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Commonwealth of Kentucky

Court of Appeals

NO. 2007-CA-000029-MR
AND NO. 2007-CA-000064-MR

HAMILTON MUTUAL INSURANCE
COMPANY OF CINCINNATI, OHIO
AND EMC INSURANCE COMPANY — APPELLANTS/CROSS-APPELLEES

APPEAL AND CROSS-APPEAL FROM TAYLOR CIRCUIT COURT
v. HONORABLE DOUGHLAS M. GEORGE, JUDGE
ACTION NO. 00-CI-00004

HARLON BARNETT, ADMINISTRATOR OF
THE ESTATE OF STEVEN RAY BARNETT — APPELLEE/CROSS-APPELLANT

OPINION AND ORDER
AFFIRMING IN PART, REVERSING AND REMANDING IN PART

** ** ** ** **

BEFORE: LAMBERT, MOORE, AND WINE, JUDGES.

LAMBERT, JUDGE: Hamilton Mutual Insurance Company (hereinafter "Hamilton Mutual") appeals from a jury verdict in favor of Harlon Barnett, finding that Hamilton Mutual acted in bad faith by delaying payment on a policy for underinsured motorists coverage. Hamilton Mutual additionally moves this Court to remove EMC Insurance Company from the style of the case. For the reasons set forth herein, we grant the

motion to dismiss EMC as a party to the appeal, and we affirm in part and reverse in part the judgment below.

Steven Ray Barnett was a passenger in a fatal head-on collision on June 2, 1995. The drivers of both vehicles were intoxicated. The estates of all five of the young men killed in the accident filed various lawsuits in Marion Circuit Court, which were promptly consolidated into one action.

Harlon Barnett, Steven's father and administrator of Steven's estate, filed an underinsured motorist insurance claim (hereinafter "UIM"), requesting the full policy limits of $900,000.00 in May of 1996. Simultaneously, Barnett filed a complaint in Marion Circuit Court seeking damages as a result of his son's death. On December 6, 1996, the Marion Circuit Court issued an order stating that (1) Steven was at all times a resident of the Barnett household; (2) it was uncontested that the Barnetts had UIM coverage on three automobiles and paid premiums for all three vehicles; (3) there was UIM coverage of $300,000.00 per vehicle; (4) "stacking" was allowable under Kentucky law; and therefore (5) there was $900,000.00 available in UIM protection.

On January 9, 1997, Barnett's attorney sent a letter to one of Hamilton Mutual's attorneys demanding settlement for the policy limits of $900,000.00. Hamilton Mutual responded to this demand in a letter dated January 31, 1997, which proposed a structured settlement with a present value of $200,000.00. The letter explained that there were two concerns with Barnett's claim. First, Steven was riding with an intoxicated driver, which invoked comparative negligence. Second, while Barnett could claim damages in excess of $2,000,000.00, the reality was that conservative juries in Kentucky and Marion County specifically rarely awarded such substantial verdicts in wrongful death cases, especially where liability was not clear. Barnett rejected this offer.

On July 14, 1997, Barnett lowered his demand to $850,000.00. Mediation was held on November 7, 1997, with all parties to the consolidated action being present. As a result of the mediation, Barnett reduced his demand to $775,000.00, and Hamilton Mutual offered a structured settlement with a present value of $300,000.00. Barnett rejected this offer.

With a trial date set for January 9, 1999, Barnett resumed settlement negotiations. In early December 1998, Barnett made a $690,000.00 settlement demand and indicated that he was not interested in a structured settlement. Hamilton Mutual responded to this demand with an offer of a structured settlement with a present value of $410,000.00. On December 21, 1998, Barnett reduced his settlement demand to $675,000.00, and Hamilton Mutual responded the following day with an offer of a structured settlement with a present value of $500,000.00. Barnett again refused. A follow-up letter reiterating the initial concerns Hamilton Mutual had regarding Barnett's claim was then sent, which concluded by urging Barnett to demand $587,500.00, the midpoint between the parties' last settlement positions. This demand was forwarded to Hamilton Mutual and, on January 8, 1999, the parties settled for an unstructured settlement amount of $587,500.00.

The complaint in this action was filed January 4, 2000, and proceeded to trial September 25, 2006. Barnett alleged that Hamilton Mutual violated its duty to exercise good faith in the handling and settlement of his UIM claim. Furthermore, he asserted that Hamilton Mutual violated duties established under the Unfair Claims Settlement Practice Act and the Consumer Protection Act. Barnett contended that said actions were done fraudulently, maliciously, intentionally, oppressively, and with reckless disregard of his rights. He complained that he sustained the following damages: 1) enormous amount of pain, suffering, and emotional distress; 2)

embarrassment and humiliation; 3) court costs and legal expenses; and 4) loss of interest and investment income on the money ultimately settled. He also claimed that he was entitled to recover punitive damages against Hamilton Mutual.

At trial, Hamilton Mutual asserted that it had relied on the experience of its attorneys in handling wrongful death claims to place a reasonable settlement value on the Barnett claim. On September 27, 2006, a jury returned a verdict in favor of Barnett with an award of $150,000.00 for loss of interest and investment income; $5,000.00 for legal costs expended in the underlying case; and punitive damages in the amount of $600,000.00. The court subsequently awarded Barnett an additional $195,833.33 pursuant to KRS 304.12-235 for legal expenses incurred in the underlying action. This appeal followed.

Hamilton Mutual first argues that the trial court erred in admitting evidence of litigation conduct and settlement offers in contravention of the Kentucky Supreme Court decision in *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512 (Ky. 2006). We disagree.

Abuse of discretion is the proper standard of review of a trial court's evidentiary rulings. *See Woodard v. Commonwealth*, 147 S.W.3d 63, 67 (Ky. 2004). The test for abuse of discretion is whether the trial judge's decision was arbitrary, unreasonable, unfair, or unsupported by sound legal principles. *Commonwealth v. English*, 993 S.W.2d 941, 945 (Ky. 1999).

In *Knotts*, the Kentucky Supreme Court held that,

> [t]he commencement of litigation by the filing of a complaint, even when the claim adjustment process is underway [ ] does not change the fundamental nature of what the claimant seeks. The "claim"-for compensatory payment under the insurance policy-is the same as before the litigation began. The claimant has simply opted to seek satisfaction of the claim through a different procedure. Nothing in KRS 304.12-230 limits its applicability to pre-litigation conduct, and since the statute applies to "claims," it continues to apply to an insurer so long as a claim is in play.

> As such, we hold that KRS 304.12-230 applies both before and during litigation.

Knotts, 197 S.W.3d at 517. Moreover,

> [o]ne should note a distinguishing factor between the insurer's settlement behavior during litigation and its other litigation conduct. The Rules of Civil Procedure provide remedies for the latter. To permit the jury to pass judgment on the defense counsel's trial tactics and to premise a finding of bad faith on counsel's conduct places an unfair burden on the insurer's counsel, potentially inhibiting the defense of the insurer. An insurer's settlement offers, on the other hand, are not a separate abuse of the litigation process itself. If a litigant refuses to settle or makes low offers, his adversary cannot avail himself of motions to compel, argument, or cross-examination to correct his failure.
>
> In principle, an insurer's duty to settle should continue after the commencement of litigation. If the insurer were immunized for objectional [sic] settlement conduct occurring after litigation begins, the insured would be left without a remedy. It makes sense, therefore, to hold the insurer responsible for such conduct. The rules, however, provide litigants with protection against other forms of litigation [conduct], and for that reason a court could rationally exclude evidence of the insurer's other misdeeds committed during the litigation process.

See Knotts, at 523, *quoting* Stephen S. Ashley, *Bad Faith Actions Liability and Damages* § 5A:6 (2005). After carefully reviewing the record, it is clear that the trial court considered these meticulous distinctions. In its order on September 5, 2006, the court carefully laid out the nuances of the *Knotts* opinion and then reasoned that,

> [t]he majority of the litigation conduct that occurred after the December 6, 1996, ruling centered on settlement discussions between the parties. [Barnett] would not be able to rely on the rules of civil procedure for sanctions if [Hamilton Mutual] failed to make reasonable offers and delayed in making these offers. Therefore, the facts of this case encompass very little litigation conduct.

Hamilton Mutual attempts to define all its settlement discussions as litigation conduct. We, however, agree with the trial court's sound reasoning that the majority of the

alleged litigation conduct was actually settlement discussions, and is therefore admissible both before and after the December 6, 1996, order.

As to any actual "litigation conduct" that was admitted, we reiterate the holding in our recent decision in *Hamilton Mutual Ins. Co. of Cincinnati v. Buttery*, 220 S.W.3d 287 (Ky. App. 2007).

> In *Knotts*, the [Kentucky Supreme] Court allowed evidence of an insurer's settlement behavior during litigation to be used to demonstrate bad faith. However, it clearly distinguished that settlement conduct from an insurer's litigation tactics in general, holding that: ['][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.['] *[Knotts]*, at 522. Consequently, evidence of an insurer's general litigation tactics (distinguished from evidence of its settlement behavior during the course of litigation) is generally not admissible on the issue of bad faith.
>
> In *Knotts*, litigation against the insurer was resolved by means of summary judgment. Therefore, the Kentucky Supreme Court did not address any evidence presented to the jury by the insured. In this case, after having reviewed the record, we are not persuaded that the introduction of the challenged evidence requires reversal of the judgment. Hamilton Mutual aggressively defended its actions based upon the "advice-of-counsel" defense. Throughout the bad faith action, it argued that its delay in ultimately satisfying Buttery's claim resulted from litigation decisions that it had made during the trial of the underlying action. Hamilton Mutual claimed that it had a reasonable basis to deny Buttery's claim because it had consistently acted on the advice of counsel. Because Hamilton Mutual effectively "opened the door" by presenting evidence of its litigation conduct, we hold that Buttery was entitled to comment on the evidence in rebuttal. *Harris v. Thompson*, 497 S.W.2d 422, 430 (Ky.1973). The admission of the challenged evidence does not constitute reversible error.

Buttery, 220 S.W.3d at 294. Similarly, in the case at hand, Hamilton Mutual aggressively defended its actions under the "advice-of-counsel" defense. Therefore, we again find that they "opened the door" by introducing their litigation conduct as a

defense. Accordingly, we do not find that the trial court abused its discretion in admitting the disputed evidence.

Hamilton Mutual then argues that it was entitled to a judgment notwithstanding the verdict (hereinafter "JNOV"). We disagree.

> In ruling on a JNOV motion, the trial court is required to consider the evidence in a light most favorable to the party opposing the motion and to give that party every reasonable inference that can be drawn from the record. *Taylor v. Kennedy*, 700 S.W.2d 415, 416 (Ky. 1985). The motion is not to be granted "unless there is a complete absence of proof on a material issue in the action, or if no disputed issue of fact exists upon which reasonable men could differ." *Taylor*, 700 S.W.2d at 416. On appeal, we are to consider the evidence in the same light. *Lovins v. Napier*, 814 S.W.2d 921, 922 (Ky. 1991).

See Brewer v. Hillard, 15 S.W.3d 1, 9 (Ky.App. 1999). Moreover,

> [w]here there is conflicting evidence, it is the responsibility of the jury to determine and resolve such conflicts. . . . *Cf. Taylor v. Kennedy*, 700 S.W.2d 415 (Ky.App. 1985). The reviewing court, upon completion of a consideration of the evidence, must determine whether the jury verdict was flagrantly against the evidence so as to indicate that it was reached as a result of passion or prejudice. If it was not, the jury verdict should be upheld. *Cf. Lewis v. Bledsoe Surface Mining Co.*, 798 S.W.2d 459 (Ky. 1990); *NCAA v. Hornung*, 754 S.W.2d 855 (Ky. 1988).

See Bierman v. Klapheke, 967 S.W.2d 16, 19 (Ky. 1998).

The litany of issues Hamilton Mutual assert that could only fairly and equitably be found in their favor all involve issues of fact upon which reasonable minds could differ. Additionally, there is no evidence in the record that the jury's verdict was flagrantly against the evidence or a result of passion or prejudice. Therefore, we will not now substitute our judgment for the jury's.

Hamilton Mutual also contends that the jury should not have been instructed under KRS 304.12-235 because Barnett did not file a claim but instead filed a

lawsuit and additionally that Barnett was not entitled to attorneys' fees because of the timing of the fee agreement. We disagree.

Barnett's attorney sent a letter to Hamilton Mutual on May 10, 1996, which notified that a claim was being made, the fact of Barnett's death, the accident report, and a draft complaint. Pursuant to the policy, Hamilton Mutual requires written notice to identify the injured person and to obtain information regarding time, place, and circumstances of the accident. These elements were satisfied. Moreover, the trial court noted that "[a]fter the [c]ourt's ruling on December 6, 1996, there appears to be no question as to the insurer's obligation to pay."

In *Knotts*, the Kentucky Supreme Court clearly stated that,

> [t]his general use [of the word claim] is applicable to KRS 304.12-230. The "right" being asserted arises under the insurance policy and is the right to compensation for injuries for which liability has been established. Thus, "claim," as used in the statute, means an assertion of a right to remuneration under an insurance policy *once liability has reasonably been established*. This is usually done by making the claim directly to the insurance company, which then engages in the claim adjustment process. But it *may also be accomplished by instituting litigation, which is simply another means of asserting the right under the insurance policy*. Though litigation is distinct from the claims adjustment process in that it specifically invokes the courts' power to decide the issue of liability, both procedures are simply methods of pursuing claims under an insurance policy. It is often the case that both methods are employed, with litigation following (or preempting) the claim adjustment process.

Knotts, at 516-17 (emphasis added). We see no reason that a different definition of claim would be applicable in KRS 304.12-235 than in KRS 304.12-230, as the two statutes are part of the same legislative scheme. Therefore, we find no merit in Hamilton Mutual's assertion that Barnett's decision to file a lawsuit in lieu of filing a formal claim precludes instructions to the jury under KRS 304.12-235. Accordingly, we also conclude that there was no error in granting reasonable attorney's fees under KRS

304.12-235(3), which states that "[i]f an insurer fails to settle a claim within the time prescribed. . .and the delay was without reasonable foundation. . .the insured person. . . *shall be entitled* to be reimbursed for his reasonable attorney's fees incurred." (Emphasis added).

Hamilton Mutual additionally argues that the jury should not have been instructed on Barnett's claim for loss of interest and investment income. Barnett alternatively contends that the trial court should not only have instructed on loss of interest and investment income but also on prejudgment interest under KRS 304.12-235.

First, KRS 304.12-235(2) is mandatory in nature. It states that "[i]]f an insurer fails to make a good faith attempt to settle a claim. . . the value of the final settlement *shall bear interest* at the rate of twelve percent (12%) per annum from and after the expiration of the thirty (30) day period." (Emphasis added). Since the jury found that Hamilton Mutual failed to make a good faith attempt to settle the claim within thirty days of notice of the claim, Barnett's assertion that he is entitled to interest on the value of the final settlement from and after January 5, 1997, is correct.

The statutory scheme governing bad faith conduct by insurance companies contemplates how to properly compensate the insured adequately. That is the function of KRS 304.12-235(2) discussed above. We agree with the trial court that allowing Barnett to collect both interest under KRS 304.12-235(2) and loss of interest and investment income would amount to double recovery. Estimating the loss of interest and investment income on Barnett's claim is simply too speculative in nature. More importantly, we would be deviating from clear legislative intent on how to adequately compensate an injured insured under KRS 304.12-235 if we endorsed loss of interest and investment income over the statutorily established 12% per annum.

Therefore, we find that awarding loss of interest and investment income was an abuse of discretion, and we instruct the trial court to award 12% per annum from January 5, 1997, to the date of settlement, January 8, 1999, on the final settlement amount of $587,500.00. After careful review, however, we decline to reverse the trial court's decision to deny pre-judgment interest after January 8, 1999, as it was within its sound discretion to do so. *See Dalton v. Mullins*, 293 S.W.2d 470, 477 (Ky. 1956); *see also, e.g., Curtis v. Campbell*, 336 S.W.2d 355 (Ky. 1960); *Beckman v. Time Fin. Co.*, 334 S.W.2d 898 (Ky. 1960); *Avritt v. O'Daniel*, 689 S.W.2d 36 (Ky.App. 1985).

Hamilton Mutual next asserts that the jury instructions were prejudicial, thereby warranting a new trial. "An error in a court's instructions must appear to have been prejudicial to the appellant's substantial rights or to have affected the merits of the case or to have misled the jury or to have brought about an unjust verdict in order to constitute sufficient ground for reversal of the judgment." *Miller v. Miller*, 296 S.W.2d 684, 687 (Ky. 1956), *quoting* Stanley's Instructions to Juries, Sec. 44, p. 60. Hamilton Mutual argues that questions two, four, six, and eight of the jury instructions were repetitive and simply rephrased the applicable law in a manner that could only confuse the jury. After carefully reviewing the jury instructions, we find that the trial court correctly outlined the common law and statutory requirements for a finding of bad faith.

> In order to sustain a claim of bad faith,
>
> > an insured must prove three elements . . .: (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 [or delaying] the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying [or delaying] the claim or acted with reckless disregard for whether such a basis existed.... [A]n insurer is ... entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.

Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky. 1993). The issue of delaying the claim was an essential element of the jury instructions, and there is no evidence that its inclusion in the disputed questions resulted in any prejudice or an unjust verdict. Moreover, despite Hamilton Mutual's contention, outrageous conduct is not required to prove bad faith. Thus there was also no error in the court not including that element in its jury instructions.

Furthermore, Hamilton Mutual fails to provide any evidence that the inclusion of denial of the claim as an element of the instructions prejudiced a substantial right, affected the merits of the case, or resulted in an unjust verdict. Therefore, we find any error in its inclusion harmless. "The test for harmless error is whether there is any reasonable possibility that absent the error the verdict would have been different." *See Crane v. Commonwealth*, 726 S.W.2d 302, 307 (Ky. 1987). The record indicates that the jury answered every question affirmatively, meaning that even excluding the alleged improper instructions on denying the claim, the jury still found Hamilton Mutual's conduct constituted a violation of Kentucky's bad faith law. Therefore, we find that any error was harmless and thus not reversible.

Hamilton Mutual finally argues that the trial court abused its discretion in refusing to admit into evidence Judge Spragen's handwritten notes from the November 7, 1997, mediation, regarding the value of the Barnett Estate. The trial court excluded the notes as inadmissible hearsay, finding that there was no way to verify what each number was intended to represent. Hamilton Mutual wanted to assert that the values represented the fair range of values on the claim. However, hearsay is "a statement, [oral or written,] other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." Kentucky Rules of Evidence (KRE) 801(c). They contend that the notes are exceptions to the general

rule against hearsay either as a regular conducted activity or to establish an existing state of mind. However, it is illogical to imply that numbers alone written by a mediator rather than a party to the action indicate an existing state of mind pertinent to the action at hand. Moreover, despite that it was routine for Judge Spragen to keep notes during mediations, there is no evidence of what the numbers mean and no routine system to discern their meaning. Therefore, after reviewing the record and the Kentucky Rules of Evidence, we find that the trial court did not abuse its discretion in declining to submit the handwritten notes as inadmissible hearsay.

As to the motion to dismiss EMC as a party, Barnett asserts that because EMC is the parent company of Hamilton Mutual, EMC should not be dismissed as a party. However, the complaint contains no allegation that Hamilton is the alter ago of EMC or that the corporate veil should be pierced. Nor does the complaint allege facts sufficient to state a claim for piercing corporate veil. Barnett does not allege that Hamilton is a shell corporation or mere facade for EMC, that Hamilton is fraudulently or otherwise undercapitalized, that Hamilton is fraudulently organized, that EMC's ownership and control of Hamilton has deprived Barnett of a remedy, that separate treatment will promote a fraud or injustice, that Hamilton's officers and directors are non-functioning, that Hamilton does not maintain corporate formalities, or that EMC siphons Hamilton's funds. *See White v. Winchester Land Dev., Inc.*, 584 S.W.2d 56, 60 (Ky.App. 1979) (*citing Poyner v. Lear Siegler, Inc.*, 542 F.2d 955, 958 (6th Cir. 1976), *cert. denied*, 430 U.S. 969, 97 S.Ct. 1653, 52 L.Ed.2d 361 (1977)); *Big Four Mills, Ltd. v. Commercial Credit Co.*, 211 S.W.2d 831 (Ky. 1948). Accordingly, EMC should be dismissed from this action.

Based upon the foregoing, we order that the motion to dismiss EMC as a party be and is hereby granted, and we affirm the judgment of the trial court in part and

reverse and remand in part with instructions to award prejudgment interest as outlined in this opinion.

ALL CONCUR.

/ James H. Lambert
Judge, Court of Appeals

Entered: August 8, 2008

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