RENDERED: October 3, 1997; 2:00 p.m.
TO BE PUBLISHED

NO. 96-CA-1697-MR

STEPHEN W. MORRIS — APPELLANT

v. — APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE STEPHEN K. MERSHON, JUDGE
ACTION NO. 94-CI-4526

PHILADELPHIA INDEMNITY INSURANCE
COMPANY, and MEDORA SANITATION, INC. — APPELLEES

OPINION

REVERSING AND REMANDING

*** *** *** ***

BEFORE: EMBERTON, HUDDLESTON, and MILLER, Judges.

MILLER, JUDGE: Stephen W. Morris brings this appeal from a June 4, 1996, order of the Jefferson Circuit Court. We reverse and remand.

The facts are these: In the course of employment, Morris was involved in an automobile accident while he was a

passenger in a sanitation truck owned by his employer, co-appellee Medora Sanitation, Inc. (Medora). As a result of the accident, Morris suffered traumatic injuries, including the severance of his right leg and a "closed head injury." Medora's workers' compensation carrier made voluntary payments of approximately $200,000.00 to Morris for medical expenses and lost wages.

On August 30, 1994, Morris filed a third-party tort action in the Jefferson Circuit Court against the opposing driver, one William Tedford. Tedford was insured by Allstate Insurance Company (Allstate) with liability coverage in the amount of $25,000.00. Allstate subsequently tendered its policy limits to Morris pursuant to a settlement agreement.

At the time of the accident, the sanitation truck was covered by a liability policy purchased by Medora and issued by co-appellee Philadelphia Indemnity Insurance Company (Philadelphia). The policy included underinsured motorists (UIM) coverage in the face amount of $100,000.00. Seeking a declaration of rights, Morris filed an amended complaint against Philadelphia on March 13, 1995. Morris alleged entitlement to the UIM benefits as his damages exceeded the amounts recovered from both workers' compensation and the tortfeasor.

Morris and Philadelphia filed cross-motions for summary judgment. On June 4, 1996, the court granted Philadelphia's motion and dismissed Morris's amended complaint. The court held that the Workers' Compensation Act (Ky. Rev. Stat. (KRS) Chapter 342) provides Morris with an exclusive remedy and thus bars

recovery of UIM benefits under Medora's policy. This appeal followed.

Morris contends that the circuit court committed reversible error by concluding that the Act's exclusive remedy provision (KRS 342.690) precludes recovery of UIM benefits. The circuit court specifically found as follows:

> . . . Any underinsured benefits payment from PIIC [Philadelphia] would still be a payment from Medora to Morris for an injury sustained in the course of his employment. The clear language of KRS 342.690 does not allow for this recovery. The workers' compensation statute preempts common law tort claims. . . .
>
> Morris has not shown how a suit against Medora and PIIC [Philadelphia] for liability insurance benefits arising from an accident otherwise covered by workers' compensation may be maintained when KRS 342.690 provides that workers' compensation benefits are "in place of all other liability of such employer to the employee."

KRS 342.690(1) states in relevant part as follows:

> If an employer secures payment of compensation as required by this chapter, the **liability** of such employer under this chapter shall be **exclusive** and in place of all other **liability** of such employer to the employee, his legal representative, . . . and anyone otherwise entitled to recover **damages** from such employer at law . . . on account of such injury or death [emphases added].

We believe the circuit court erred in construing KRS 342.690. We construe the statute as providing an exclusive remedy against the employer only when the employer is legally liable for injuries sustained. In the case at hand, legal liability for injury is upon the third-party tortfeasor, Tedford,

and not upon the employer, Medora. This fact is pivotal. Morris's entitlement to UIM benefits does not derive from Medora's legal liability for his injuries. As more succinctly enunciated in State Farm Mutual Insurance Company v. Fireman's Fund American Insurance Company, Ky., 550 S.W.2d 554, 557 (1977):

> . . . payment made in performance of a contractual obligation is not a payment of "damages." Hence the liability of an insurance company under its **uninsured** motorist coverage cannot be the "legal liability for damages" . . . [emphasis added].

We similarly view UIM coverage as contractual in nature and not attributable to an employer's legal liability for damages. Because Morris's entitlement to UIM benefits is not owing to Medora's liability, we believe KRS 342.690 does not bar Morris from recovering UIM benefits under Medora's liability insurance policy. Cf. Affiliated FM Insurance Companies v. Grange Mutual Casualty Company, Ky. App., 641 S.W.2d 49 (1982) (holding that KRS 342.690 did not bar recovery of basic reparation benefits).

We turn now to the troublesome issue of "setoff."[1] The UIM endorsement of Medora's liability policy provided for the following setoff of workers' compensation benefits:

> 2. Any amount payable for damages under this coverage shall be reduced by:
>
> a. All sums paid or payable under any workers' compensation . . . .

[1] We use the term setoff to mean simply "deduction." For the record, we note that setoff and offset are used interchangeably. See Black's Law Dictionary 1237 (4th ed. 1968).

Morris urges this Court to declare the above setoff provision void as against public policy. Conversely, Philadelphia argues that the setoff provision does not offend public policy and, thus, should be enforced. As Morris has recovered over $200,000.00 in workers' compensation benefits and as the face amount of UIM coverage is $100,000.00, Philadelphia asserts that the setoff, utilized pro tanto, effectively reduces Morris's UIM benefits to naught.

It is well established in this Commonwealth that insurance policy provisions contrary to public policy are ineffectual and void. See Tharp v. Security Insurance Company of New Haven, Connecticut, Ky., 405 S.W.2d 760 (1966), and Windham v. Cunningham, Ky. App., 902 S.W.2d 838 (1995). We believe resolution of this issue centers upon the public policy behind UIM coverage.

There are two generally accepted views of UIM coverage --the narrow and the broad. See Royal Insurance Company v. Cole, 13 Cal. App. 4th 880, 16 Cal. Rptr. 2d 660 (1993); see also William P. Chesser, A Motorist Is Underinsured Under Texas Insurance Code Article 5.06-1(2)(b) Whenever His Liability Insurance Proceeds Are Insufficient To Compensate For The Injured Party's Actual Damages: Stracener v. United Services Automobile Association, 777 S.W.2d 378 (Tex. 1989), 21 Texas Tech L. Rev. 2249 (1989-1990); and Steven P. Means, Underinsured Motorist Coverage in Iowa: American States Insurance Co. v. Tollari, 71 Iowa L. Rev. 1569 (1986).

Under the narrow view, UIM coverage is triggered when and only if the tortfeasor's liability limits are less than the insured's UIM coverage stated on the face of the policy. UIM coverage is always set off or reduced by the tortfeasor's liability limits, the net effect being to so reduce the UIM coverage stated on the face of the policy. The public policy underlying the narrow view is to place the insured in the same financial position as if the tortfeasor had liability limits equal to the insured's own UIM limits.

The broad view, of course, provides greater coverage to the insured. Per this view, UIM coverage is "triggered" when the insured's damages exceed the tortfeasor's liability limits. Upon triggering, the insured is entitled, if necessary, to UIM protection to the extent of the policy's face amount of coverage. The public policy supporting the broad view is to provide maximal compensation.

Prior to 1988, our UIM statute (KRS 304.39-320) specifically provided for setoff of tortfeasor's liability limits. It stated in relevant part as follows:

> Every insurer shall make available upon request to its insureds underinsured motorist coverage, whereby subject to the terms and conditions of such coverage the insurance company agrees to pay its own insured for such uncompensated damages as he may recover on account of injury due to a motor vehicle accident because the judgment[2] recovered against the owner of the other vehicle ex-

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[2]In Ky. Rev. Stat. 304.39-320, the term judgment has been liberally interpreted so as to also include "settlement." See Coots v. Allstate Insurance Company, Ky., 853 S.W.2d 895 (1993).

> ceeds the policy limits thereon, **<u>to the extent of the policy limits on the vehicle of the party recovering less the amount paid by the liability insurer of the party recovered against</u>** [emphasis added; footnote added].

This statute afforded a mandatory setoff of the tortfeasor's liability limits against the insured's UIM limits, and was so interpreted in <u>LaFrange v. United Services Automobile Association</u>, Ky., 700 S.W.2d 411 (1985). The setoff's effect was twofold: (1) to activate UIM coverage only when the tortfeasor's liability limits were less than the insured's coverage stated on the face of the policy and (2) to diminish UIM benefits by the amount of the tortfeasor's liability coverage.

We think the above version of KRS 304.39-320 clearly elucidated the narrow view of UIM coverage. The statute, however, was amended in 1988, and the setoff language was deleted therefrom. <u>See</u> <u>Coots v. Allstate Insurance Company</u>, Ky., 853 S.W.2d 895, 900 (1993) (stating that the "1988 change in statutory language eliminated the offset problem").

The current version of KRS 304.39-320 states in relevant part as follows:

> (1) Every insurer shall make available upon request to its insureds underinsured motorist coverage, whereby subject to the terms and conditions of such coverage not inconsistent with this section the insurance company agrees to pay its own insured for such uncompensated damages as he may recover on account of injury due to a motor vehicle accident because the judgment recovered against the owner of the other vehicle exceeds the liability policy limits thereon, to the extent of the underinsurance policy limits on the vehicle of the party recovering.

We are of the opinion that the amended UIM statute clearly reflects the broad view.[3] The effect of eliminating the setoff is to make available the total policy's face amount of UIM coverage to the insured. She is granted broad coverage.

UIM coverage is no longer activated by juxtaposing it with the tortfeasor's liability limits and no longer are the tortfeasor's liability limits set off pro tanto against UIM coverage. Indeed, recently it has been observed that:

> [t]he reasonable expectation of the average person who purchases UIM coverage is that she will be entitled to UIM benefits if she is struck by another driver whose liability limits are not sufficient **to satisfy her damages** [emphasis added].

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[3]Our construction of KRS 304.39-320 is supported by Owens v. DeClark, 1995 WL 912492 (E.D.Ky.) (unpublished), wherein the Court observed in footnote 3:

> The Kentucky UIM statutes provide coverage where the injured party's total damages exceed the tortfeasor's liability limits. The tortfeasor's vehicle is considered underinsured whenever the damages or injuries sustained by an insured exceed the limit of the tortfeasor's liability coverage. K.R.S. 304.39-329 (**broad UIM coverage**). Some states, notably Indiana, define UIM benefits differently. Indiana statutes provide coverage where the underinsured motorist coverage exceeds the tortfeasor's liability limits. Ind. Code Ann. 27-7-5-4(c) [emphasis added].

See also William P. Chesser, A Motorist Is Underinsured Under Texas Insurance Code Article 5.06-1(2)(b) Whenever His Liability Insurance Proceeds Are Insufficient To Compensate For The Injured Party's Actual Damages: Stracener v. United Services Automobile Association, 777 S.W.2d 378 (Tex. 1989), 21 Texas Tech L. Rev. 2249, 2270 (1990).

Windham v. Cunningham, supra, at 841.

Inasmuch as this Commonwealth has adopted the broad view of UIM coverage via the 1988 amendment to KRS 304.39-329, we think LaFrange, supra, is no longer controlling for it was premised upon the pre-1988 version of the UIM statute.

As the public policy of broad UIM coverage is to provide maximal recovery for the insured, we believe it axiomatic that an insurance carrier cannot set off pro tanto workers' compensation benefits against the policy's face amount of UIM coverage. See Caberto v. National Union Fire Insurance Company, 77 Haw. 39, 881 P.2d 526 (1994) (recognizing and holding that a majority of jurisdictions have invalidated workers' compensation setoff clauses as violative of public policy); and Matthess v. State Farm Mutual Automobile Insurance Company, 548 N.W.2d 562 (Iowa 1996) (holding that a workers' compensation setoff provision violated the public policy behind broad UIM coverage). Allowance of such setoff pro tanto, as urged by Philadelphia, would defeat the underlying purpose of UIM, which is to fully compensate the insured up to UIM face policy limits. We also recognize, however, the strong public policy in this Commonwealth against double recovery for the **same elements of loss**. See Hargett v. Dodson, Ky. App., 597 S.W.2d 151 (1979).

To accommodate both public policies, we believe the setoff provision should be given validity by permitting the setoff of workers' compensation benefits against the insured's total amount of damages--not against the face amount of UIM

coverage. Under this approach, double recovery of identical elements of loss would be denied. The insured, however, would be permitted to recover both workers' compensation benefits and UIM benefits to the extent that the combined amount of such recovery does not exceed the total amount of his damages. See Matthess, supra, and Williamson v. United States Fire Insurance Company, 442 S.E.2d 587 (S.C. 1994); cf. Poulos v. Aetna Casualty & Surety Company, 119 R.I. 409, 379 A.2d 362 (1977).

For example, let us assume that an insured has suffered $115,000.00 in total damages. He has UIM coverage in the face amount of $100,000.00. He has received $15,000.00 in workers' compensation benefits. The UIM endorsement contains a workers' compensation setoff provision. In this Commonwealth, under the broad view, he can recover $100,000.00 under the UIM coverage--the amount representing uncompensated damages. Uncompensated damages are computed by simply subtracting his $15,000.00 workers' compensation benefits from his total damages ($115,000.00). The UIM payment, along with his workers' compensation benefits, renders him totally compensated. Under the narrow view, which prevailed in this Commonwealth prior to the 1988 amendment of KRS 304.39-320, he could have recovered only $85,000.00 in UIM benefits--the difference between the workers' compensation benefits ($15,000.00) and this UIM coverage of ($100,000.00). This $85,000.00 UIM payment, plus the $15,000.00 workers' compensation payment, leaves him with $15,000.00 uncompensated damages.

Because of the speculative nature of future workers'

compensation benefits and the attending difficulties of ascertaining entitlement, we reject any attempt to set off future workers' compensation benefits. We are of the opinion that only the amount of workers' compensation benefits theretofore paid may be set off.

We note State Farm, supra, which involved setting off workers' compensation benefits against **uninsured** motorist coverage (UM). Therein, the Court recognized the validity of a setoff provision to those amounts over and above the statutorily mandated minimum UM coverage.

We believe State Farm is clearly distinguishable from the case at hand. The public policy behind UM, as is the policy supporting the narrow view of UIM coverage, is to provide minimum insurance coverage designed to place the injured party in the same position financially as if injured by a motorist with the mandated minimum liability coverage. See Wine v. Globe American Casualty Company, Ky., 917 S.W.2d 558 (1996); Preferred Risk Mutual Insurance Company v. Oliver, Ky., 551 S.W.2d 574 (1977); and Commonwealth Fire and Casualty Insurance Company v. Manis, Ky. App., 549 S.W.2d 303 (1977). Thus, setoffs do not offend the public policy underlying UM coverage. Conversely, as maximal compensation is the objective of broad UIM coverage, setoffs against the face amount of a policy's UIM coverage are offensive.

In summary, we hold that KRS 342.690 does not bar Morris's recovery of UIM benefits under Medora's liability policy. We further hold that Philadelphia may not set off

workers' compensation benefits paid to Morris against the $100,000.00 face amount of UIM coverage, but may only set off such benefits against Morris's total amount of damages.

For the foregoing reasons, the order of the Jefferson Circuit Court is reversed, and this cause is remanded for proceedings consistent with this opinion.

ALL CONCUR.

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