



COMMONWEALTH OF KENTUCKY  
SUPREME COURT  
CASE NO. 2012-SC-317-D

JAMES D. NICHOLS

APPELLANT

v. On Discretionary Review from the Kentucky Court of Appeals  
Case No. 2010-CA-1393-MR

Appeal from Jefferson Circuit Court  
Honorable Irvin G. Maze, Presiding  
Case No. 05-CI-8961

ZURICH AMERICAN INSURANCE COMPANY

APPELLEE

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REPLY BRIEF ON BEHALF OF APPELLANT  
JAMES D. NICHOLS

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CERTIFICATE OF SERVICE

I hereby certify that on this 29th day of April, 2013, ten (10) originals of this reply brief were served via Federal Express upon Hon. Susan Stokley Clary, Clerk of the Supreme Court, Room 209, 700 Capital Ave., Frankfort, KY 40601, with one (1) copy served by regular mail on the following: Robert E. Stopher, Robert D. Bobrow, Boehl Stopher & Graves, LLP, Aegon Center, Suite 2300, 400 W. Market St., Louisville, KY 40202; Hon. Angela Bisig, Judge, Jefferson Circuit Court, Division Ten, 700 W. Jefferson St., Louisville, KY 40202; and Sam Givens, Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 40601.

  
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KEVIN C. BURKE

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## INTRODUCTION

Mutual mistake requires clear and convincing evidence that *both parties* were mistaken. Here Zurich included UM and UIM for no additional premium as part of a comprehensive commercial fleet policy. Under both Indiana and Kentucky law Zurich had to include UM (which included UIM under the policy terms) unless rejected in writing by the insured. The insured made no written rejection before Nichols' accident. In any event, Zurich fails to cite evidence—let alone clear and convincing evidence—that Zurich knew or agreed to exclude UIM before issuing the commercial fleet policy.

Moreover, insurance statutes prohibit retroactive annulment of coverage to the detriment of third-party accident victims like Nichols. Contrary to Zurich's arguments, contract reformation that voids a third party's right to UIM benefits *is* "retroactive annulment." The statutes cited in Appellant's opening brief protect Kentucky accident victims like Nichols from the tactics employed by Zurich in this case.

Zurich does make an important admission. Zurich claims that the "Common Policy Change Endorsement" issued after the accident reveals the "mutual mistake."<sup>1</sup> However, as detailed in the opening brief, UIM benefits are available under either of two endorsements:<sup>2</sup>

- "Kentucky Underinsured Motorists Coverage" (CA 21 79); *or*
- "Uninsured Motorist Coverage" (CA 21 17)

Endorsement CA 21-17 allows recovery for UM *or* UIM benefits up to a \$1,000,000, and

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<sup>1</sup> Appellee's Br., p. 27. Zurich mischaracterizes the "Common Policy Change Endorsement." No one from Zurich has ever testified that Zurich issued the Change Endorsement because Zurich "mistakenly" included UM and UIM in the policy. Zurich continues to make this argument—but there is no record evidence to support it. The Change Endorsement amended the policy to *cancel* certain UM and UIM endorsements *after* the insured rejected the coverage in writing on June 20, 2002—which is exactly what the Change Endorsement and proof shows in this case.

<sup>2</sup> Appellant's Br., pp. 2, 7, 21-22.

applies in every state Miller Pipeline conducted business.<sup>3</sup> *The “Common Policy Change Endorsement” only identifies state-specific endorsements. It does not list or purport to cancel Endorsement CA 21 17.*<sup>4</sup> If the Common Policy Change Endorsement defines the alleged “mutual mistake”—as Zurich maintains throughout its brief—then reversal is required. Even what Zurich represents as “mutual mistake” cannot invalidate UIM benefits under Endorsement CA 21 17.

### REBUTTAL

Zurich distorts the standard of review. Zurich suggests that a “clearly erroneous standard” applies.<sup>5</sup> Zurich is mistaken. The circuit court entered summary judgment. *De novo* review applies.<sup>6</sup>

#### **I. Zurich fails to cite case law supportive of its theory of “mutual mistake.”**

Zurich’s primary argument is that “mutual mistake” voids a third party accident victim’s right to UIM benefits included in a policy—even without proof the insurer knew or agreed to exclude UIM coverage before policy issuance.<sup>7</sup> Of the five Kentucky mutual mistake cases cited by Zurich,<sup>8</sup> all pre-date the adoption of the 1970 Kentucky Insurance Code. All involve parties to the contracts. None involve the rights of third party accident

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<sup>3</sup>Appellant’s Br. Exhibit 3: Endorsement CA 21 17 “Uninsured Motorist Coverage, Section F “Additional Definitions,” Subsection (3)(b).

<sup>4</sup>Appellant’s Br. Exhibit 9: Common Policy Change Endorsement.

<sup>5</sup>Appellee’s Br., p. 8, fn. 24.

<sup>6</sup>Zurich relies on cases where the court issued findings after bench trials or evidentiary hearings for non-jury matters. In this case, the circuit court did not conduct a bench trial or evidentiary hearing to decide disputed issues of mutual mistake. Instead, the circuit court entered *summary judgment*, and both the circuit court and Court of Appeals purported to apply the summary judgment standard. Summary judgment does not involve fact-finding or the weighing of evidence. *Steelvest, Inc. v. Scansteel Service Center, Inc.*, 807 S.W.2d 476, 480 (Ky. 1991). Accordingly, *de novo* review is appropriate. *Stilger v. Flint*, 391 S.W.3d 751, 753 (Ky. 2013).

<sup>7</sup>Appellee Br., pp. 17-18.

<sup>8</sup>Appellee Br., pp. 11-17.

victims. And none allow reformation without clear evidence that *the insurer agreed to different terms from those in the written policy*:

▪In *Hemphill v. New York Life Ins. Co.*, 195 Ky. 783, 243 S.W. 1040 (1922), the insurer agreed to reissue a life insurance policy under certain terms and premiums. The reissued policy contained different terms.

▪In *Home Ins. Co. of New York v. Evans*, 201 Ky. 487, 257 S.W. 22 (1923), the insurer's special agent agreed to omit an exclusion for a stock barn in a fire policy. The policy incorrectly contained the exclusion.

▪In *Girard Fire & Marine Ins. Co. v. Anglo-American Mill Co.*, 220 Ky. 173, 294 S.W. 1035 (1927), the insurer's local agent agreed to cover a grain elevator. The written policy failed to cover it.

▪In *Flimin's Adm'x v. Metropolitan Life Ins. Co.*, 255 Ky. 621, 75 S.W.2d 207 (1934), the insurer accepted a life insurance application that did not include a request for a double indemnity. The written policy contained a double indemnity rider.

▪In *U.S. Fidelity & Guar. Co. v. Hunt*, 336 S.W.2d 559 (Ky. App. 1960), the insurer's agent testified that the insurer agreed to cover a certain dwelling. The written policy described another dwelling instead.

In contrast, Zurich argues that it only needs to prove: “(1) that Miller Pipeline unilaterally decided they did not want Kentucky UIM coverage; (2) that Zurich included Kentucky UIM coverage [in the policy]; and (3) that Miller Pipeline accepted the original version of [the policy].”<sup>9</sup> In other words, Zurich argues (in this case only) that the insured dictates all policy terms and conditions whether Zurich knows about them or not.

Under Zurich's standard, if an insured wants certain terms of coverage, the insured is entitled to policy reformation, whether or not the insurer affirmed or agreed to those changes. *Zurich's standard for insurance policy reformation is unilateral mistake*. The cases cited in Appellant's opening brief do not allow reformation for unilateral mistake absent fraud, and the cases Zurich cites are entirely consistent with that

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<sup>9</sup> Appellee's Br., p. 17.

principle, even though Zurich's argument is not.<sup>10</sup>

## **II. Zurich fails to cite evidence that it ever knew or agreed to exclude UIM from the policy before the accident.**

Zurich subsequently claims in a one sentence that it knew and agreed to its insured's desire to exclude UIM coverage.<sup>11</sup> There is no such proof.<sup>12</sup> Neither the insured (Miller Pipeline) nor its broker-agent (M.J. Insurance) communicated any policy change request to Zurich before the date of the accident. Miller's representative, Jeanne Fuqua, had no contact with Zurich.<sup>13</sup> Fuqua only communicated with M.J.<sup>14</sup> M.J.'s representative, Kathy Kebo, had no contact with Zurich.<sup>15</sup> Kebo testified she sent the policy changes to M.J.'s commercial account manager, not Zurich.<sup>16</sup> Zurich cites no record evidence Zurich knew of Miller's intention before the accident—let alone proof Zurich actually agreed to exclude UIM coverage from the policy.

## **III. Zurich refuses to acknowledge that Indiana law governs the relationship between the insured, Miller Pipeline, and Miller's broker-agent, M.J. Insurance.**

Recognizing the absence of proof, Zurich argues that M.J. Insurance's knowledge

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<sup>10</sup> Although not mentioned by Zurich, Zurich issued its policy in Indiana to an Indiana insured. However, the elements of mutual mistake are the same in Indiana as Kentucky so there is no conflict. Indiana, like Kentucky, refuses to apply mutual mistake where the insurer fails to submit proof it knew or agreed to terms different from those contained in the policy. *See Monroe Guar. Ins. Co. v. Langreck*, 816 N.E.2d 485, 490 (Ind. App. 2004) (examining mutual mistake and denying insurer's request to reform a commercial policy absent "evidence [the insurer] and [the insured] had reached any agreement regarding the endorsement that was erroneously excluded or that the endorsement as originally written contravened the parties' expressed intent.")

<sup>11</sup> Appellee Br., p. 18, fn. 66.

<sup>12</sup> Even if some proof exists, clear and convincing evidence is required. *Abney v. Nationwide Mut. Ins. Co.*, 215 S.W.3d 699, 704 (Ky. 2006); *Monroe Guar. Ins. Co. v. Langreck*, *supra*.

<sup>13</sup> Fuqua depo., pp. 18-19.

<sup>14</sup> Fuqua depo., pp. 62-63.

<sup>15</sup> Kebo depo., p. 91.

<sup>16</sup> Kebo depo., 74.

must be “imputed” to Zurich.<sup>17</sup> This is contrary to both law and fact. Miller Pipeline is an Indiana corporation. Miller conveyed its intention to M.J.—an insurance “producer” under Indiana law.<sup>18</sup> M.J. is not licensed in Kentucky, and the discussions between Miller and M.J. occurred solely in Indiana between Indiana corporate entities.

Under Indiana law, M.J. acted only on behalf of Miller—not Zurich. See I.C. 27-1-15.6-14 (“An insurance producer *shall not* act as an agent of an insurer unless the insurance producer becomes an appointed producer of the insurer.”). Therefore, communications between Miller and M.J. cannot be “imputed” to Zurich under an agency theory. Zurich cites a Kentucky case, *Pan-American Life Ins. Co. v. Roethke*, 30 S.W.3d 128 (Ky. 2000), and statute, KRS 304.9-035—but those do not apply because M.J. is not licensed in Kentucky. In any event, *Roethke* did not involve mutual mistake.

However, even if Kentucky law governed the Miller/M.J. relationship, Zurich fails to cite, let alone distinguish *Investors Heritage Life Ins. Co. v. Farmers Bank*, 749 S.W.2d 688 (Ky. App.1987) which holds that the knowledge of a dual agent is insufficient to establish an insurer’s mistake. *See also Lawson v. Twin City Fire Ins. Co.*, 2 F.Supp. 171 (E.D.Ky. 1932) (knowledge of insurer’s agent is insufficient for mutual mistake).

#### **IV. Zurich ignores plain statutory language designed to protect innocent third party accident victims like Nichols.**

Kentucky law is clear: “the public policy of Kentucky is to ensure that victims of motor vehicle accidents on Kentucky highways are fully compensated.” *State Farm Mut. Auto. Ins. Co. v. Marley*, 151 S.W.2d 33, 36 (Ky. 2004). Insurance statutes designed to

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<sup>17</sup> Appellee Br., p. 18, fn. 68.

<sup>18</sup> Miller Pipeline is designated as an Indiana corporation and M.J. Insurance is identified as an Indiana “Producer” on the Common Policy Declarations Page. See Appellant’s Br. Exhibit 3.

protect such accident victims reflect such public policy.

Zurich devotes most of its analysis to KRS 304.20-030 which provides:

No insurance contract insuring against loss or damage through legal liability for the bodily injury or death by accident of any individual, or for damage to the property of any person, shall be *retroactively annulled by any agreement between the insurer and insured after the occurrence of any such injury*, death, or damage for which the insured may be liable, and any such annulment attempted shall be void. (Emphasis added).<sup>19</sup>

This statute is similar in purpose to the provision contained in Restatement (Second) of Contracts, §155 prohibiting reformation of a contract when the “rights of third parties...will be unfairly affected.” To avoid the statute’s plain language, Zurich cites two unpublished federal district court decisions purporting to apply California and Missouri law. Both involve different statutory language. Neither case involved recovery by a third party accident victim like Nichols.

Zurich ignores case law interpreting KRS 304.20-030. For example, *National Ins. Ass’n v. Peach*, 926 S.W.2d 859 (Ky. App. 1996) holds that an insured’s fraud—which voids a policy *ab initio* like a mutual mistake—cannot retroactively annul coverage to the detriment of an innocent third party accident victim. Zurich also fails to cite published extra-jurisdictional case law that refuses to apply mutual mistake if reformation would deny coverage to a third party accident victim. See, e.g., *Washington v. Savoie*, 634 So.2d 1176 (La. 1994)(in the context of UM coverage).

Zurich likewise argues that KRS 304.14-180 does not apply in instances of mutual mistake. Zurich suggests, without any proof, that it issued the “Common Policy

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<sup>19</sup> The dictionary definition of “annul” means: “to declare legally invalid or void.” The dictionary definition of “retroactive” means “extending in scope or effect to a prior time or to conditions that existed or originated in the past; especially: made effective as of a date prior to enactment, promulgation, or imposition.” See [www.merriam-webster.com](http://www.merriam-webster.com). Therefore, “retroactive annulment” in the context of KRS 304.20-030 necessarily includes any legal theory that voids insurance *ab initio*.

Change Endorsement” to confirm Zurich’s mistaken inclusion of UIM coverage. But the Change Endorsement’s express terms show that it was issued consistent with KRS 304.14-180, which provides, “[n]o agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy.” Zurich relies on a nearly one hundred year-old case, *Westchester Fire Ins. Co. v. Wilson*, 220 Ky. 142, 294 S.W. 1059 (1927). The predecessor statute cited in *Wilson* pre-dates the Kentucky Insurance Code by nearly fifty years and is not the same as KRS 304.14-180. Most importantly, however, *Wilson* was decided on other grounds and discusses mutual mistake only in *dicta*.

Zurich fails to meaningfully address KRS 304.20-020 because Zurich fails to acknowledge the existence of Endorsement CA 21 17. Endorsement CA 21 17 includes UIM within the definition of UM and makes both benefits available in every state Miller conducts business. KRS 304.20-020(1) requires an insured to reject UM coverage *in writing*. Even Zurich agrees that Miller *never rejected* Endorsement CA 21 17 in writing before the accident. Indeed, as mentioned at the outset of this brief, Endorsement CA 21 17 is not even listed in the “Common Policy Change Endorsement” which, according to Zurich, defines the scope of its alleged “mutual mistake”.<sup>20</sup>

Finally, Zurich claims that Nichols’ reliance on Zurich’s UIM coverage in settling with the at-fault driver and following the *Coots* procedure in KRS 304.39-320 is insufficient to establish detrimental reliance. According to Zurich, only good faith

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<sup>20</sup> Zurich also fails to cite or distinguish *Howard v. INA County Mut. Ins. Co.*, 933 S.W.2d 212 (Tex. App. 1996) (court refused to invalidate an UM policy endorsement, which included underinsured motorist benefits, based on mutual mistake where the coverage was not rejected in writing before an injury claim accrued). See Appellant’s Br., p. 22.

purchasers for value may claim detrimental reliance.<sup>21</sup> That is not law in Kentucky, and the language of the Restatement (Second) of Contracts is at odds with Zurich's position. Zurich also fails to distinguish the two Kentucky cases cited in Nichols' opening brief. Neither case requires a party who detrimentally relies on the written instrument to be a good faith purchaser for value. Moreover, Zurich fails to acknowledge that Nichols relied on Zurich's high-limit UIM coverage when agreeing to pay one-third of the liability settlement (\$8,333.33) as repayment of Zurich's workers' compensation subrogation lien.

**V. Zurich defines the scope "mutual mistake" by the Common Policy Change Endorsement—but even the Change Endorsement does not purport to cancel all UIM coverage.**

Zurich represents that "Nichols misunderstands reformation" because Zurich issued the "Common Policy Change Endorsement" after Nichols' accident "to correct the mistake" and show that "the UIM coverage was never there."<sup>22</sup> As explained in the opening brief and at the outset of this reply brief, UIM benefits are available under either of two policy endorsements. One is the state-specific UIM endorsement (CA 21 79 "Kentucky Underinsured Motorists Coverage"). The other is an all-state endorsement titled "Uninsured Motorist Coverage" (CA 21 17).

Although nominally labeled "Uninsured Motorist Coverage," Endorsement CA 21 17 offers UM or UIM benefits up to \$1,000,000 just like the state-specific endorsements. Endorsement CA 21 17 defines "uninsured motor vehicle" as follows:

**F. ADDITIONAL DEFINITIONS**

**As used in this endorsement:**

**3. "Uninsured motor vehicle" means a land motor vehicle or**

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<sup>21</sup> Appellee's Br., p. 35.

<sup>22</sup> Appellee's Br., p. 27. Once again, Zurich mischaracterizes the Change Endorsement.

trailer:

**b. That is an underinsured motor vehicle. An underinsured motor vehicle is a motor vehicle or trailer for which the sum of all liability bonds or policies at the time of an “accident” provides at least the amounts required by the applicable law where a covered “auto” is principally garaged but that sum is less than the Limit of Insurance of this coverage<sup>23</sup>**

The “Common Policy Change Endorsement” only lists the state-specific endorsements eventually rejected by Miller—it does not list or purport to exclude or reject Endorsement CA 21 17.<sup>24</sup> If the Common Policy Change Endorsement reveals the entirety of the alleged “mutual mistake”—as Zurich represents to this Court—Nichols is still entitled to recovery under Endorsement CA 21 17. Despite repeated reference to Endorsement CA 21 17 throughout this case, it is most telling that Zurich chooses to ignore it.

**VI. Zurich does not explain its seven-year delay in raising the defense of mutual mistake.**

Zurich fails to answer the question posed in Appellant’s opening brief: “Assuming Zurich mistakenly issued UIM coverage in 2002, before the accident, with knowledge of Miller Pipeline’s wishes, why did Zurich not plead mutual mistake as an affirmative defense in its first responsive pleading?”<sup>25</sup> Instead, Zurich manufactures a preservation argument that has no merit.<sup>26</sup> Zurich claims that Nichols did not argue that Zurich belatedly raised the mutual mistake defense. But pages 11 and 12 of Nichols’ Court of Appeals brief reveal otherwise. Nichols also listed the issue in the civil appeal prehearing statement. Tellingly, Zurich did not argue lack of preservation when Nichols

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<sup>23</sup> Appellant’s Br. Exhibit 3: Endorsement CA 21 17 “Uninsured Motorist Coverage, Section F “Additional Definitions,” Subsection (3)(b).

<sup>24</sup> Appellant’s Br. Exhibit 9: Common Policy Change Endorsement.

<sup>25</sup> Appellant’s Br., p. 15.

<sup>26</sup> Appellee’s Br., p. 21.

most recently identified the issue in the motion for discretionary review. Nichols also argued the issue in the circuit court, which Zurich concedes.

Other than the preservation argument, Zurich makes no effort to explain why, if Zurich issued the Change Endorsement to reflect its alleged “mutual mistake” just sixteen days after the June 4, 2002 accident, Zurich representatives continued to acknowledge that UIM coverage in their pre-litigation correspondence. Zurich also fails to explain why it made no mention of “mutual mistake” when it responded to Nichols’ Complaint. Indeed, Zurich does not explain why it waited seven years—and only after the completion of discovery — to finally give notice to Nichols of its alleged mutual mistake defense. Zurich has no valid excuse for its lengthy, unreasonable, and prejudicial delay.

**VII. Zurich offers no legitimate reason why, on remand, Nichols cannot amend his complaint to allege bad faith.**

The circuit court denied Nichols leave to allege bad faith. But the court did so because it granted Zurich’s motion for summary judgment. Zurich ignores this fact. There can be no bad faith without coverage. However, if the case is reversed and remanded, Zurich offers no legitimate reason why Nichols should be denied leave to file an amended complaint. All of Zurich’s arguments go to *the merits* of any bad faith claim, and Zurich is more than capable of arguing the merits after Nichols files the amended complaint. Accordingly, Nichols requests reversal and remand with instructions for the circuit court to grant leave to file his amended complaint and assert a claim for bad faith.

**CONCLUSION**

Appellant asks this Court to reverse and remand with instructions for the circuit court to (1) enter partial summary judgment in favor of Nichols on the issue of UIM coverage and (2) grant Nichols leave to file an amended complaint for bad faith.

Respectfully submitted,



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