S.W.2d at 450).

Two other cases that make *Hodgkiss-Warrick*'s point about the limited purpose of optional UM and UIM coverage are *Safeco Ins. Co. v. Hubbard* and *MFA Ins. Co. v. Whitlock.*[23] In both cases, the Court enforced owned-but-not-scheduled exclusions that limited UM coverage because the exclusions were unambiguous and reasonable.[24] And that's the bottom line (the forest) in *Hodgkiss-Warrick* that Tryon misses. *Hodgkiss-Warrick* holds that insurers can place reasonable limits on UIM coverage without violating public policy because UIM coverage is optional.

Turning back to this case, Philadelphia has acknowledged that its owned-but-not-scheduled exclusion isn't identical to the regular-use exclusion in *Hodgkiss-Warrick*. But that's immaterial. What matters is that Philadelphia's owned-but-not-scheduled exclusion is as clear and as reasonable as the regular-use exclusion in *Hodgkiss-Warrick*. Philadelphia's exclusion is intended to prevent Philadelphia from being exposed to risks that Tryon didn't pay Philadelphia to underwrite. That's a reasonable purpose. The Court held as much in *Hubbard, Whitlock*, and *State Farm v. Christian.*[25] In the *Hubbard* Court's words: "[the owned-but-not-scheduled exclusion] [i]s a reasonable exclusion and preclude[s] the insured's recovery from the insurer for injuries sustained while occupying an automobile that was not described in the liability portion of the policy."[26]

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[23] 578 S.W.2d 49, 50 (Ky. 1979) (owned-but-not-scheduled exclusion was reasonable and so enforceable); 572 S.W.2d 856 (Ky. 1978) (owned-but-not-scheduled exclusion was reasonable and so enforceable).

[24] *Hubbard*, 578 S.W.2d at 50; *Whitlock*, 572 S.W.2d at 856.

[25] *Hubbard*, 578 S.W.2d at 50; *Whitlock*, 572 S.W.2d at 856; *State Farm v. Christian*, 555 S.W.2d 571 (Ky. 1977).

[26] *Hubbard*, 578 S.W.2d at 50.

In the end, we don't believe that there's any way to reconcile *Hodgkiss-Warrick*'s holding that plain and reasonable UIM exclusions are enforceable with *Chaffin*'s refusal to enforce a plain and reasonable owned-but-not-scheduled exclusion. Thus, it seems to us, that the Court has to choose between *Hodgkiss-Warrick* and *Chaffin*. *Hodgkiss-Warrick* seems the better choice.

## C. TYRON'S ARGUMENT THAT THE COURT SHOULD APPLY ITS DECISION IN THIS CASE PROSPECTIVELY IS MISPLACED.

Tryon argues that, should the Court rule against him, it should apply its decision prospectively. The argument is based on the same flawed reasoning as Tryon's reasonable-expectations argument. In short, Tryon claims that the Court's case law gave him a reasonable expectation of coverage (induced reasonable reliance on his part) and so the Court should only apply a decision reversing herein prospectively. We debunked Tryon's reasonable-expectations/reasonable-reliance argument above. First, Philadelphia's unambiguous owned-but-not-scheduled exclusion defeated Tryon's reasonable expectation of UIM coverage on its face. Second, contrary to Tryon's argument, the applicable case law has never been uniformly in Tryon's favor. The dissent in *Chaffin* pointed this out and so did the majority in *Hamilton Mutual*. The *Hartley* decision is squarely against Tryon. In light of this inconsistent case law, Tryon couldn't reasonably have believed that the courts would refuse to enforce Philadelphia's owned-but-not-scheduled exclusion. Thus, his argument for prospective application of the Court's decision herein is misplaced.

### D. THE OWNED-BUT-NOT-SCHEDULED EXCLUSION IN TRYON'S UNINSURED MOTORISTS COVERAGE PART APPLIES HERE BECAUSE TRYON'S UNDERINSURED MOTORISTS COVERAGE IS INCLUDED IN HIS UNINSURED MOTORISTS COVERAGE.[27]

Tryon notes that the owned-but-not-scheduled exclusion that Philadelphia relies on is in the Uninsured Motorists Coverage Part of his Philadelphia policy, not the Underinsured Motorists Coverage Part. The reason for that is that Tryon's policy doesn't have a UIM Coverage Part. The policy includes UIM coverage as part of its UM coverage. The policy's declarations reflect this by noting that UIM is separate only "when not included in Uninsured Motorists Coverage." Therefore, the owned-but-not-scheduled exclusion in Tryon's UM Coverage Part applies to the included UIM coverage.

## II. CONCLUSION

As Philadelphia argued in its original brief, *Hartley* is on point. Therefore, the Court could decide this case by borrowing *Hartley*'s analysis, which distinguishes *Chaffin* on facts nearly identical to those here. But that's not the best option. The best option is for the Court to decide this case under *Hodgkiss-Warrick*, *Glass*, *Hubbard*, *Whitlock*, and *Christian*. Under those cases, Philadelphia and Encompass's owned-but-not-scheduled exclusions are enforceable because they are unambiguous and reasonable.

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[27] As we noted on page 12 of our Appellee's Brief in the court of appeals, Tryon didn't raise this issue in the circuit court so Philadelphia didn't address it there.

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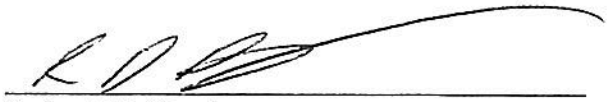

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