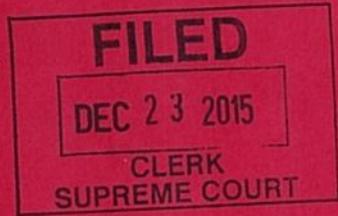


COMMONWEALTH OF KENTUCKY  
KENTUCKY SUPREME COURT  
NO. 2015-SC-107-D



INDIANA INSURANCE COMPANY

APPELLANT

v. ON DISCRETIONARY REVIEW FROM COURT  
OF APPEALS NO. 2013-CA-338  
CAMPBELL CIRCUIT COURT NO. 09-CI-1175

JAMES DEMETRE

APPELLEE

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Certificate of Service

This is to certify that this Appellant's Brief has been served by mailing a true copy thereof, postage prepaid, on this 21st day of December, 2015 to Jeffrey M. Sanders, Esq., Jeffrey M. Sanders, PLLC, 437 Highlands Avenue, Fort Thomas, KY 41075; Robert E. Sanders, Esq., Justin E. Sanders, Esq., The Sanders Law Firm, 1017 Russell Street, Covington, KY 41011; Kevin C. Burke, Esq., 125 South 7<sup>th</sup> Street, Louisville, KY 40202; and Hon. Fred A. Stine IV, Judge, Campbell Circuit Court, 330 York Street, Newport, KY 41071. It is further certified that the Record on Appeal was not withdrawn from the Campbell Circuit Clerk's Office.

  
Michael D. Risley

## INTRODUCTION

Notwithstanding the fact that Indiana Insurance provided its insured, James Demetre, with a defense and full indemnity with regard to the claims asserted against him and there was a total absence of any medical or scientific evidence to support Mr. Demetre's alleged emotion distress, the trial court submitted Mr. Demetre's bad faith claims to the jury. Indiana Insurance appeals from the jury's award of \$925,000 in emotional distress damages and \$2,500,000 in punitive damages in favor of Mr. Demetre.

### STATEMENT CONCERNING ORAL ARGUMENT

Appellant believes that oral argument would be useful in expanding on the errors committed below and to address any questions members of the Court may have.

Accordingly, appellant requests that oral argument be held.

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## APPENDIX

## STATEMENT OF THE CASE

### A. Summary

When James Demetre was sued by Mahannare Harris for injuries to her children and her property allegedly caused by pollutants traveling from Mr. Demetre's property to the Harris property next door, Indiana Insurance Company provided Mr. Demetre with defense counsel even though there were questions about whether coverage existed for those claims. Those coverage issues involved the known loss or loss in progress rule, pursuant to which insurance coverage cannot be obtained for a loss the applicant knows about at the time of the application or which is in progress at the time of the application. *See Pizza Magia International, LLC v. Assurance Co. of America*, 447 F. Supp. 2d 766, 774 (W.D. Ky 2006) ("This doctrine precludes coverage when the insured is aware of an ongoing progressive loss at the time the policy becomes effective.") (applying Kentucky law). Mr. Demetre's property was polluted, and Mr. Demetre knew about the pollution, years before he applied to Indiana Insurance to insure the property.

Because of those coverage issues, Indiana Insurance provided Mr. Demetre's defense pursuant to a reservation of rights, a procedure well-established in Kentucky law. *See O'Bannon v. Aetna Cas. & Indem. Co.*, 678 S.W.2d 390, 392 (Ky. 1984) ("This rule allows an insurer to defend a case with a reservation of rights agreement if it believes there is no coverage owed."); *Hensley v. Hartford Acc. & Indem. Co.*, 451 S.W.2d 415 (Ky. 1971) (insurer's reservation of rights letter properly reserved its right to later contest whether coverage existed). The trial court eventually ruled that it would not recognize the known loss rule, even though a federal court sitting in Kentucky predicted that this Court would adopt the rule and applied it in the case before it. Following the trial court so ruling, Indiana Insurance settled the claims against Mr. Demetre within the coverage

provided by the Indiana Insurance policy and obtained a full release for Mr. Demetre and his wife, thereby protecting Mr. Demetre from a verdict in excess of the available insurance coverage.

Prior to Indiana Insurance resolving the claims against Mr. Demetre, he brought this claim against Indiana Insurance, claiming that Indiana Insurance had engaged in bad faith conduct. As alleged by Mr. Demetre, the bad faith did not involve Indiana Insurance's failure to settle the claim against him, as is the more typical act of bad faith alleged by either an insured or a claimant. Instead, the alleged bad faith concerned supposed wrongdoing in raising coverage issues, the conduct of his defense by the attorney retained for him by Indiana Insurance, and a supposed shortcoming in the investigation of the claims.

**B. Mr. Demetre acquires property undergoing remediation and monitoring for pollutants, acquired insurance knowing of the pollutant remediation and monitoring, and is sued for damages due to the pollutants.**

Mr. Demetre's in-laws previously operated a Texaco gas station on the property at issue in the underlying suit. (VR No. 7: 9/26/12; 3:15:16) After removal of the gas station, the Commonwealth of Kentucky conducted remediation and monitoring at the property for some time. (VR No. 7: 9/26/12; 3:16:28)

Because of the amount of correspondence and activity relating to the remediation, Mr. Demetre's wife asked if they could take over responsibility for the lot. *Id.* Mr. Demetre agreed and acquired the property from his in-laws in 2000. (VR No. 7: 9/26/12; 3:16:15) He did not add the lot to his insurance policy with Indiana Insurance until 2008. (VR No. 7: 9/26/12: 3:23:40) Thus, prior to Mr. Demetre procuring insurance coverage from Indiana Insurance, he knew the property had been the site of a gas station and that

remediation and monitoring activities were ongoing at the property. (VR No. 7: 9/26/12; 3:16:28)

In August 2009, Mr. Demetre was sued by Mahannare Harris, who lived next door to the property. (VR No. 7: 9/26/12; 3:30:24) In her complaint, Ms. Harris alleged that gasoline constituents had seeped onto her property, causing her family physical distress and rendering her house valueless. (Trial Record (“TR”) 1)

**C. Indiana Insurance provides a defense under a reservation of rights, properly raises the coverage issue, and settles the underlying claim within the coverage limits.**

Mr. Demetre notified Indiana Insurance of the lawsuit, and Indiana Insurance retained attorney Timothy Schenkel to represent Mr. Demetre. (VR No. 7: 9/26/12; 3:42:24) The defense was provided subject to a reservation of rights based on the fact that Mr. Demetre may have known of the contamination prior to insuring the property. Such potential knowledge brought into play the known loss or loss in progress doctrine, which had been recognized under Kentucky law. *See Pizza Magia International, LLC v. Assurance Co. of America*, 447 F. Supp. 2d 766, 776 (W.D. Ky. 2006) (“[T]his Court today likewise concludes that the Kentucky Supreme Court would adopt the loss-in-progress doctrine.”).

Mr. Demetre was displeased with Mr. Schenkel’s representation and moved the court to remove him and replace him with Jeff Sanders, Mr. Demetre’s personal counsel, and to order Indiana Insurance to pay for Mr. Sanders’s representation. (VR No. 7: 9/26/12; 5:04:02) In response, Mr. Schenkel withdrew from his representation of Mr. Demetre, and Indiana Insurance replaced Mr. Schenkel with Philip Schworer of Frost, Brown Todd. Mr. Demetre was pleased with Mr. Schworer’s representation. (VR No. 7: 9/26/12; 4:55:16)

By way of a counterclaim and cross-claim,<sup>1</sup> Indiana Insurance raised the known loss/loss in progress coverage issue. (TR 48) In an Order dated December 8, 2010, the trial court recognized that the federal courts in Kentucky and the Sixth Circuit had concluded that Kentucky would adopt the doctrine but held that it would not apply the doctrine since the doctrine had not been recognized in the state courts of Kentucky. (TR 264, Appendix (“Apx.”) 4) Even while rejecting the known loss doctrine, however, the trial court recognized that coverage might not exist under the related concept of fortuity, which requires that a loss be fortuitous for coverage to exist for the loss. *See Aetna Cas. & Surety Co. v. Commonwealth*, 179 S.W. 3d 830, 835 (Ky. 2005) (“‘Fortuity’ is the principle that an insured cannot have coverage for those things that are ‘expected or intended’ from the covered conduct.”) Because there were factual issues as to whether coverage existed under the concept of fortuity, the trial court denied Mr. Demetre’s motion for summary judgment on whether coverage existed:

Indiana is entitled to raise its defense based upon fortuity if it produces at trial evidence sufficient to show that Demetre had subjective knowledge of an imminent loss or intended the loss to occur. Thus, there is enough evidence in the record to show that it is not impossible for Indiana to prevail at trial on this issue.

*Id.* at 8.

Subsequent to that Order, and consistent with its discretion to settle claims, Indiana Insurance settled the Harris claims for \$165,000. (VR No. 7: 9/26/12; 9:50:12) As Mr. Demetre testified that he was stressed because of the large amount of money being claimed by the Harrises and did not know where that money would come from (VR No. 7: 9/26/12; 3:41:37), that settlement clearly was in Mr. Demetre’s best interest. Yet

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<sup>1</sup> Indiana Insurance was a defendant in the lawsuit filed by Mahannare Harris.

at trial Mr. Demetre described the settlement as outrageous (VR No. 7: 9/26/12; 3:59:27), although he admitted the settlement caused him no harm. (VR No. 7: 9/26/12; 4:53:45)

**D. Despite Indiana Insurance's defense and indemnification, the bad faith claim proceeds to verdict.**

Mr. Demetre admitted that Indiana Insurance never denied him coverage, had defended him at all times, and had indemnified him. (VR No. 7: 9/26/12; 4:54:06)

Based on those undisputed facts, Indiana Insurance moved for summary judgment on Mr. Demetre's bad faith claims. The trial court denied that motion in an Order entered on May 30, 2012. (TR 1789)

The case originally was set for trial on June 4, 2012. However, because of construction at the Campbell County courthouse, the trial date was reassigned to September 20, 2012. At trial, the only testimony about Mr. Demetre's alleged emotional distress came from Mr. Demetre himself, who testified that his dealings with Indiana Insurance had caused him stress because it was something he thought about all the time and that it resulted in, for example, him saying things he should not say to the people he loved. (VR No. 7: 9/26/12; 4:06:43) He testified that he wondered if he was looking at bankruptcy.<sup>2</sup> (VR No. 7: 9/26/12; 3:41:50) Yet Mr. Demetre also testified that he exercised for two hours five times a week (VR No. 7: 9/26/12; 4:59:50); his medication had been the same for forty years and that did not change as a result of his dealings with Indiana Insurance (VR No. 7: 9/26/12; 4:58:04); he suffered no physical health problems because of his alleged emotional distress (VR No. 7: 9/26/12; 4:59:15); and in March

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<sup>2</sup> Indiana Insurance was not allowed to challenge this testimony by questioning Mr. Demetre about a prior bankruptcy and his felony conviction involving dishonesty. (VR No. 7: 9/26/12; 4:25:37)

2012 he received a clean bill of health from his physician. (VR No. 7: 9/26/12; 4:57:50) Mr. Demetre further testified that he had never been to any counselor, psychologist, or psychiatrist for the stress about which he testified.<sup>3</sup> (VR No. 7: 9/26/12; 4:59:28) Mr. Demetre's doctor told him that, at 72 years old, Mr. Demetre has the body of a 30-year old. (VR No. 7: 9/26/12; 3:13:32)

Mr. Demetre offered the testimony of Carl Grayson, a practicing attorney, in support of his bad faith claim. Grayson agreed with Indiana Insurance that there were coverage issues upon which Indiana Insurance could reserve its rights (VR No. 7: 9/26/12; 2:28:54) and that a declaratory judgment action is a proper device for an insurer to use to resolve coverage issues (VR No. 7: 9/26/12; 2:04:00). But he was critical of Indiana Insurance for not resolving those coverage issues in an expeditious manner and for not investigating the claims asserted against Mr. Demetre. (VR No. 7: 9/26/12; 11:24:45) Mr. Grayson also was critical of Mr. Schenkel, criticizing a perceived delay in deposing the plaintiffs in the tort action and in hiring experts (VR No. 7: 9/26/12; 11:26:10, 1:22:00), and specifically suggesting that Mr. Schenkel was not doing much to defend Mr. Demetre. (VR No. 7: 9/26/12; 1:41:45)

At the end of Mr. Demetre's case, Indiana Insurance moved for a directed verdict because the evidence showed that Indiana Insurance had provided to Mr. Demetre a defense and indemnification, the two things to which he was entitled, and because there was insufficient evidence of Mr. Demetre's alleged emotional distress. The trial court denied Indiana Insurance's motion for a directed verdict.

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<sup>3</sup> Mr. Demetre testified that his priest provided spiritual counseling (VR No. 7: 9/26/12; 4:07:43), but there was no evidence of the substance of that counseling. The priest did not testify.

Because the trial court had allowed Mr. Demetre to complain about events that had happened in litigating the coverage dispute in support of his claim for bad faith (such as testifying that it was degrading to be deposed (VR No. 7: 9/26/12; 4:01:40)), Indiana Insurance sought to introduce the testimony of Don Lane, who had represented Indiana Insurance in the declaratory judgment action, and Tim Schenkel. Although Mr. Lane and Mr. Schenkel had appeared on Indiana Insurance's witness list prior to the original June trial date, the court had ruled that they could not testify trial because Mr. Demetre's counsel had not been able to depose them. Despite Mr. Demetre's counsel being given the opportunity to depose them when the trial date was moved from June to September, the trial court did not allow Mr. Lane and Mr. Schenkel to testify at the September trial except by avowal.

Mr. Schenkel testified by avowal that the case initially focused on plaintiffs' motion for an emergency temporary injunction, which the court denied in April 2010. (VR No. 7: 9/26/12; 12:26:17) At a status conference with the court in July 2010, the parties discussed with the court how the case should move forward. (VR No. 7: 9/26/12; 12:31:03) Jeff Sanders, Mr. Demetre's counsel, reported to the court that he did not want Mr. Schenkel to be taking depositions in the tort case while the coverage issues were pending and suggested that the coverage issues should be resolved first. (*Id.*) The court indicated that was fine, so the parties and the court agreed that the declaratory judgment claim would be resolved before the tort case would move forward. (*Id.*) Mr Schenkel's avowal testimony on these issues was unchallenged, either through cross examination or by introducing contrary testimony from Mr. Sanders or anyone else.

Indiana Insurance again moved for a directed verdict at the close of all the evidence. The trial court denied that motion. The case was then submitted to the jury under a set of instructions setting forth three causes of action: (1) breach of contract; (2) violation of the Unfair Claims Settlement Practices Act; and (3) violation of the Consumer Protection Act. The jury found for Mr. Demetre on all three theories. The only compensatory damages awarded by the jury were \$925,000 for Mr. Demetre's "emotional pain and suffering, stress, worry, anxiety, or mental anguish . . . ." The jury also awarded \$2,500,000 in punitive damages. (TR 2104, Apx. 1)

Indiana Insurance filed a motion for judgment notwithstanding the verdict or for a new trial (TR 2133). While that motion was pending, Indiana Insurance brought to the court's attention this Court's Opinion in *Osborne v. Keeney*, 399 S.W.3d 1 (Ky. 2013), in which this Court held that for claims for emotional distress, "a plaintiff will not be allowed to recover without showing, by expert or scientific proof that the claimed emotional injury is severe or serious." 399 S.W.3d at 6. The trial court did not mention *Osborne* either at a hearing on January 17, 2013, or in the Order overruling the motion for judgment nov entered on February 5, 2013. (TR 2757, Apx. 2)

Mr. Demetre subsequently moved for an award of attorneys' fees of \$1,006,991. (TR DD) In a February 8, 2013 Order, the court denied that motion, except in the event the verdict under the Consumer Protection Act was affirmed and the overall verdict in favor of Mr. Demetre was reduced below the amount claimed by Mr. Demetre as fees, in which case Mr. Demetre would be entitled to an award of fees in an amount to get him back up to a total award of \$1,006,991. (TR 2762, Apx. 3)

**E. Court of Appeals renders opinion contrary to rulings from this Court.**

In a 39-page to-be-published Opinion authored by Judge Thompson and joined by Judges Combs and Stumbo, the Court of Appeals affirmed. As for whether Mr. Demetre had provided sufficient evidence of bad faith conduct on Indiana Insurance's part, the Court of Appeals never stated or even suggested that Indiana Insurance's coverage defenses were meritless. Nonetheless, the Court of Appeals affirmed the jury's bad faith verdict because, according to the Court of Appeals, an insurer "cannot simply defend under a reservation of rights and force it's insured to litigate the issue of coverage and, after coverage is established, then claim no harm, no foul." Opinion, at 20.

Previously, however, this Court has repeatedly recognized that: (1) an insurer can offer a defense pursuant to a reservation of rights; (2) an insurer can raise and pursue coverage issues; and (3) an insurer's litigation conduct cannot be the basis of a bad faith claim. Thus, Kentucky law would seem to be that an insurer can provide a defense pursuant to a reservation of rights while coverage issues are resolved without facing bad faith liability in the event coverage is found to exist. But the Court of Appeals held otherwise in affirming the bad faith verdict in plaintiff's favor.

In connection with plaintiff's bad faith claim under the Consumer Protection Act, the Court of Appeals held that plaintiff had suffered an "ascertainable loss" even though the only damages awarded by the jury were for emotional distress and punitive damages. According to the Court of Appeals, the attorneys' fees incurred in defending the declaratory judgment claim were an "ascertainable loss" for purposes of the Consumer Protection Act, even though Mr. Demetre was not awarded those fees.

On the issue of *Osborne v. Kenney's* applicability, the Court of Appeals stated that "we decline to extend *Osborne's* requirement that emotional distress be proven by

expert medical or scientific proof to claims brought pursuant to the Unfair Claims Settlement Practices Act.” Opinion, at 31-32. Thus, although this Court in *Osborne* said without qualification that a person seeking to recover for emotional distress must prove his or her claim with medical or scientific proof, the Court of Appeals did not so apply it.

#### ARGUMENT

#### **I. The trial court erred in not granting Indiana Insurance’s motion for directed verdict and motion for judgment nov.**

This issue was preserved in Indiana Insurance’s motions for a directed verdict (VR No. 8: 9/27/12; 12:33:34, 5:32:04) and its motion for judgment notwithstanding the verdict. (TR 2133)

While Mr. Demetre phrased his first claim against Indiana Insurance as being for breach of contract,<sup>4</sup> he did not cite to any provision of the insurance policy Indiana Insurance supposedly breached. In reality, there was no dispute that Indiana Insurance complied with the duties imposed upon it by the policy. Those duties were aptly described by Justice Cooper:

Finally, although the complaint appears to allege a breach of contract, the contract of insurance in this case only required Guaranty National to provide Appellees with a defense to the tort action and to pay any judgment up to its policy limits. A defense was provided and the tort claim was settled before judgment. Nothing in the contract precludes either party from seeking a judicial construction of its terms.

*Guaranty Nat’l Ins. v. George*, 953 S.W.2d 946, 951 (Ky. 1997) (Cooper, J., concurring).

The evidence at trial established that Indiana Insurance provided both a defense and indemnity to Mr. Demetre. In fact, the trial court correctly recognized that Indiana

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<sup>4</sup> The trial court instructed the jury on a breach of contract theory, which was error. See pages 40-42, *infra*.

Insurance had not breached the contract of insurance. *See* Order of April 26, 2011 (TR 344, Apx. 5), at 7 (“Because the Court finds Indiana has not breached the contract, the Court need not reach the question of damages . . . .”). Mr. Demetre himself admitted that Indiana Insurance had never denied him coverage, had defended him, and had indemnified him. (VR No. 5: 9/26/12; 4:54:16)<sup>5</sup>

Instead of alleging the breach of any actual provision of the policy, Mr. Demetre alleged a series of supposedly wrongful acts committed by Indiana Insurance. *See* Amended Cross-Claim (TR 358) Thus, as with his other claims brought under the Unfair Claims Settlement Practices Act and the Consumer Protection Act, plaintiff’s supposed breach of contract claim actually was a bad faith claim.

In *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993), this Court recognized the three theories upon which a bad faith claim against an insurer could be based. *See* 864 S.W.2d at 886. As this Court expressly recognized in *Davidson v. American Freightways, Inc.*, 25 S.W.3d 94 (Ky. 2000), the Court in *Wittmer* “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 claimant or a third-party claimant, and whether premised upon common law theory or a statutory violation.” 25 S.W.3d at 100. That test provides:

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

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<sup>5</sup> As it had a right to do, Indiana Insurance provided that defense to Mr. Demetre subject to a reservation of rights. The trial court recognized that an insurer does not breach its contract with the insured by providing the insured with counsel pursuant to a reservation of rights. (Order of May 30, 2012 (TR 1789, Apx. 6) at 4 (“A reservation of rights, even if later proven to be incorrect, does not equate to bad faith or a breach of contract.”)) At no time was Mr. Demetre without Indiana Insurance-provided counsel.

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.

*Wittmer, supra*, 864 S.W.2d at 890, quoting from *Federal Kemper Ins. Co. v. Hornback*, 711 S.W.2d 844, 846-47 (Ky. 1986) (Leibson, J., dissenting).

Mr. Demetre actually does not fit into any of the bad faith theories described in *Wittmer*. He was not a third-party claimant injured by a tortfeasor seeking recovery under the tortfeasor's liability insurance policy. Nor was he a first-party claimant seeking to recover under his or her own policy of insurance for damages to personal or real property insured under the policy. Mr. Demetre was not a claimant at all. Instead, Mr. Demetre was an insured against whom a claim was asserted. While an insured in such a position may have a bad faith claim in very narrow circumstances, the evidence established that Indiana Insurance was entitled to judgment in its favor as a matter of law on Mr. Demetre's bad faith claims.

**A. Indiana Insurance had a right to raise coverage issues and file a declaratory judgment action without facing liability for bad faith.**

This Court considered a bad faith claim brought by an insured against whom a claim had been asserted in *Guaranty National Ins. Co. v. George, supra*. In *George*, the insurer, as Indiana Insurance did here, provided a defense to its insured and also requested the court to declare the parties' rights as to whether coverage existed for the claim. In affirming the summary judgment granted the insurer on the insured's bad faith claim, this Court held that it was "not inclined to deprive an insurer of its election to explore its legal remedy." 953 S.W.2d at 946.

This Court’s opinion in *George* should have controlled. The facts in *George* are similar to those here: (1) an insured was sued; (2) the insurer defended under a reservation of rights because the facts indicated that there was a coverage issue; (3) the insured filed a bad faith claim against the insurer; (4) the trial court granted summary judgment to the insured on the coverage issue<sup>6</sup>; and (5) the insurer settled the underlying lawsuit within policy limits. Under the circumstances, the trial court found that the coverage question was “fairly debatable” and dismissed the bad faith claim because “[i]t should not be left to a jury to determine whether the legal principles involved are ‘fairly debatable.’” *George*, 953 S.W.3d at 948. Although the Court of Appeals reversed the trial court in *George*, this Court reversed the Court of Appeals and affirmed the trial court. Even though “in retrospect” the coverage issues may appear clear and undebatable, when there is a reason that coverage may be excluded, “we do not believe it is bad faith for a party to ask a court to either reform or decline to reform the policy.” *Id.* at 949. In other words, the insurer’s conduct did not meet the “bad faith threshold,” and the trial court correctly dismissed the bad faith claim rather than letting a jury decide whether the coverage question was “fairly debatable.” Here, in marked contrast, the trial court and Court of Appeals let the jury decide whether Indiana Insurance had the right to file a declaratory judgment action—an action in which the trial court *denied* Mr. Demetre’s motion for summary judgment on the coverage issue.

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<sup>6</sup> Here, the facts are even stronger for the insurer. Although the trial court declined to adopt the known loss rule, it denied plaintiff’s motion for summary judgment regarding coverage because there was sufficient evidence in the record regarding Mr. Demetre’s knowledge that Indiana Insurance could have prevailed on the coverage issue.

**B. The Court of Appeals has recently properly applied *George* in factually similar circumstances.**

The Court of Appeals understood *George*'s direction that an insurer should not be deprived of its election to explore its legal remedy when it recently affirmed the dismissal of a bad faith case in *Settles v. Owners Ins. Co.*, 2015 Ky. App. Unpub. LEXIS 623 (Ky. App. 2015) (Apx. 14). *Settles* involved insureds who were sued for injuries incurred by the plaintiff in a fall on property owned by the insureds. Owners Insurance provided the insureds with a defense, but also filed a declaratory judgment action raising a coverage issue based on whether the plaintiff was an employee of the insureds (which would make an exclusion for bodily injury to an employee of the insured applicable). Owners Insurance eventually settled the claims against its insureds.

The allegations of bad faith in *Settles* were much the same as they are here: the insured breached its duty to its insureds by causing them expenses in defending against the declaratory action (slip op. at \*2); the insurer acted in bad faith in not trying to settle the underlying claim but instead “fil[ed] the declaratory action at the time and in the manner that it did” (*id.*, at \*3); and the insurer “fail[ed] to seek dismissal of [plaintiff’s] case against them” and instead filed the declaratory judgment action. *Id.*, at \*9. The Court of Appeals in *Settles* recognized that the facts as alleged by the insureds, which were accepted as true for purposes of the motion to dismiss, “appear at first blush to be facts which, if proven, could provide a basis for relief.” *Id.*

Yet the Court of Appeals in *Settles* dug deeper and held that the facts alleged therein did not constitute bad faith as a matter of law. That is the step missing in this case. Here, the trial court and Court of Appeals never moved past that first blush impression, and instead let the jury decide whether similar facts could constitute bad faith

on Indiana Insurance's part. That was error, as both the trial court and the Court of Appeals in this case should have recognized what the Court of Appeals recognized in *Settles*: those facts are insufficient to constitute bad faith as a matter of law.

The Court of Appeals in *Settles* started with this Court's decision in *George*, *supra*. Challenging the existence of coverage while providing a defense to an insured and eventually settling the claims against the insured simply does not constitute bad faith:

Our Supreme Court has permitted the dismissal of a bad faith claim brought after an insurance company sought to resolve coverage issues via a declaratory action. See *Guaranty Nat. Ins. Co. v. George*, 953 S.W.2d 946, 44:11 Ky. L. Summary 28 (Ky. 1997). We agree with the *Settles* that the majority opinion in *George* did not foreclose the viability of bad faith claims following the filing of a declaratory judgment. Indeed, the Court stated that it could "envision" circumstances where a bad faith claim would be appropriate. *George* at 949. However, the Court concluded that where an insurance company provided a defense to its insured, paid on the underlying claim, but challenged the legitimacy of coverage by filing a declaration of rights action, such did not cross the "threshold" of bad faith. *George* at 949. On the contrary, the trial court refused "to deprive an insurer of its election to explore its legal remedy." *Id.*, citing *Empire Fire & Marine v. Simpsonville Wrecker*, 880 S.W.2d 886 (Ky. App. 1994). The facts in *George* square with those before us, compelling a similar result.

*Id.* at \*8-9.

As Mr. Demetre does here, the insureds in *Settles* argued that their bad faith claim was not based solely on the filing of the declaratory judgment action but instead argued that the bad faith claim also was based on the insurer's rejection of the claimant's final settlement demand at mediation without making a counteroffer, the filing of the declaratory judgment action close to the mediation (which had the effect of undermining their case against the plaintiff), and the failure to seek dismissal of the tort case against

them. The Court of Appeals in *Settles* rejected the argument that an insurer can be found to have acted in bad faith for such actions:

Consistent with this vital and long-held principle, the present case was not the proper venue to challenge the decisions of counsel in the underlying negligence action. Owners had no control over counsel's decisions in that case. Furthermore, Owners Insurance's decision to file a declaratory action was very likely the only means of avoiding a conflict of interest while possessing doubts regarding Owners Insurance's liability for the claim. More to the ultimate question on appeal, the well-established principle establishing counsel's sole duty to the Settles and independence from the Owners Insurance constituted a legal bar to the Settles' claims of negligence and bad faith.

*Id.*, at \*10-11.

**C. The Sixth Circuit recognizes that Kentucky law allows an insurer to raise coverage disputes without opening itself up to a bad faith claim.**

The Sixth Circuit Court of Appeals reached a similar result under Kentucky law in *Philadelphia Indem. Ins. Co. v. Youth Alive, Inc.*, 732 F.3d 645 (6th Cir. 2013), in which an insured nonprofit corporation (Youth Alive) was sued for the deaths of four passengers in an auto accident. The insurer, Philadelphia Indemnity, provided a defense to Youth Alive pursuant to a reservation of rights. Philadelphia Indemnity also filed a declaratory judgment action raising an issue as to whether an exclusion for bodily injury arising from the use of an automobile by an insured applied. The trial court in the declaratory judgment action held that Philadelphia Indemnity was obligated to defend and indemnify Youth Alive under its Commercial General Liability policy. Subsequent to that determination, Philadelphia Indemnity settled the wrongful death claims against Youth Alive.

Thus, the factual scenario in *Philadelphia Indemnity* is much the same as it was here: the insurer provided a defense pursuant to a reservation of rights while raising

coverage issues in a declaratory judgment action, and then settled the claims against its insured. Also like here, the insured in *Philadelphia Indemnity* alleged that the insurer's conduct "caused Youth Alive to suffer significant damages – including cessation of its operations – during the pendency of the underlying litigation." 732 F.3d at 649.

In rejecting the insured's claim for those damages as a matter of law, the Sixth Circuit reviewed the Kentucky cases recognizing an insurer's right to raise coverage issues and held:

Thus, when an insured's claim implicates an "unresolved legal issue" – such as when recovery under an insurance policy is "dependent upon a legal issue of first impression in Kentucky courts," *id.* at 375 – the claim is "fairly debatable as a matter of law and will not support a claim of bad faith." *Empire*, 880 S.W.2d at 891. Because the courts do not expect an insurer to "subject . . . itself to the risk of subsequently being sued for the tort of bad faith" simply for litigating a first-impression issue, 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, even if in hindsight it was "fairly predictable" that the dispute would be resolved against the insurer.

*Id.* at 650.

The Sixth Circuit also rejected the insured's argument that the insurer's delay in settling the claim and creating "adversarial hoops" to coverage could constitute bad faith. *See id.* at 650-51. In fact, the Sixth Circuit correctly recognized that providing a defense pursuant to a reservation of rights while pursuing a declaratory judgment action, which is exactly what Indiana Insurance did here, is the "preferred course of conduct":

Finally, to the extent that Youth Alive asserts that Philadelphia Indemnity proceeded in bad faith by unreasonably delaying settlement and erecting "needless adversarial hoops" as preconditions to Youth Alive's indemnification, we disagree. *Farmland*, 36 S.W.3d at 376 (quotation marks omitted); *see Phelps*, 680 F.3d at 733.

The only dilatory tactic alleged by Youth Alive is that Philadelphia Indemnity refused to settle the estates' claims against Youth Alive pending the outcome of its declaratory judgment action in the district court. But, as indicated, Philadelphia Indemnity's litigation stance in the district court was reasonable. When coverage is reasonably in dispute, the preferred course of conduct for an insurance company is what occurred in the present case: (1) a defense of its insured's underlying personal injury action under a reservation of rights; and (2) a separate declaratory action adjudicating the issue of coverage.

*Id.*

The trial court and Court of Appeals in this case erred when they reached a diametrically opposite result. Instead of recognizing an insurer's right to file a declaratory judgment action and the necessary consequences flowing from the recognition of that right, the courts below stopped at what the Court of Appeals in *Settles* described as a first blush impression and let the jury decide whether it believed Indiana Insurance should have had the right to file a declaratory judgment action. But the trial court and the Court of Appeals instead should have recognized and protected Indiana Insurance's right as a matter of law to raise coverage issues and to file a declaratory judgment action. The Court of Appeals decision letting the jury decide whether Indiana Insurance had the right to file a declaratory judgment action was error.

And the Court of Appeal's statement that "it is the rule that an insurer cannot simply defend under a reservation of rights and force its insured to litigate the issue of coverage and after coverage is established, then claim no harm, no foul," Opinion, at 20, evidences a basic misunderstanding of the law. Such a pronouncement equates to a rule of law that an insurer raises coverage issues at its own risk; if it loses on the coverage issues, it faces potential bad faith liability for having raised the coverage issues. While that was the rule of law applied in this case, it is directly contrary to the law established

in *George* and applied in *Settles* and *Philadelphia Indemnity*. As explained in *Philadelphia Indemnity*, “the court does not expect an insurer to ‘subject . . . itself to the risk of subsequently being sued for the tort of bad faith’ simply for litigating a first-impression issue. . . .” 732 F.3d at 650. But that is exactly what happened to Indiana Insurance here.

**D. This case does not reach the bad faith “threshold” established in *George*.**

Mr. Demetre attempts to avoid the application of the true rule of law by attaching himself to the statement in *George* that the Court could “envision” situations in which an insurer abuses its legal prerogative in requesting a court to determine coverage issues, with the Court in *George* stating that those may well be addressed by a Rule 11 motion or, in certain circumstances, an action for bad faith. *See* 953 S.W.2d at 949. That statement does not mean a jury gets to decide in a bad faith case whether the insurer had a right to file a declaratory judgment action.

As recognized by the Court of Appeals in *Settles, supra*, this Court in *George* concluded that “where an insurance company provided a defense to its insured, paid on the underlying claim, but challenged the legitimacy of coverage by filing a declaration of rights action, such did not cross the ‘threshold’ of bad faith.” Slip op., at \* 9. This Court in *George* expressly recognized that whether a coverage issue is fairly debatable should not be left up to a jury. 953 S.W.2d at 948. Just as the Court of Appeals in *Settles* said that the facts in *George* “square with those before us,” the facts of *George* square with the facts before this Court in this case. As in *George, Settles* and *Philadelphia Indemnity*, Indiana Insurance was entitled to judgment in its favor as a matter of law.

In addition, the trial court already had found that a reasonable basis existed for

Indiana Insurance's raising of the known loss doctrine. The property was contaminated at the time Mr. Demetre acquired the property and when he added it to his Indiana Insurance policy. Further, the known loss/loss in progress had been recognized under Kentucky law. In fact, the federal court in *Pizza Magia v. Assurance Co. of America*, *supra*, recognized that the known loss doctrine "is widely accepted as a fundamental principle of insurance law." 447 F. Supp. 2d at 775. In such circumstances, and as recognized by the trial court, there was enough evidence for Indiana Insurance to raise those issues. As recognized in *George*, an insurer in that situation has an absolute right to raise and pursue such issues. The trial court's later decision to not apply the known loss/loss in progress doctrine because no Kentucky state appellate court had applied the doctrine simply confirmed that it was an issue of first impression in Kentucky. An insurer must be able to raise such issues without facing allegations that it acted in bad faith in doing so. *Empire Fire & Marine Ins. Co. v. Simpsonville Wrecker Service, Inc.*, 880 S.W.2d 886, 891 (Ky. App. 1994).

**E. The filing of a declaratory judgment action cannot give rise to a bad faith claim.**

Finally, the filing of a declaratory judgment claim cannot give rise to a claim for bad faith, as the remedy for the allegedly improper filing of a declaratory action would be Rule 11 sanctions, not an award of bad faith damages. *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512 (Ky. 2006). This Court in *Knotts* analyzed various approaches to what role litigation conduct should play in a bad faith action and held that it should play no role. Indeed, evidence of litigation conduct should not even be admissible in a bad faith action because permitting evidence of an insurer's litigation strategies "would impede insurers' access to the courts and right to defend, because it makes them reluctant to contest

coverage of questionable claims.” 197 S.W.3d at 521. Under *Knotts*, any alleged improper conduct in the filing and handling of litigation is to be dealt with under the Rules of Civil Procedure since “[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 [in a bad faith action].” *Id.*

The statement in *George* that the filing of a declaratory judgment action might be addressed in certain circumstances in a bad faith action was effectively overruled once this Court held in *Knotts* that litigation conduct could not be the basis of a bad faith action. Thus, even if there was not a reasonable basis for filing the declaratory judgment action, the bad faith verdict cannot stand because a bad faith action is not the proper vehicle to seek recovery for the alleged wrongful filing of a declaratory judgment action.

This case presents a great example why that is the case. In discussions with the trial court, Mr. Demetre’s personal counsel suggested and the trial judge agreed that the tort claim should be slowed down until the coverage issues were resolved. (VR No. 7: 9/26/12; 12:31:03 (avowal testimony of Timothy Schenkel); Defendant’s ex. 3) Then Mr. Demetre was allowed to present an opinion and to argue that the delay was the result of Indiana Insurance’s bad faith. That exemplifies why the filing of and conduct of the declaratory judgment action cannot be the basis of a bad faith action.

**F. Mr. Demetre’s dissatisfaction with his counsel cannot be the basis of a bad faith claim against Indiana Insurance.**

Mr. Demetre’s unhappiness with the actions of Timothy Schenkel, the counsel initially retained to represent Demetre, also was a supposed basis for his bad faith claim against Indiana Insurance. But such unhappiness cannot turn into a bad faith claim

against Indiana Insurance as a matter of law. The attorney's duty to exercise independent professional judgment on behalf of the insured the attorney represents negates the possibility that the acts of the attorney should expose the insurer to liability for the attorney's allegedly negligent acts. As the Massachusetts Supreme Court decided:

[W]e consider here whether an insurer who hires an attorney to defend its insured may be liable for any negligence by that attorney in the representation of the insured. "Since an insurer is not permitted to practice law, it must rely on independent counsel for conduct of litigation, and in doing so it does not assume a nondelegable duty to present an adequate defense. Since the conduct of the litigation is the responsibility of trial counsel, the insurer is not vicariously liable for the negligence of the attorneys who conduct the defense for the insured." . . . . It is the lawyer who controls the strategy, conduct, and daily details of the defense. To the extent that the lawyer is not permitted to act as he or she thinks best, the lawyer properly can withdraw from the case. . . . In these circumstances, an insurer cannot be vicariously liable for the lawyer's negligence.

*Herbert A. Sullivan, Inc. v. Utica Mut. Ins. Co.*, 788 N.E.2d 522, 538-40 (Mass. 2003).

This rule has been universally applied. See *Mirville v. Allstate Indem. Co.*, 87 F. Supp. 2d 1184, 1191 (D. Kan. 2000) (Although plaintiff went to "great lengths" to establish the shortcomings of the retained counsel's representation, "[i]f Joseph Mirville feels as though the failure to investigate in some way damaged him, it seems as though the proper course of conduct would be to file suit against Mr. McGrath for legal malpractice rather than Allstate for bad faith."); *Merritt v. Reserve Ins. Co.*, 34 Cal. App. 3d 858, 880 (Cal. App. 1973) ("We do not accept the claim that vicarious liability falls on one who retains independent trial counsel to conduct litigation on behalf of a third party when retained counsel have conducted the litigation negligently."); *Marlin v. State Farm Mut. Auto. Ins. Co.*, 761 So. 2d 380, 381 (Fla. App. 2000) ("Here, the insurer complied with its

obligation by retaining the attorney. The insurer has no obligation or right to supervise or control the professional conduct of the attorney, it is not liable for the litigation decisions of counsel.”); *Brocato v. Prairie State Farmers Ins. Ass’n*, 520 N.E.2d 1200, 1203 (Ill. App. 1988) (“Any complaints that the insured might have about the conduct of the litigation itself must be directed to the attorneys themselves.”); *Feliberty v. Damon*, 527 N.E.2d 261, 265 (N.Y. App. 1988); *State Farm Mut. Auto. Ins. Co. v. Traver*, 980 S.W.2d 625, 626 (Tex. 1998).

The Court of Appeals recently recognized and applied this rule in *Settles v. Owners Ins. Co.*, *supra*. The plaintiffs based their bad faith claims on, among other things, the retained counsel’s failure to assert the exclusive remedy provisions of the Workers Compensation Act as a defense or otherwise seek dismissal of the claims against them. The Court of Appeals in *Settles* held that the retained counsel’s failures cannot be the basis of a bad faith claim against the insurer:

Insurance-related litigation often involves a tripartite relationship between an insured, and insurer, and counsel hired by the latter to represent the interests of the former. In such a relationship, “the interest of the insured and the insurer frequently differ.” *Kuhlman Electric Corp. v. Chappell*, 2005 Ky. App. Unpub. LEXIS 1185, 2005 WL 3243498 (Ky. App. 2005), *aff’d*, *Chappell v. Kuhlman Electric Corp.*, 304 S.W.3d 8 (Ky. 2009). Therefore, our Courts have, and out of necessity, established that, in the context of insurance litigation, “no man can serve two masters[.]” *American Ins. Ass’n v. Kentucky Bar Ass’n*, 917 S.W.2d 568, 571 (Ky. 1996), *citing Kentucky Fair Bd. V. Fowler*, 310 Ky. 607, 221 S.W.2d 435 (Ky. 1949). “[T]he defense attorney’s primary duty of loyalty lies with the insured, and not the insurer.” *Kuhlman*, 2005 Ky. App. Unpub. LEXIS 1185 [WL] at 18.

Consistent with this vital and long-held principle, the present case was not the proper venue to challenge the decisions of counsel in the underlying negligence action.

Owners had no control over counsel's decisions in that case. Furthermore, Owners Insurance's decision to file a declaratory action was very likely the only means of avoiding a conflict of interest while possessing doubts regarding Owners Insurance's liability for the claim. More to the ultimate question on appeal, the well-established principle establishing counsel's sole duty to the Settles and independence from Owners Insurance constituted a legal bar to the Settles' claims of negligence and bad faith.

*Slip op.*, \* 10-11.

The Court of Appeals in *Settles* correctly analyzed the law in this area. Indeed, the Rules of Professional Conduct adopted by this Court *require* independence and diligence of a lawyer representing a client – a set of requirements separate and distinct from anything an insurance company could control even if it wanted to. *See* SCR 3.130(1.1), *et seq.* If Mr. Demetre was not satisfied with his counsel, his remedy was against that counsel, not backdoored through a bad faith claim against Indiana Insurance.<sup>7</sup>

Mr. Demetre had his offered expert, Mr. Grayson, restate Mr. Demetre's displeasure with Mr. Schenkel as a form of bad faith on the part of Indiana Insurance. As Mr. Grayson's opinion in that regard is fundamentally at odds with Kentucky law, his testimony did not create factual issues to be submitted to the jury. If that were the case, every bad faith case in which the plaintiff offers expert testimony would be submitted to the jury. That certainly is not the case. *See, e.g., United Services Auto. Ass'n v. Bult*, 183 S.W.3d 181 (Ky. App. 2003) (insurer was entitled to a directed verdict on bad faith claim even though four experts testified that insurer had acted in bad faith).

Mr. Demetre also tries to turn Mr. Schenkel's supposed deficiencies into Indiana

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<sup>7</sup> As recognized by the trial court in its Order of April 26, 2011 (TR 344), what Mr. Demetre really wanted was "an Order discharging Attorney Schenkel and requiring Indiana to pay for counsel of his choosing." The trial court did not enter such an Order and Indiana Insurance retained new counsel for Mr. Demetre.

Insurance's bad faith by alleging that Indiana Insurance controlled Mr. Schenkel's actions in defense of Mr. Demetre. The only evidence he offers on that point is that Mr. Schenkel was supposed to inform Indiana Insurance before incurring the expense of filing various motions and retaining experts. (VR No. 6:9/12; 10:07:07)

Mr. Demetre's argument in that regard is totally misplaced, because there is absolutely no evidence that Indiana Insurance instructed Mr. Schenkel to do or not do anything. In fact, the evidence was established that one of the first things Indiana Insurance did in the matter was to talk with that Mr. Schenkel about retaining an environmental expert (VR No. 6:9/24/12; 4:43:35) and to approve the expert being retained. (VR No. 6: 9/24/12; 4:44:14) There is no evidence that Indiana Insurance controlled anything that affected what Mr. Schenkel did or did not do in his defense of Mr. Demetre.

That is a good example of why Indiana Insurance was entitled to a directed verdict. The trial court and Court of Appeals allowed the case to go to the jury based on rhetoric instead of evidence. The evidence at trial established that Indiana Insurance at all times provided Mr. Demetre with counsel and never interfered with counsel's handling of the defense. It raised coverage issues and filed a declaratory judgment action, which it had a right to do. Indiana Insurance fully indemnified Mr. Demetre. Based on the evidence presented at trial, Indiana Insurance was entitled to a directed verdict. The trial court and the Court of Appeals erred in not recognizing that to be the case.

**G. Nothing else cited by Mr. Demetre’s proffered expert can support the bad faith verdict against Indiana Insurance.**

Mr. Grayson’s opinion that Indiana Insurance should have acted more quickly to investigate and resolve the coverage issues is directly contrary to an insurer’s right to seek resolution of coverage issues through a declaratory judgment action. That is particularly true here, where the primary coverage issue presented was an issue of first impression in Kentucky. His testimony also is directly contrary to the UCSPA not creating specific duties relating to the evaluation of a claim. *See Motorists Mutual Ins. Co. v. Glass*, 996 S.W.2d 437, 454 (Ky. 1997) (“[T]he UCSPA does not require that a claim be evaluated, or that it be evaluated correctly. It only requires that payment of a claim not be refused without conducting a reasonable investigation based on all available information.”). Further, his reliance of KRS 304.12-230(5) is misplaced as its reference to proof of loss statements indicates that it deals with the submission of first party claims. Mr. Demetre did not submit any proof of loss; he was sued and requested a defense and indemnity. Indiana Insurance provided him those things, but also exercised its right to raise coverage issues and file a declaratory judgment action. As a matter of law, Mr. Grayson’s opinions concerning Indiana Insurance’s supposed investigation/evaluation obligations, which were inconsistent with Kentucky law, were insufficient to create a triable fact.

The reference in *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 386, 375 (Ky. 2000), to an insurer’s obligation “to investigate, negotiate and attempt to settle the claim in a fair and reasonable manner” must be considered in context. As explained in *Lee v. Medical Protective Co.*, 901 F. Supp. 2d 648 (E.D. Ky. 2012), the bad faith claim in *Farmland* was brought by a claimant seeking a payment from the insurer and “the

language [concerning an insurer's duties] was clearly limited to cases where liability was a certainty." 901 F. Supp. 2d at 655. Indeed, not long after *Farmland* this Court reiterated the rule from *Motorists Mutual v. Glass* that there is no requirement that a claim be evaluated at all. See *Coomer v. Phelps*, 172 S.W.2d 389, 394 (Ky. 2005).

Again, Mr. Demetre's status as an insured against whom a claim was asserted puts him in a much different position than an injured party seeking a payment from the insurer. As a party against whom a claim was asserted, Mr. Demetre was entitled to the protections offered by a policy of liability insurance. Without dispute, he received those protections.

In addition, mere delay cannot be the basis of a finding of bad faith. *United Services Auto. Ass'n v. Bult*, *supra*, 183 S.W.3d at 190. For bad faith to exist, the delay must be the result of some evil motive or indifference on the insurer's part. *Id.*; *Wittmer supra*, 864 S.W.2d at 890. Here, Mr. Demetre tried to create a triable issue concerning the alleged delay in investigating the claim by arguing that the delay was caused by Indiana Insurance asserting the existence of coverage issues, which he has described as Indiana Insurance putting its own interests above the interests of its insured. But if, as recognized in *George*, an insurer has a right to raise coverage issues and file a declaratory judgment action, the insured cannot have a bad faith claim for alleged delay associated with the resolution of the coverage issues. Exercising a legal right does not constitute the type of outrageous conduct necessary to recover for bad faith under *Wittmer v. Jones*, *supra*. As recognized in *Philadelphia Indemnity*, that is the preferred course of conduct, not a tortious course of conduct.

Missing from the opinions offered by Mr. Grayson is what should or would have been done differently based on the results of any different type of investigation. If the investigation Mr. Grayson says was missing showed that the claims were baseless, Indiana Insurance would not have settled the claims and Mr. Demetre would have been sued. Of course, that is exactly what happened. If the investigation showed that there was merit to the claims, Indiana Insurance would have tried to settle the claims once the coverage issues were resolved. Again, that is what happened. In short, the evidence did not show what difference any other investigation would have made.

Also missing from Mr. Grayson's testimony was how Mr. Demetre supposedly was damaged by the alleged delay in investigating the claim. At all times, Mr. Demetre was being defended and was fully indemnified by Indiana Insurance.

In *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 500-01 (Ky. 1975), this Court held that an insurer has a duty to settle a claim against an insured if the failure to do so exposed the insured to an unreasonable risk of a verdict in excess of the available insurance coverage being entered against the insured. This was the original bad faith claim recognized in Kentucky, and Indiana Insurance complied with this duty and protected Mr. Demetre from a verdict in excess of the available insurance coverage by settling the Harris claims. But the duty recognized in *Manchester v. Grundy* has never been interpreted as creating a general duty to settle a third-party claim against an insured, much less to settle the claim against the insured "as quickly as possible" or within any certain amount of time. To the contrary, the Indiana Insurance policy grants Indiana Insurance the right to make decisions about settlement. Such a provision is proper and enforceable under Kentucky law. See *United Propane Gas, Inc. v. Federated Mut. Ins.*

*Co.*, 2007 Ky. App. Unpub. LEXIS 503, \* 9 (Ky. App. 2007) (Apx. 16) (Policy language giving the insurer discretion to settle any claim or suit that may result “vest[s] [the insurer] with the discretion to settle a claim according to its best judgment.”).

Indiana Insurance did what it should have done: (1) it provided Mr. Demetre with counsel; (2) it filed a declaratory judgment action to resolve debatable coverage issues; and (3) it resolved the claim asserted against Mr. Demetre within the policy limits. That being the case, it was error for the trial court to not grant Indiana Insurance a directed verdict on Mr. Demetre’s bad faith claim.

**H. The UCSPA was never intended to apply in this situation.**

While a private right of action under the Unfair Claims Settlement Practices Act was found to exist in *State Farm Mut. Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1989), the problems with recognizing a private cause of action when one was not intended are substantial. See, e.g., *Motorists Mutual Ins. Co. v. Glass*, 996 S.W.2d 437, 460 (Ky. 1997) (Lambert, J., dissenting) (“We would be remiss, however, if we did not observe that the statute is not specifically designed to accommodate third party claims. This, of course, makes trial nearly impossible and appellate review most difficult.”).

Chief Justice Lambert’s keen observation is even more true when the person asserting the private cause of action under the UCSPA is an insured against whom a claim has been asserted. The UCSPA is designed to afford protections to persons asserting a claim for benefits under the policy, and Mr. Demetre never asserted a claim for benefits under the policy. Instead, Mr. Demetre was an insured against whom a claim had been asserted.

As discussed above, Indiana Insurance satisfied the duties it owed to Mr. Demetre. His effort to shoehorn a bad faith claim under the UCSPA is misplaced. For

this additional reason, the courts below erred in not recognizing Indiana Insurance's right to pursue the coverage issues without facing potential liability for bad faith.

**I. Mr. Demetre suffered no ascertainable loss for purposes of the Consumer Protection Act.**

The trial court further erred in not granting Indiana Insurance's motions for a directed verdict and for judgment notwithstanding the verdict on Mr. Demetre's Consumer Protection Act claim for the additional reason that Mr. Demetre did not suffer any ascertainable loss of money or property as a result of Indiana Insurance's conduct. KRS 367.220 limits the remedy created therein to "any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, real or personal . . . ."

The evidence established that Mr. Demetre did not suffer any ascertainable loss of money or property as a result of Indiana Insurance's conduct. Mr. Demetre admitted that he was only seeking recovery for his alleged emotional distress and attorney fees. (VR No. 7: 9/26/12; 5:01:00) The only compensatory damages awarded by the jury were for plaintiff's alleged mental anguish, which is not an ascertainable loss of money or property. *See, e.g., Pagliari v. Johnson Barton Proctor and Rose, LP*, 708 F.3d 813, 820 (6th Cir. 2013) ("[S]everal Tennessee cases clearly hold that emotional distress is insufficient to state a claim under the TCPA."); *Cole v. Laughrey Funeral Home*, 869 A.2d 457, 463 (N.J. App. 2005) (emotional distress damages "constitute non-economic losses that are not recoverable under the CFA.").

In addition, attorney fees cannot satisfy the Act's requirement of an "ascertainable loss of money or property." *Holmes v. Countrywide Financial Corp.*, 2012 U.S. Dist. LEXIS 96587, slip op. at \* 41 n.3 (W.D. Ky. 2012) (Apx. 9); *Yates v. Bankers Life*, 420

F. Supp. 2d 809, 816 (W.D. Ky. 2010). Thus, the verdict under the Consumer Protection Act cannot be saved by the court's contingent, unliquidated award of attorney fees.

The Court of Appeals concluded that the fees Mr. Demetre incurred in connection with the declaratory judgment action were a sufficient "ascertainable loss" to satisfy the Consumer Protection Act. While that conclusion is consistent with the Court of Appeal's declaration that an insurer files a declaratory judgment action at its own risk, it best exemplifies the Court of Appeal's failure to recognize an insurer's right to file a declaratory judgment action. The Court of Appeals absolutely "deprive[d] an insurer of its election to explore its legal remedy," which this Court vowed to avoid in *Guaranty National Ins. Co. v. George, supra*. The Court of Appeals erred in doing so.

That is particularly true since Mr. Demetre did not recover those fees. Apparently, the Court of Appeals believed that a plaintiff does not have to actually prove an ascertainable loss or be awarded damages in connection with the alleged ascertainable loss. All a plaintiff must do to satisfy the Consumer Protection Act's ascertainable loss requirement is talk about a supposed ascertainable less. That simply is not the law.

**II. The evidence of Mr. Demetre's alleged emotional distress was insufficient to sustain an award of emotional distress damages.**

Indiana Insurance properly preserved the issue of whether Mr. Demetre presented sufficient evidence of his alleged emotional distress damages in multiple ways. It first raised the issue in its pre-trial Supplemental Memorandum on Emotional Distress Damages, arguing that Mr. Demetre was not entitled to emotional distress damages because "Mr. Demetre will not present an expert witness to testify to the nature and severity of his emotional distress" and that "Mr. Demetre has failed to identify an objective source that he has suffered emotional distress outside of his own self-serving

testimony.” (TR 1930, at 1941). It again raised the issue in its motion for a directed verdict at the end of Mr. Demetre’s case. (VR No. 8: 9/27/12; 12:33:34 (incorporating previously filed briefs and arguing: “There’s been no diagnosis by a doctor, been no treatment”)) Indiana Insurance raised the issue again in its motion for a directed verdict made at the close of all the evidence. (VR No. 8: 9/27/12; 5:32:04 (renewing motion for directed verdict for “all reasons discussed before”)). Indiana Insurance once again raised the issue in its motion for judgment notwithstanding the verdict. (TR 2133, at 2162-68). While that motion was pending, *Osborne v. Keeney*, 399 S.W.3d 1 (Ky. 2013), was decided and Indiana Insurance brought it to the court’s attention the day after it was decided. (TR 2391).

**A. *Osborne v. Keeney* applies in bad faith actions.**

The only compensatory damages awarded were \$925,000 for Mr. Demetre’s alleged emotional distress. In *Osborne v. Keeney*, 399 S.W.3d 1 (Ky. 2013), a legal malpractice claim, this Court held that “for claims involving emotional distress . . . , a plaintiff will not be allowed to recover without showing, by expert or scientific proof, that the claimed emotional injury is severe or serious.” 399 S.W.3d at 6. In abandoning the former physical impact rule, this Court recognized that “emotional tranquility is rarely attained and . . . some degree of emotional harm is an unfortunate reality of living in a modern society.” *Id.* at 17. To ensure that claims for emotional distress are genuine, any person asserting a claim for emotional distress must offer medical or scientific proof to support such a claim:

[R]ecover should be provided only for “severe” or “serious” emotional injury. A “serious” or “severe” emotional injury occurs when a reasonable person, normally constituted, would not be expected to endure the mental stress engendered by the circumstances of the case.

Distress that does not significantly affect the plaintiff's everyday life or require significant treatment will not suffice. And a plaintiff claiming emotional distress damages must present expert medical or scientific proof to support the claimed injury or impairment.

*Id.* at 17-18. The Opinion in *Osborne* applies retroactively. *Id.*, at 18.

In *Sergent v. ICG Knott County, LLC*, 2013 U.S. Dist. LEXIS 173102 (E.D. Ky. 2013), the court cogently explained why *Osborne v. Keeney* applies to all claims in which a party seeks to recover damages for emotional distress. First, “as the Supreme Court gave no indication that the expert testimony requirement was limited to some subset of cases, *Osborne* announced a generally applicable rule that applies to all claims for emotional distress.” Slip op., \* 17. Second, the Supreme Court’s logic in *Osborne* “confirms that *Osborne* meant precisely what it said.” *Id.*, \* 18. Third, each reason given by the Supreme Court for abandoning the impact rule weighs against limiting the new rule to a limited number of cases. The court concluded:

In conclusion, the language and logic of *Osborne* point in the same direction. In Kentucky, plaintiffs seeking damages for emotional distress must adduce expert testimony in support of their claim. The Sergents failed to obtain an expert here, so their claims for emotional damages are barred.

*Id.*, \* 21.

As someone “claiming emotional distress damages,” Mr. Demetre was required to “present expert medical or scientific proof to support the claimed injury. . . .” *Id.* at 17. Mr. Demetre presented nothing other than his own self-serving testimony. In fact, the evidence actually established that Mr. Demetre was not affected physically by anything Indiana Insurance did or did not do. Such evidence falls far short of the evidence necessary to support a claim for emotional distress damages under *Osborne v. Keeney*.

Notwithstanding such thoughtful analysis set forth in *Sergent* as to why the rule announced in *Osborne v. Keeney* is not limited to some subset of cases involving claims for emotional distress damages, other courts have limited the reach of this Court's decision in *Osborne*. See, e.g., *Smith v. Walle Corp.*, 2014 U.S. Dist. LEXIS 156859 \*9-11 (E.D. Ky. 2014) (Apx. 15). The courts so holding seem oblivious to the fact that this Court in *Osborne* never used the phrase "negligent infliction of emotional distress." *Powell v. Tosh*, 2013 U.S. Dist. LEXIS 63567, \*16 n.6 (W.D. Ky. 2013) (Apx. 12). In concluding that *Osborne* is not limited to certain types of claims, the court in *Powell* explained why *Osborne* should apply in any case in which emotional distress damages are sought:

Regardless of *Osborne*'s effect on the physical-impact rule or the need for expert proof, Plaintiffs here have neither alleged nor put forward any evidence that their alleged emotional distress has required significant treatment. As the Court noted in its prior Opinion, "Although some Plaintiffs recount mental or emotional distress as a result of the odors, none have sought or received treatment or counseling." (Docket No. 536, at 25 (footnote omitted).) The Kentucky Court's express purpose in imposing the serious/severe requirement was "to ensure claims are genuine." It follows that a genuine emotional distress injury is one that necessarily requires significant treatment. Here, no Plaintiff has sought significant treatment – in fact, no Plaintiff has sought *any* treatment. Because Plaintiffs have failed to establish an essential element of their negligence and negligence *per se* claims, summary judgment remains appropriate.

*Id.*, at \*17-18.

The only court to address the issue in a reported bad faith case did so only in dicta. In *Minter v. Liberty Mutual Fire Ins. Co.*, 2014 U.S. Dist. LEXIS 137741 (W.D. Ky. 2014), the court granted the insurer's motion for summary judgment on plaintiff's bad faith claim, finding that plaintiff's proof of alleged emotional damages was

insufficient even under the “clear and convincing” standard discussed in *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 454 (Ky. 1997).<sup>8</sup> Just as here, the plaintiff offered no real proof of emotional damages, entitling the insurer to summary judgment on plaintiff’s bad faith claim.

In dicta set forth in a footnote, the court suggested that *Osborne v. Keeney* might not apply in a bad faith case and criticized the insurer for not citing any authority applying *Osborne* in the context of bad faith. See slip op. at \*12 n.1. As *Osborne* had been decided less than 2 years before, there were no reported cases addressing whether *Osborne* applies in bad faith cases. Thus, in its dicta, the court in *Minter* suggested a standard that the insurer could not meet.

The recognition in *Powell v. Tosh, supra*, that “a genuine emotional distress injury is one that requires significant treatment” is particularly applicable in bad faith cases such as this one, in which Mr. Demetre asked for \$2,500,000 in emotional distress damages and was awarded \$925,000. That award was based solely on Mr. Demetre’s testimony, as he offered no supporting evidence of his alleged emotional distress.

It is not surprising that Mr. Demetre may have been experiencing stress, since a claim had been made against him and he had been sued by Ms. Harris. Those are certainly stress-inducing events. The only way to relieve an insured of that stress is to immediately pay the full amount sought by a claimant whenever a claim is made against an insured, regardless of the merits of the claim. If the insurer does not do that, the insured is facing the stress of having a claim made against them and a lawsuit filed

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<sup>8</sup> The true holding in *Minter* supports the insufficiency of Mr. Demetre’s proof of his alleged emotional distress damages even under the standard set forth in *Motorists Mutual v. Glass*.

against them. There is nothing that can be done about that, unless the insurer is required to pay every claim for the full amount sought.

Thus, the rationale for adopting the evidentiary standard in *Osborne* applies with full force to bad faith actions. That was recognized in the seminal case of *Anderson v. Continental Ins. Co.*, 271 N.W.2d 368 (Wis. 1978), in which the Wisconsin Supreme Court first concluded that “an insured may assert a cause of action in tort against an insurer for the bad faith refusal to honor a claim of the insured.” 271 N.W.2d at 371. After recognizing the parameters of the cause of action, the Wisconsin Supreme Court considered the damages available for an insurer’s bad faith. First, absent evidence that the insurer intentionally inflicted emotional distress upon the claimant, “substantial other damages in addition to the emotional distress are required if there is to be recovery for damages resulting from the infliction of emotional distress.” *Id.* at 378. Thus, “the plaintiff must plead and prove substantial damages aside and apart from the emotional distress itself and the damages occasioned by the simple breach of contract” in order to recover emotional distress damages. *Id.*

Second, in addition to proving substantial damages in addition to the emotional distress, a plaintiff must prove that the emotional distress was severe:

[I]n no circumstance may a plaintiff recover for emotional distress, even when there are other accompanying damages, unless the emotional distress is severe. A recovery for emotional distress caused by an insurer’s bad faith refusal to pay an insured’s claim should be allowed only when the distress is severe and substantial other damage is suffered apart from the loss of the contract benefits and the emotional distress.

*Id.* at 378-79.

As to whether *Anderson v. Continental* should be a part of Kentucky law, it actually already is. The genesis of modern bad faith law in Kentucky is found in Justice Leibson's dissent in *Federal Kemper Ins. Co. v. Hornback*, 711 S.W.2d 844 (Ky. 1986), which was adopted by the majority of this Court and became the law of Kentucky in *Curry v. Fireman's Fund Insurance Co.*, 784 S.W.2d 176 (Ky. 1989). In that informative dissent, Justice Leibson embraced the description of the bad faith cause of action set forth in *Anderson v. Continental* and stated that the guidelines set forth therein "are a fair statement of the law." *Federal Kemper v. Hornback*, *supra*, 711 S.W.2d at 847 (Leibson, J., dissenting). The Court of Appeals likewise relied on *Anderson v. Continental* in *Empire Fire & Marine Insurance v. Simpsonville Wrecker Service*, *supra*, where it recognized that the principles of Kentucky bad faith law were "extracted" from *Anderson v. Continental* and another Wisconsin case. *See* 880 S.W.2d at 889-90.

Many other states have followed *Anderson v. Continental* and require proof of substantial other damages or that the emotional distress be severe before emotional distress damages can be recovered in a bad faith action. *See, e.g., Farmers Ins. Exchange v. Shirley*, 958 P.2d 1040, 1047 (Wyo. 1998) ("We agree . . . that to recover damages for emotional distress, the insured must allege that as a result of the breach of the duty of good faith and fair dealing, the insured has suffered substantial other damages, such as economic loss, in addition to the emotional distress."); *McKenzie v. Pacific Health & Life Ins. Co.*, 847 P.2d 879, 881 (Or. 1993) (emotional distress damages are recoverable in bad faith action only if accompanied by physical harm); *Athey v. Farmers Ins. Exch.*, 234 F.3d 357, 363 (8<sup>th</sup> Cir. 2000) ("To recover damages for emotional distress in South Dakota, a plaintiff must established that he sustained a pecuniary loss because of the bad

faith of an insurer”); *Bailey v. Farmers Union Coop. Inc.*, 498 N.W.2d 591, 603 (Neb. 2007) (“[W]e . . . follow the proposition in the *Anderson* line of cases that in a bad faith claim, emotional distress must be severe in order to justify recovery.”). Of course, many other states simply do not allow for the recovery of emotional distress damages in bad faith cases. See, e.g., *Anderson v. Virginia Surety Co.*, 985 F. Supp. 182 (D. Me. 1998); *Southern General Ins. Co. v. Holt*, 416 S.E.2d 274 (Ga. 1992); *Kewin v. Massachusetts Mut. Ins. Co.*, 295 N.W.2d 50, 55 (Mich. 1980).

The various permutations of the *Anderson* rule applied in these cases are meant to avoid what happened in this case: an insured who has suffered no physical harm and no pecuniary loss receives a substantial award of emotional distress damages based solely on his own testimony. While this Court in *Motorists Mutual v. Glass* held that emotional distress damages were recoverable in a bad faith action, this Court continues to have the authority to determine what standard of proof is required before such damages are to be awarded. The same reasons underlying this Court’s decision in *Osborne* call for the same rule to apply in bad faith cases against insurers.

This Court in *Osborne* made the insightful observation that we rarely attain emotional tranquility and some emotional harm is an unfortunate reality of living in a modern society. 399 S.W.3d at 17. That is particularly true when someone is sued. And that likely is also true when an insurer asserts the existence of coverage issues. But the fact that the act of doing so may cause stress or anxiety does not mean that a claimant or insured can recover for that stress or anxiety. This Court already has decided that an insurer has the right to raise coverage defenses and file a declaratory judgment action.

The fact that such lawful conduct may cause stress to an insured in no way takes away from such conduct being lawful.

As the above cases make clear, something more than just an insured's self-serving testimony should be required before someone can recover emotional distress damages. This Court already recognized that fact in *Osborne v. Keeney* when it adopted the rule that a person claiming emotional distress damages must prove that the emotional distress was severe. That should be the standard applicable to Mr. Demetre's claim for emotional distress damages in this bad faith case and he fell far short of that standard, offering no expert medical or scientific evidence to support the claimed emotional injury. Because he did not, the judgment in Mr. Demetre's favor should be vacated with directions to enter judgment in favor of Indiana Insurance.

**B. Mr. Demetre's evidence of his emotional distress fell short of even the pre-*Osborne* standard.**

Even if the pre-*Osborne* standard applicable in bad faith cases is applied, Indiana Insurance was entitled to a directed verdict because the evidence of Mr. Demetre's alleged emotional distress was not clear and convincing.

In *Motorists Mutual Ins. Co. v. Glass, supra*, this Court held that emotional distress damages were recoverable in a bad faith action but held that the evidence of the alleged emotional distress must be clear and convincing. While *Osborne* changed that for anyone like Mr. Demetre seeking emotional distress damages in a bad faith case or other type of case, Mr. Demetre did not offer clear and convincing evidence of his alleged emotional distress. In fact, he offered very little evidence at all. He testified about being worried about his potential liability, but that stress was caused by being sued by Mahannare Harris. Such stress is typical of anyone who has been sued.

Not only did Mr. Demetre not offer any medical or scientific evidence to support his claim of emotional distress, he offered no support at all. Neither his spouse nor any other family member or friend testified about Mr. Demetre's alleged emotional distress. All the jury heard was Mr. Demetre's very limited, self-serving statements about his alleged stress that did not manifest itself in any physical way.

*Osborne v. Keeney* applies to this case for the reasons discussed above. But even if *Osborne v. Keeney* had never been decided, Mr. Demetre's evidence of his alleged emotional distress was insufficient, entitling Indiana Insurance to a directed verdict.

**III. If judgment is not entered in Indiana Insurance's favor, it is entitled to a new trial.**

In the event this Court does not set aside the trial court's judgment and direct that judgment be entered in Indiana Insurance's favor, Indiana Insurance is entitled to a new trial based on substantial errors committed by the trial court.

**A. The jury instructions were erroneous.**

This issue was preserved in Indiana Insurance's objections to the trial court instructions (VR No. 8:10/1/12; 11:53:10), its tendered instructions (TR 2036) and its motion for a new trial (TR 2133).

It has long been the law of Kentucky that erroneous jury instructions are presumed to be prejudicial. *McKinney v. Heisel*, 947 S.W.2d 32, 35 (Ky. 1997). Appellees such as Mr. Demetre have the burden of trying to show that the use of erroneous instructions was harmless error. *Id.*

In submitting the case to the jury on a breach of contract theory, the trial court instructed the jury that "a violation of the covenant of good faith and fair dealing is a breach of the contract." (TR 2065, instruction no. 3.) The trial court further instructed

the jury concerning supposed “fiduciary duties” owed an insured by an insurer and told the jury:

If the insurance company does not investigate, negotiate or attempt to settle a claim in a fair and reasonable manner, then it has breached its fiduciary duty owed to its policyholder. A violation of the fiduciary duty under the contract is a breach of the contract.

(TR 2065, instruction no. 8.)

In *Davidson v. American Freightways, Inc.*, 25 S.W.3d 94 (Ky. 2000), this Court recognized that, regardless of whether based on the common law or statutory law, the essential elements of a bad faith claim are those established in *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993): (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 insured either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed. In addition, the insurer’s conduct must be sufficiently wrongful to justify the imposition of punitive damages. *Id.*

Submitting the issue of Indiana Insurance’s good faith under a breach of contract theory violated *Wittmer v. Jones*. The bad faith breach of contract theory did not mention the punitive damage standard that must be shown to prevail on a bad faith claim, and thus allowed the jury to find Indiana Insurance liable for bad faith without being required to prove all of the essential elements of a bad faith claim.

In addition, the bad faith breach of contract theory allowed Mr. Demetre to recover damages which he could not recover for a breach of contract. The damages recoverable for breach of contract do not include emotional distress damages or punitive damages. See *Flowitt v. Ashland Hospital Corp.*, 2007 Ky. App. Unpub. LEXIS 1220,

\*26 (Ky. App. 2007) (Apx. 8) (“Generally, tort damages such as punitives or as here, damages for emotional distress, are recoverable for breach of contract only if the breach involved conduct that was independently tortious and outside the risks contemplated by the contract.”); *Ford Motor Co. v. Mayes*, 575 S.W.2d 480, 486 (Ky. App. 1978) (“Kentucky has long followed the general rule that punitive damages ordinarily are not recoverable for a breach of contract”); KRS 411.184(4) (“In no case shall punitive damages be awarded for breach of contract.”). The award of damages to Mr. Demetre included no compensatory damages recoverable for a breach of contract, but was solely for damages potentially available for tortious conduct.

The evidence established and Mr. Demetre admitted that Indiana Insurance did not breach its contract with Mr. Demetre because it provided to Mr. Demetre everything to which he was entitled to under the policy. (VR No. 5: 9/26/12; 4:54:16) The trial court erred in submitting the breach of contract claim to the jury, as there was no evidence that Mr. Demetre was not provided with anything to which he was contractually entitled.

In addition, the damages instruction was erroneous. The only compensatory damages sought were for Mr. Demetre’s alleged emotional distress, and the instruction given is inconsistent with *Osborne v. Kenney*, *supra*, which this Court held would be applied retroactively. The damage instruction given in this case did not instruct the jury on the proper standard for an award of emotional distress damages and the evidence required to make an award of emotional distress damages.

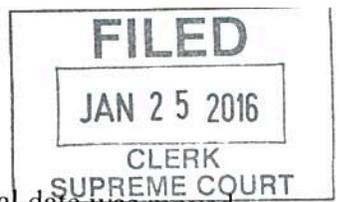
If the judgment in Mr. Demetre's favor is not set aside with directions to enter judgment in Indiana Insurance's favor, a new trial should be ordered based on the court's prejudicial erroneous instructions.

**B. The trial court erred in excluding the testimony of Tim Schenkel and Don Lane.**

This issue was preserved in Indiana Insurance's response to plaintiff's motion in limine to exclude witnesses (TR 1665), its motion to reconsider the order excluding the testimony of Donald Lane and Timothy Schenkel (TR 1833, 1863), the affidavit of Donald Lane (TR 1781), and the avowal testimony of Timothy Schenkel (VR no. 7: 9/26/12; 12:26:17).

Under *Knotts v. Zurich Ins., supra*, 197 S.W.3d 512, evidence of litigation conduct is inadmissible to prove bad faith. Such evidence was improperly allowed and in fact litigation conduct, such as Mr. Demetre being deposed by Mr. Lane in the declaratory judgment action, became a focal point of Mr. Demetre's testimony.

The trial court's error in allowing such evidence was compounded by the trial court's exclusion of Mr. Schenkel and Mr. Lane as witnesses. When Indiana Insurance realized that Demetre was going to use litigation conduct as supposed proof of Indiana Insurance's bad faith, Indiana Insurance indicated it would call Mr. Schenkel and Mr. Lane to rebut the suggestion that their conduct in representing their clients were acts of bad faith attributable to Indiana Insurance. When Mr. Demetre argued that he had not been able to depose either Mr. Schenkel or Mr. Lane, the trial court held that they could not testify even though (1) the trial court's pretrial order indicated that the deadline did not apply to rebuttal witnesses, and (2) they were classic rebuttal witnesses.



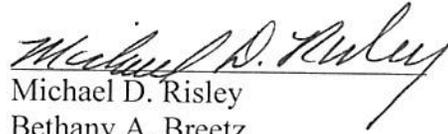
The trial court abused its discretion even further when the trial date was moved from June 2012 to September 2012. When that happened, the purpose behind the exclusion of Schenkel and Lane as witnesses (that Mr. Demetre did not have an adequate opportunity to depose them) vanished. In allowing Mr. Demetre to use Indiana Insurance's litigation conduct as evidence of its alleged bad faith but denying Indiana Insurance the ability to rebut that testimony with testimony from the people involved, the trial court erred.

The Court of Appeals agreed that the trial court erred when it excluded the testimony, but held it was harmless error because there was no showing of what testimony was excluded. But Indiana Insurance cited to the Court of Appeals what it cites to this Court: Timothy Schenkel's avowal testimony that the parties and the trial judge agreed that the tort case should be slowed down while the coverage issues were resolved; in fact, that procedure was suggested by Mr. Demetre's personal counsel who did not testify to the contrary. (VR No. 7:9/26/12; 12:31:03; Defendant's exhibit 3.) As Indiana Insurance's alleged bad faith turned at least in part on perceived delays it allegedly caused, it was reversible error for the trial court to exclude such testimony.

#### CONCLUSION

For the reasons stated herein, Indiana Insurance requests that the judgment in James Demetre's favor be vacated with directions to enter judgment in favor of Indiana Insurance.

Respectfully submitted,



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