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# Multiple Claims, Limited Funds, and Conflicting Duties: Kentucky's Need for Clarity in Liability Insurance and Claims of Bad Faith

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# Multiple Claims, Limited Funds, and Conflicting Duties: Kentucky's Need for Clarity in Liability Insurance and Claims of Bad Faith

*James Grant Sharp*<sup>1</sup>

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<sup>1</sup> J.D. Candidate, 2017, University of Kentucky College of Law. I would like to thank William Orberson of Phillips, Parker, Orberson and Arnett for introducing me to this topic. I would also like to thank Professor Richard Underwood for his guidance in writing this Note.

## INTRODUCTION

Imagine an insured driver carrying an automobile liability policy with bodily injury limits of \$25,000 per person and \$50,000 per occurrence. This insured driver is deemed to be at fault in an accident that injures one passenger within her own vehicle and two persons in a separate vehicle. The two passengers in the other vehicle both file claims against the insured, settling with the liability insurer for the maximum of \$25,000 each, which exhausts the policy limits of \$50,000 per occurrence. Subsequent to these settlements, the injured passenger in the driver's vehicle files a claim with the insurer for injuries that she also sustained as a result of the accident. This scenario seems to suggest the insurer has fulfilled its duties under the terms of the policy and is neither obligated to settle with nor defend the insured against the subsequent claimant because the policy limits were exhausted.<sup>1</sup> However, Kentucky law places certain duties on the insurer that may suggest otherwise. These duties include an obligation to attempt in good faith both to protect an insured from a potential excess judgment and to promptly settle with all claimants where liability is reasonably clear.<sup>2</sup> Due to the apparent conflict of these duties, coupled with the lack of guidance by Kentucky courts, insurers, insureds, and potential claimants are in the dark with regard to their rights and obligations in such situations.

Although Kentucky courts have not yet explained the various rights and obligations of the parties in the previous scenario, a number of other states have.<sup>3</sup> These states have employed a number of different approaches that consider various factors in determining whether the insurer has fulfilled its good faith duties.<sup>4</sup> These various approaches provide an adequate foundation for Kentucky courts to develop a straightforward framework that clarifies each party's rights and obligations.

Although there are a number of writings that discuss an insurer's best practices in this situation, there has been relatively little written about the need for clarity and guidance from the courts.<sup>5</sup> Furthermore, liability insurance has wide-reaching implications in all of our lives. This is evidenced by the types of liability insurance available, including automobile, corporate directors and officers, professional malpractice, and even coverage for sexual abuse by an employee. Due to this lack of

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<sup>1</sup> See *Ky. Ass'n of Ctys. All Lines Fund Tr. v. McClendon*, 157 S.W.3d 626, 635 (Ky. 2005).

<sup>2</sup> See KY. REV. STAT. ANN. § 304.12-230(6) (West 2008); *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 497 (Ky. 1975).

<sup>3</sup> *Safeco Ins. Co. v. Ritz*, No. Civ.A. 03-240, 2006 WL 119991, at \*6-8 (E.D. Ky. Jan. 12, 2006).

<sup>4</sup> See *id.* at \*7-8; see also Douglas R. Richmond, *Too Many Claimants or Insureds and Too Little Money: Insurers' Good Faith Dilemmas*, 44 TORT TRIAL & INS. PRAC. L.J. 871, 880-92 (2009).

<sup>5</sup> See generally Eric A. Hamilton, *Too Many Hands in the Pot: The Morass of Multiple Claims with Limited Insurance*, COMMON DEFENSE, Spring/Summer 2015, at 6; Duana J. Grage & Suzanne L. Jones, *Settling with Limited Funds*, AM. B. ASS'N: SEC. OF LITIG.: INS. COVERAGE (Aug. 1, 2012), <http://apps.americanbar.org/litigation/committees/insurance/articles/mayjune2012-competing-files.html> [<https://perma.cc/4SL2-37TQ>]; Jonathan M. Stern, *What's an Insurer to Do? Multiple Claims and Insufficient Limits*, FOR THE DEFENSE, Sept. 2009, at 18.

clarity and the prevalence of liability insurance, the need for a clear and definitive framework from Kentucky courts is of the utmost importance. As such, this Note will provide an analysis that promotes prompt and fair settlements, while also protecting insureds from excess judgments. Specifically, this Note will address whether, and under what circumstances, an insurer can settle in good faith with certain claimants to the exclusion of others. Furthermore, this Note will address whether, and under what circumstances, an insurer is obligated to defend its insured after exhausting the policy limits when other claims remain or subsequently arise. Ultimately, this Note will advocate for a solution to these problems by incorporating and adapting other states' approaches into a straightforward analysis that promotes prompt and fair settlements.

Part I examines the various duties and obligations an insurer owes to both its insured and potential claimants under Kentucky law. Specifically, Part I examines an insurer's duty to act in good faith to protect an insured from an excess judgment, the insurer's duty to attempt in good faith to promptly settle with potential claimants where liability is reasonably clear, and an insurer's duty to defend after policy limits have been exhausted. Most importantly, Part I discusses how these duties conflict in the situation of multiple claims and limited funds.

Part II examines the various jurisdictional approaches on whether, and how, an insurer may settle with certain claimants to the exclusion of others when the claims exceed the policy limits. Part II also discusses the factors jurisdictions employ in determining if an insurer has fulfilled its good faith obligations when settling with certain claimants to the exclusion of others. Part II also discusses the various approaches to whether an insurer's duty to defend terminates upon exhaustion of the policy limits.

Part III advocates for Kentucky courts to provide a straightforward resolution with regard to this problem by drawing on other jurisdictions' approaches. In seeking such a resolution, Part III proposes a relatively easy to apply step-by-step analysis that promotes the protection of an insured from an excess judgment, provides potential claimants with prompt and fair settlements, and informs insurers of what actions constitute good faith in such situations.

## I. AN INSURER'S CONFLICTING DUTIES UNDER KENTUCKY LAW

A covered occurrence involving potential multiple claims that will exceed the policy's limits creates inescapable problems, such as exposing an insured to an excess judgment, denying a claimant a prompt and fair settlement, and exposing an insurer to potential claims of bad faith. Kentucky courts and legislators have long attempted to reconcile these problems within liability insurance.<sup>6</sup> However, Kentucky case law addressing these attempts has been limited to situations involving a single claimant, and not the situation of multiple claims and limited

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<sup>6</sup> See § 304.12-230(6); *Grundy*, 531 S.W.2d at 497.

funds.<sup>7</sup> Furthermore, these attempts have inadvertently created a conflict among an insurer's duties in the context of multiple claims and limited funds. To fully understand the potential for such conflict, an examination of an insurer's duty to its insured and claimants in single claimant situations is necessary.

### *A. The Duties an Insurer Owes to its Insured*

In addition to a liability insurer's well-known duty to indemnify, the insurer also owes a duty to act in good faith to protect its insured from a judgment in excess of the policy limits.<sup>8</sup> As a part of this duty, an insurer must also attempt to obtain a release of the claims against its insured.<sup>9</sup> In order to protect the insured from an excess judgment, the insurer must make a good faith attempt to settle the claims against the insured.<sup>10</sup> If the insurer fails to act in good faith to settle the claims, the insurer is liable for any excess judgment.<sup>11</sup>

In *Manchester Insurance & Indemnity Company v. Grundy*, the issue was whether the insurer had acted in bad faith for failing to settle in a single claimant situation.<sup>12</sup> The court explained an insurer's liability in excess of the policy limits as:

There is no liability on the insurer for failure to settle claims against the insured in excess of the policy limit in the absence of bad faith. It is the duty of the insurer to exercise the utmost good faith. Mere errors of judgment are not sufficient to constitute bad faith. Acting in bad faith or the failure to exercise good faith is sufficient to create liability on the part of the insurer for the excess of the policy limit.<sup>13</sup>

The *Grundy* court restated the test for bad faith in failing to protect the insured from an excess judgment in a single claimant case as, "Did the insurer's failure to settle expose the insured to an unreasonable risk of having a judgment rendered against him in excess of the policy limits?"<sup>14</sup> If so, the insurer is guilty of bad faith.<sup>15</sup> The court employed several factors to determine if the insurer acted in bad faith.<sup>16</sup> Those factors included the probability of recovery, whether the recovery would be in excess of the policy limits, whether the claimant offered to settle for less than the

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<sup>7</sup> See *Ritz*, 2006 WL 119991, at \*6.

<sup>8</sup> *Grundy*, 531 S.W.2d at 498.

<sup>9</sup> *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 453 (Ky. 1997).

<sup>10</sup> See *id.*

<sup>11</sup> *Am. Physicians Assurance Corp. v. Schmidt*, 187 S.W.3d 313, 318 (Ky. 2006).

<sup>12</sup> *Grundy*, 531 S.W.2d at 494-95.

<sup>13</sup> *Id.* at 497 (quoting *Am. Sur. Co. of N.Y. v. J. F. Schneider & Son*, 307 S.W.2d 192, 195 (Ky. 1957)).

<sup>14</sup> *Id.* at 501.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.* at 499-500.

policy limits, and whether the insured made a demand for settlement from the insurer.<sup>17</sup>

In addition to this duty, an insurer also has a duty to defend the insured when there is an allegation that might fall within the coverage terms of the policy.<sup>18</sup> This duty terminates once the insurer establishes that the allegation is not covered by the policy.<sup>19</sup> Considering that many liability policies state the duty to defend ends when the policy's limits are exhausted,<sup>20</sup> one would reason that once an insurer exhausts the policy limits there exists no remaining allegations that might fall within the coverage terms of the policy. As such, an insurer's duty to defend would terminate.<sup>21</sup>

Although the majority of jurisdictions employ this reasoning,<sup>22</sup> several Kentucky cases have suggested that the insurer may still be required to defend the insured after exhausting the policy's limits regardless of the policy's language.<sup>23</sup> In *Schmidt*, the Kentucky Supreme Court stated, in dicta, that an insurer may be required to pursue an appeal on behalf of its insured after paying out the policy's limits, but did not elaborate under what circumstance an insurer would be required to do so.<sup>24</sup> The Kentucky Court of Appeals has also made this distinction in a single claimant case where the policy's duty to defend provision was construed as ambiguous. The court stated that to leave an insured without a defense simply because the insurer had paid out the policy's limits would be "an extremely harsh construction" and would "leave the insured without adequate or any protection."<sup>25</sup> Ultimately, whether the duty to defend continues after exhausting the policy's limits remains an open question under Kentucky law.

### *B. The Duties an Insurer Owes to Claimants*

In an attempt to ensure that potential claimants received payments for injuries caused by a covered occurrence, Kentucky passed the Kentucky Unfair Claims Settlement Practices Act ("KUCSPA").<sup>26</sup> Like many other states' versions, the KUCSPA requires insurers to attempt "in good faith to . . . effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably

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<sup>17</sup> *Id.*

<sup>18</sup> *Actna Cas. & Sur. Co. v. Commonwealth*, 179 S.W.3d 830, 841 (Ky. 2005); *Ky. Ass'n of Cnty. All Lines Fund Tr. v. McClendon*, 157 S.W.3d 626, 635 (Ky. 2005).

<sup>19</sup> *McClendon*, 157 S.W.3d at 635.

<sup>20</sup> ROBERT P. REDEMANN & MICHAEL F. SMITH, 1 *LAW AND PRACTICE OF INSURANCE COVERAGE LITIGATION* § 4:24 (July 2016).

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> See *e.g.*, *Am. Physicians Assurances Corp. v. Schmidt*, 187 S.W.3d 313, 319 (Ky. 2006); *Ursprung v. Safeco Ins. Co. of Am.*, 497 S.W.2d 726, 729-31 (Ky. 1973).

<sup>24</sup> *Schmidt*, 187 S.W.3d at 319.

<sup>25</sup> *Ursprung*, 497 S.W.2d at 729.

<sup>26</sup> See KY. REV. STAT. ANN. § 304.12-230 (2008).

clear.”<sup>27</sup> In *State Farm Mutual Automobile Insurance Company v. Reeder*, the Kentucky Supreme Court stated that the KUCSPA’s purpose was to “protect the public from unfair trade practices and fraud” and that the statute should “be liberally construed so as to effectuate its purpose.”<sup>28</sup> Furthermore, under KRS § 446.070, a third party claimant has a direct cause of action against an insured for violating the KUCSPA.<sup>29</sup> Ultimately, the purposes of the KUCSPA, KRS § 446.070, and the court’s interpretation of them, seek to prevent an insurer from taking advantage of a claimant’s weaker bargaining position by imposing a direct duty from the insurer to potential claimants.<sup>30</sup>

However, the Kentucky Supreme Court has also limited the reach of KUCSPA by stating that the KUCSPA “only requires that an insurer make a good faith attempt to settle any claim, for which liability is beyond dispute, for a reasonable amount.”<sup>31</sup> In addition to this limitation, the Kentucky Supreme Court has also stated that an insurer has not acted in bad faith for failing to settle a claim unless “the insurer either knew there was no reasonable basis for denying the claim or acted in reckless disregard for whether such a basis existed.”<sup>32</sup>

The Kentucky Supreme Court has explained the test for determining whether an insurer has acted in bad faith for failing to settle when the action is brought by the claimant is the same as the test in *Grundy*, where the action was brought by the insured.<sup>33</sup> Specifically, the question is whether the insurer’s failure to settle exposed the insured to an unreasonable risk of having a judgment rendered against them in excess of the policy limits.<sup>34</sup> Also, the factors used to determine this question are very similar to the factors in *Grundy*. Those factors are: “(1) whether the plaintiff offered to settle for the policy limits or less, (2) whether the insured made a demand for settlement on the insurer, and (3) the probability of recovery and of a jury verdict which would exceed the policy limits.”<sup>35</sup> Since the test is practically the same in both situations, it is clear that an insurer’s duties to both its insured and claimants are significantly intertwined.

### *C. The Conflict Between an Insurer’s Duties When There are Multiple Claims and Limited Funds*

Kentucky courts have addressed situations where an insurer’s failure to settle with a *single* claimant exposes the insured to liability in excess of the policy’s limits.

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<sup>27</sup> *Id.*

<sup>28</sup> *State Farm Mut. Auto. Ins. Co. v. Reeder*, 763 S.W.2d 116, 118 (Ky. 1988).

<sup>29</sup> KY. REV. STAT. ANN. § 446.070 (1942); *Reeder*, 763 S.W.2d at 117–18.

<sup>30</sup> *Reeder*, 763 S.W.2d at 118.

<sup>31</sup> *Coomer v. Phelps*, 172 S.W.3d 389, 395 (Ky. 2005).

<sup>32</sup> *Bentley v. Bentley*, 172 S.W.3d 375, 378 (Ky. 2005).

<sup>33</sup> *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 451 (Ky. 1997).

<sup>34</sup> *Id.* (quoting *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 501 (Ky. 1975)).

<sup>35</sup> *Id.* (citing *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 500 (Ky. 1975)).

However, Kentucky courts have yet to provide an analysis in the case where the insurer is presented with *multiple* claimants and limited funds.<sup>36</sup> Considering how the above-described duties are intertwined, there becomes an apparent conflict between the duties owed by the insurer to act in good faith to settle all claims where liability is reasonably clear and its duty to protect an insured from an excess judgment when there are multiple claims that exceed the policy limits. To exhaust the policy limits in settling with certain claimants where liability is reasonably clear, while not settling with other claimants where liability is also clear, deprives the non-settling claimants of their fair share under the KUCSPA.<sup>37</sup> As such, an unsettled claimant may proceed against the insured for damages sustained, and may possibly proceed against the insurer for failing to settle in good faith. Furthermore, under this scenario the insurer may also be subject to a claim of bad faith by the insured for subjecting the insured to an excess judgment owed to the unsettled claimants.

Additionally, the question remains: at what point does an insurer's duty to defend end when the insurer has paid out the policy limits, while other claimants who have yet to settle proceed against the insured? If the insurer's duty ends when the policy limits are exhausted, it seems that the insurer would not be obligated to defend the insured against the unsettled claims. However, as stated above, Kentucky courts have not explicitly ruled on this.<sup>38</sup> Ultimately, in order for insurers, insureds, and potential claimants to understand their rights and obligations in such a situation, it is imperative that Kentucky courts provide guidance on this issue that is consistent with the purposes of these underlying duties.

## II. EXAMINATION OF MULTIPLE CLAIMANT AND LIMITED FUNDS SITUATIONS

Fortunately, many other states have attempted to answer the questions with regard to an insurer's conflicting duties in multiple claims and limited funds situations. Their answers serve as a useful guide for Kentucky courts. However, relative to other areas of the law, the various approaches courts apply to the issue of multiple claims and limited funds vary greatly. In order to build an adequate framework for developing an analysis for Kentucky, a detailed examination of these approaches is necessary.

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<sup>36</sup> See *Safeco Ins. Co. v. Ritz*, No. Civ.A. 03-240, 2006 WL 119991, at \*6 (E.D. Ky. Jan. 12, 2006).

<sup>37</sup> See KY. REV. STAT. ANN. § 304.12-230(6) (2008).

<sup>38</sup> See *Ritz*, 2006 WL 119991, at \*6.



*A. Various Approaches to Multiple Claimants Situations*

Although a number of commentators have attempted to categorize these approaches, the categorizations lack uniformity.<sup>39</sup> However, Douglas Richmond has provided one of the most comprehensive and logical categorizations in his article *Too Many Claimants or Insureds and Too Little Money: Insurer's Good Faith Dilemmas*.<sup>40</sup> Richmond organizes the various approaches into three broad categories: (1) the first to judgment rule; (2) the pro rata rule; and (3) the first to settle rule.<sup>41</sup> Richmond is quick to note that the first to judgment rule has been widely discarded due to the rise of bad faith litigation and the increasing length of time between filings and judgments.<sup>42</sup> Additionally, a fourth approach that may fit within each of the three previously mentioned approaches or stand independent is the filing of an interpleader action by the insurer.<sup>43</sup>

Courts applying the pro rata rule distribute the policy's proceeds on a pro rata basis in proportion to the damages suffered by each claimant.<sup>44</sup> The amount any individual claimant may receive is capped by the per person limits within the policy.<sup>45</sup> Although an insurer may choose to settle on a pro rata basis before litigation, assuming that each claimant cooperates in the settlement, such a practice is typically not required by law.<sup>46</sup> As such, and in the absence of a settlement, the pro rata rule requires litigating each of the claims to determine the proportion by which the limited proceeds will be distributed.<sup>47</sup> This forces each claimant to wait until the litigation of each claim is resolved before they may recover any of the insurance proceeds.<sup>48</sup> As such, the delay in payment that the pro rata rule may impose seems opposed to the KUCSPA's effort to ensure prompt settlement.<sup>49</sup>

*Underwriters for Lloyds of London v. Jones*, a 1953 Kentucky case, suggests that Kentucky is a pro rata state.<sup>50</sup> In *Jones*, Jerry Smith was a driver who was involved in an accident where one person died and three were injured.<sup>51</sup> Smith had an automobile policy with a per accident and per person limit of \$5,000.<sup>52</sup> Claims were brought on behalf of the three injured parties and the estate of the deceased.<sup>53</sup>

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<sup>39</sup> Compare Richmond, *supra* note 4, at 880, with Grage & Jones, *supra* note 5, and Stern, *supra* note 5, at 18.

<sup>40</sup> Richmond, *supra* note 4, at 872.

<sup>41</sup> *Id.* at 880.

<sup>42</sup> *Id.*

<sup>43</sup> See Grage & Jones, *supra* note 5.

<sup>44</sup> Richmond, *supra* note 4 at 880–81.

<sup>45</sup> *Id.*

<sup>46</sup> See *id.* at 881.

<sup>47</sup> See *id.*

<sup>48</sup> See *id.* at 880–81.

<sup>49</sup> See KY. REV. STAT. ANN. § 304.12-230(6) (2008).

<sup>50</sup> *Underwriters for Lloyds of London v. Jones*, 261 S.W.2d 686, 688 (Ky. 1953).

<sup>51</sup> *Id.* at 686.

<sup>52</sup> *Id.*

<sup>53</sup> *Id.*

Jones, one of the injured parties, recovered a judgment for \$20,000 against Smith.<sup>54</sup> The trial court construed the policy as limiting the liability for each claimant, and not as a limit of the liability for individual accidents.<sup>55</sup> As such, the court applied the \$5,000 of insurance proceeds toward the judgment.<sup>56</sup> However, the Court of Appeals reversed, holding that the clear language of the policy limited the liability to \$5,000 for one accident.<sup>57</sup> As such, the Court of Appeals directed that the \$5,000 proceeds should be distributed on a pro rata basis to each of the four claimants once each claimant had received a final judgment on their claim.<sup>58</sup>

Based on the facts and holding of *Jones*, Kentucky is arguably a pro rata state.<sup>59</sup> However, the subsequent rise in bad faith insurance law has made *Jones* irrelevant. The rise of duties such as the insurer's good faith duty to protect its insured from an excess judgment and the good faith duty on an insurer to attempt to effectuate a prompt and fair settlement with claimants where liability has become reasonably clear were not as widely recognized under Kentucky law in 1953 as they are today.<sup>60</sup> As such, Kentucky should make a clear departure from the pro rata approach expressed in *Jones*.

Under the first to settle rule, an insurer has the ability to settle for the policy limits with certain claimants to the exclusion of others.<sup>61</sup> Generally, this approach grants insurers increased discretion in determining when, and with whom, the insurer settles.<sup>62</sup> However, the application of this rule varies across jurisdictions with two major distinctions.

Under the first variation, the insurer is given broad discretion on how it distributes, and ultimately exhausts the proceeds.<sup>63</sup> In *Scott v. Gallacher*, the Appeals Court of Massachusetts termed this discretion as within the business judgment of the insurer.<sup>64</sup> The insurer had settled with claimants on a first to settle basis.<sup>65</sup> The court explained: "Nothing in the statutory scheme requires an insurer to effectuate a global settlement simultaneously with all potential claimants."<sup>66</sup> The court noted the importance of the fact that the insurer had reached out to Rivera, a potential claimant who initially declined to file a claim.<sup>67</sup> After learning that Rivera was not interested in filing a claim, the insurer settled with the other cooperative

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<sup>54</sup> *Id.*

<sup>55</sup> *Id.*

<sup>56</sup> *Id.*

<sup>57</sup> *Id.* at 687–88.

<sup>58</sup> *Id.* at 688.

<sup>59</sup> See Grage & Jones, *supra* note 5.

<sup>60</sup> See KY. REV. STAT. ANN. § 304.12-230(6) (2008); *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 497 (Ky. 1975).

<sup>61</sup> *Richmond*, *supra* note 4, at 881–82.

<sup>62</sup> See *id.* at 881.

<sup>63</sup> See Stern, *supra* note 5, at 19.

<sup>64</sup> *Scott v. Gallacher*, No. 10-P-209, 2011 WL 93084, \*2 (Mass. App. Ct., Jan. 11, 2011).

<sup>65</sup> *Id.* at \*1–2.

<sup>66</sup> *Id.* at \*2.

<sup>67</sup> *Id.* at \*1, 3.

claimants.<sup>68</sup> The court stated the insurer was “entitled to make a good faith business judgment to settle the claims in the order that they were presented” after the insurer “reasonably concluded that Rivera was not interested in pursuing a claim.”<sup>69</sup>

The alternative approach to the first to settle rule applies a heightened standard on the insurer’s decision to settle with certain claimants to the exclusion of others by requiring the insurer to select the claimants it will settle with in a manner that will maximize the benefit to the insured.<sup>70</sup> Florida law, for example, allows for an insurer to settle with certain claimants to the exclusion of others but requires an insurer to fulfill three obligations in determining whom it may choose to exclude in settlement.<sup>71</sup> The first obligation requires the insurer to fully investigate all claims in order to best limit the insured’s exposure.<sup>72</sup> The second requires the insurer to attempt “to settle as many claims as possible within the policy limits.”<sup>73</sup> The third requires the insurer to choose certain claimants to settle with in a manner that minimizes the insured’s risk of an excess judgment.<sup>74</sup> This third requirement distinguishes this variation from the insurer’s business judgment seen in *Scott*.<sup>75</sup> Instead of allowing the insurer to simply choose to settle with claimants under a broad first to settle approach, the insured must rationalize its choice of who to settle with.

The fourth approach of filing an interpleader action is generally available to an insurer regardless of which of the three traditional approaches that a specific jurisdiction follows.<sup>76</sup> Interpleader allows the insurer to place the insurance proceeds with the court, while the various claimants litigate their rights to the funds.<sup>77</sup> Various jurisdictions have suggested the use of filing an interpleader action when there exists multiple claims and limited funds.<sup>78</sup> These courts stress the benefit of filing an interpleader action is that it greatly reduces the chances of an insurer’s actions being construed as bad faith.<sup>79</sup> Some courts have even suggested that an insurer’s failure to file an interpleader action is evidence of bad faith.<sup>80</sup> The use of interpleader also discharges an insurer’s duty to indemnify.<sup>81</sup> Another benefit

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<sup>68</sup> *Id.*

<sup>69</sup> *Id.* at \*2.

<sup>70</sup> Stern, *supra* note 5, at 19.

<sup>71</sup> *Id.*

<sup>72</sup> *Id.* (quoting *Farinas v. Fla. Farm Bureau Gen. Ins. Co.*, 850 So.2d 555, 560–61 (Fla. Dist. Ct. App. 2003)).

<sup>73</sup> *Id.* (quoting *Farinas*, 850 So.2d at 560).

<sup>74</sup> *Id.* (quoting *Farinas*, 850 So.2d at 560).

<sup>75</sup> *Scott v. Gallacher*, No. 10-P-209, 2011 WL 93084, \*2 (Mass. App. Ct., Jan. 11, 2011).

<sup>76</sup> See *Grage & Jones*, *supra* note 5.

<sup>77</sup> *Richmond*, *supra* note 4 at 877.

<sup>78</sup> *E.g.*, *Club Exch. Corp. v. Searing*, 567 P.2d 1353, 1356 (Kan. 1977); *McReynolds v. Am. Commerce Ins. Co.*, 235 P.3d 278, 284 (Ariz. Ct. App. 2010).

<sup>79</sup> See *Grage & Jones*, *supra* note 5.

<sup>80</sup> See *McNally v. Nationwide Ins. Co.*, 815 F.2d 254, 262–63 (3d Cir. 1987).

<sup>81</sup> *Richmond*, *supra* note 4, at 877.

to the use of interpleader is that it provides compensation to each worthy claimant.<sup>82</sup>

On its face, the use of interpleader seems like a simple solution to a complex problem; however, there are a number of issues that interpleader does not address. One is it is unclear whether an insurer's use of interpleader will discharge the insurer's duty to defend because the claimants may still proceed against the insured despite the insurer exhausting the policy limits in the interpleader action.<sup>83</sup> As such, an insurer cannot be certain whether it has discharged all of its obligations to its insured, thus leaving the door open to claims of bad faith by the insured or claimants.<sup>84</sup>

Another problem with interpleader is that it does not automatically release the insured from the full amount of liability resulting from the judgment of an interpleader action.<sup>85</sup> Unlike the insurer's duty to indemnify, which includes the duty to seek a release of liability for the insured, an insured may still be subject to liability that is not completely covered by the insured's policy upon the judgment of an interpleader action.<sup>86</sup> This means, although an insurer has filed an interpleader action, the insured may still be subject to the full amounts of any judgment rendered against the insured, regardless of the policy limits. Although an insurer that files an interpleader action which results in an excess judgment cannot reasonably be held to have acted in bad faith, the result of an excess judgment against the insured is not a desirable outcome.

Ultimately, Kentucky courts have not made it clear which approach is applicable in Kentucky. However, as mentioned in the discussion of *Jones*, Kentucky may arguably be a pro rata state.<sup>87</sup> If an insurer strictly followed the pro rata rule in *Jones*, though, the insurer's actions are contrary to the purposes of the duties it owes to both the claimant and insured. The pro rata rule implicates an insurer's duty to act in good faith in effectuating a prompt settlement by requiring the lengthy process of litigating each claim.<sup>88</sup> This means that certain claimants who are willing to negotiate a global settlement must wait for the conclusion of litigation before receiving their fair share, depriving them of a prompt settlement. The pro rata rule's requirement of litigating each individual claim to determine the damages each claimant is entitled to clearly conflicts with the KUCSPA promotion of prompt settlements.<sup>89</sup> Furthermore, requiring litigation to determine each claimant's share provides an unnecessary burden on the court when there exists

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<sup>82</sup> See *Grage & Jones*, *supra* note 5.

<sup>83</sup> *Richmond*, *supra* note 4, at 878.

<sup>84</sup> *Id.*

<sup>85</sup> See *id.*

<sup>86</sup> See *id.*

<sup>87</sup> See *Underwriters for Lloyds of London v. Jones*, 261 S.W.2d 686, 688 (Ky. 1953).

<sup>88</sup> KY. REV. STAT. ANN. 304.12-230(6) (2008); see *Jones*, 261 S.W.2d at 688; *Richmond*, *supra* note 4 at 880-81.

<sup>89</sup> See § 304.12-230(6).

more efficient approaches to handle these situations, such as the first to settle approach.

On the other hand, an insurer may disregard *Jones* and proceed with settlements on a first to settle basis in an effort to provide prompt settlements under the KUCSPA. Yet, if an insurer follows this approach, the insurer risks incurring bad faith liability arising from its failure to settle with certain claimants where liability is also reasonably clear and for subjecting the insured to an excess judgment arising from the non-settling claimants. Although some commentators have considered Kentucky a pro rata state because of *Jones*,<sup>90</sup> it is important to note that *Jones* was decided well before the good faith duties of protecting the insured from an excess judgment and to effectuate prompt and fair settlements to claims where liability is reasonably clear were firmly established Kentucky law.<sup>91</sup>

### *B. Bad Faith Analysis in Multiple Claims and Limited Funds Situations*

Each of these approaches is subject to a fair share of problems, which are addressed through each jurisdiction's bad faith analysis. However, Kentucky law lacks a bad faith analysis for the situation of settling with certain claimants to the exclusion of others.<sup>92</sup> Before addressing the ideal solution for Kentucky, an examination of other jurisdictions' bad faith reasoning is necessary.

The issue of bad faith by an insurer for settling for the policy's limits with certain claimants to the exclusion of others was at issue in *Safeco Insurance Company v. Ritz*, a 2006 federal case in the Eastern District of Kentucky.<sup>93</sup> In *Ritz*, similar to the hypothetical at the beginning of this note, the insured had an automobile liability policy with bodily injury limits of \$25,000 per person and \$50,000 per occurrence.<sup>94</sup> The insured was involved in an accident that caused bodily injury to one of his passengers and two other persons in another vehicle.<sup>95</sup> The insurer, without notice that the passenger intended to file a claim and after informing the insured that the policy's limits were not very high, settled with the two injured claimants from the other vehicle, exhausting the policy limits.<sup>96</sup> Subsequent to these settlements, the passenger filed a claim, prompting the insurer to seek a declaration that it had acted in good faith in settling the claims with the

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<sup>90</sup> See Grage & Jones, *supra* note 5; ROBERT D. MONFORT, KENTUCKY MOTOR VEHICLE INSURANCE LAW § 7:4 (2015–2016 ed.); see also *Jones*, 261 S.W.2d at 688.

<sup>91</sup> § 304.12-230(6) (established in 2008, while *Jones* was decided in 1953); *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493, 498 (Ky. 1975) (decided in 1975, while *Jones* was decided in 1953).

<sup>92</sup> See *Safeco Ins. Co. v. Ritz*, No. Civ.A. 03-240, 2006 WL 119991, at \*6 (E.D. Ky. Jan. 12, 2006) (“Neither the parties nor the Court have been able to locate any Kentucky case involving a bad faith claim where the insurer settles with certain claimants to the exclusion of other claimants.”).

<sup>93</sup> *Id.*

<sup>94</sup> *Id.* at \*1.

<sup>95</sup> *Id.*

<sup>96</sup> *Id.*

injured persons in the other vehicle and that it no longer had a duty to indemnify or defend the insured against the subsequent claimant.<sup>97</sup>

The court began its analysis by examining the duty to defend provision in the policy, which read: “Our duty to settle or defend ends when our limit of liability for this coverage has been exhausted.”<sup>98</sup> The court reasoned that under Kentucky law, an insurer’s duty to defend ends when an insurer establishes that the liability claimed is not covered by the policy.<sup>99</sup> To support this rule, the court cited *Kentucky Association of Counties All Lines Fund Trust v. McClendon*. In *McClendon*, the issue was whether the insurer had a duty to defend fiscal court magistrates who had illegally increased their salaries against a suit brought by the People for Ethical Government, Inc.<sup>100</sup> The Kentucky Supreme Court held that the duty to defend did not extend to this suit because the nature of the actions of the magistrates was not covered by the policy. However, as explained earlier, Kentucky law is not clear on whether the duty to defend terminates at the same time as the duty to indemnify where the policy states that both the duty to defend and indemnify terminates when an insurer has exhausted the policy limits.<sup>101</sup> As such, the use of the rule in *McClendon* in this situation is debatable. Regardless, the *Ritz* court held that the insurer’s duty to defend had terminated as long as the settlements were valid and entered in good faith.<sup>102</sup>

The court prefaced its analysis of whether the settlements were valid and entered in good faith by stating that neither the parties nor the court were able to locate a Kentucky case addressing the issue.<sup>103</sup> Although the court did not render judgment on this issue due to the lack of discovery with regard to it, the court provided what it reasoned would be the proper analysis under Kentucky law.<sup>104</sup> Ultimately, the court structured its analysis similar to a bad faith failure to settle action with one claimant.<sup>105</sup> The court specifically mentioned the three factors involved with that analysis, and adapted those factors to represent a situation involving multiple claimants. Those factors were:

[W]hether the settlement offers of all the claimants totaled the policy limits or less, (2) whether the insured demanded that the insurer settle with all claimants, and (3) the probability that the claimants excluded from the settlement would obtain a jury

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<sup>97</sup> *Id.* at \*2.

<sup>98</sup> *Id.* at \*5.

<sup>99</sup> *Id.*

<sup>100</sup> *Ky. Ass’n of Cts. All Lines Fund Tr. v. McClendon*, 157 S.W.3d 626, 628–29, 635 (Ky. 2005).

<sup>101</sup> *See Am. Physicians Assurance Corp. v. Schmidt*, 187 S.W.3d 313, 319 (Ky. 2006); *Ursprung v. Safeco Ins. Co. of Am.*, 497 S.W.2d 726, 729–31 (Ky. 1973).

<sup>102</sup> *Ritz*, 2006 WL 119991, at \*5.

<sup>103</sup> *Id.* at \*6 (“Neither the parties nor the Court have been able to locate any Kentucky case involving a bad faith claim where the insurer settles with certain claimants to the exclusion of other claimants.”).

<sup>104</sup> *Id.* at \*6–8.

<sup>105</sup> *Id.*

verdict or verdicts against the insured which would exceed the policy limits.<sup>106</sup>

However, believing that this analysis was inadequate, the court examined other states' reasoning regarding the settlement with certain claimants to the exclusion of others.<sup>107</sup>

The *Ritz* court looked to the Kansas case of *Levier v. Koppenheffer*, where the court was faced with multiple claims and limited funds.<sup>108</sup> In *Levier*, the insured, Koppenheffer, was at fault in an automobile accident that injured Cartwright and Levier.<sup>109</sup> The insurer, Aetna, promptly investigated the accident and concluded that the aggregate claims by the two injured parties would exceed Koppenheffer's policy limit of \$100,000.<sup>110</sup> Within the next month, Aetna sent a letter to Koppenheffer informing him that Cartwright and Levier's claims would exceed his policy limits.<sup>111</sup> The letter also advised Koppenheffer that he might wish to retain his own attorney.<sup>112</sup> Several months after the accident, Aetna prepared a detailed report that valued Levier's claim at \$2,120,000.00 and Cartwright's at \$49,965.67.<sup>113</sup> The report recommended offering each claimant a \$25,000 settlement and placing the remaining funds with the court in an interpleader action.<sup>114</sup> Aetna proposed this settlement to each of the claimants, settling with Cartwright for the \$25,000 and receiving a counteroffer from Levier for \$100,000.<sup>115</sup> However, Aetna did not respond to Levier and failed to inform Koppenheffer of Levier's counteroffer.<sup>116</sup> Instead, Aetna proceeded to place the remaining policy limits with the court in an interpleader action.<sup>117</sup> Subsequently, Levier obtained a judgment of \$600,000 against Koppenheffer.<sup>118</sup> Koppenheffer assigned his right to a bad faith cause of action against Aetna to Levier for a full release of liability.<sup>119</sup>

To determine if Aetna had acted in bad faith, the court considered eight factors:

- (1) [T]he strength of the injured claimant's case on the issues of liability and damages;
- (2) attempts by the insurer to induce the

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<sup>106</sup> *Id.* at \*7.

<sup>108</sup> *Id.*

<sup>109</sup> *Levier v. Koppenheffer*, 879 P.2d 40, 42-43 (Kan. Ct. App. 1994).

<sup>110</sup> *Id.*

<sup>111</sup> *Id.* at 43.

<sup>112</sup> *Id.*

<sup>113</sup> *Id.*

<sup>114</sup> *Id.*

<sup>115</sup> *Id.*

<sup>116</sup> *Id.*

<sup>117</sup> *Id.*

<sup>118</sup> *Id.*

<sup>119</sup> *Id.*

insured to contribute to a settlement; (3) failure of the insurer to properly investigate the circumstances so as to ascertain the evidence against the insured; (4) the insurer's rejection of advice of its own attorney or agent; (5) failure of the insurer to inform the insured of a compromise offer; (6) the amount of financial risk to which each party is exposed in the event of a refusal to settle; (7) the fault of the insured in inducing the insurer's rejection of the compromise offer by misleading it as to the facts; and (8) any other factors tending to establish or negate bad faith on part of the insurer.<sup>120</sup>

In analyzing the factors, the court found Levier had a strong case against Koppenheffer for both liability and the amount of damages.<sup>121</sup> First, Aetna made no effort to induce Koppenheffer to contribute to the settlement.<sup>122</sup> Second, Aetna had not informed Koppenheffer of Levier's compromise offer.<sup>123</sup> Third, and noted as the most significant factor in this case, was that Aetna was not exposed to any greater financial risk if the Levier refused to settle because Aetna was going to exhaust the full amount of the policy limits regardless of Levier's decision.<sup>124</sup> Koppenheffer, instead, faced the risk of being liable for over \$2 million as opposed to only being liable for the difference between Levier's \$100,000 counteroffer and the \$25,000 that Aetna had settled with Cartwright for.<sup>125</sup> After analyzing the factors, the Court of Appeals of Kansas found that Aetna had breached its duty of good faith to Koppenheffer.<sup>126</sup>

The *Ritz* court also looked to *TIG Insurance Co. v. Smart School*, a federal case applying Florida law.<sup>127</sup> In that case, Smart School had a liability policy from TIG insurance that covered "sexual abuse occurrence" with a \$1 million per occurrence limit.<sup>128</sup> Under the terms of the policy, a single "sexual abuse occurrence" included multiple acts of abuse if done by one individual. On August 18, 2003, "D.N.," a parent of a "A.N." who was a student at Smart School, filed suit alleging that Curtis Gordon, a Smart School teacher, began inappropriately touching A.N. in July of 2002, which culminated in her rape on August 30, 2002.<sup>129</sup> The suit alleged that Smart School failed to properly respond to complaints that Gordon was inappropriately touching A.N.<sup>130</sup> TIG defended Smart

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<sup>120</sup> *Id.* at 46–47 (quoting *Bollinger v. Nuss*, 449 P.2d 502, 512 (1969)).

<sup>121</sup> *Id.* at 47.

<sup>122</sup> *Id.*

<sup>123</sup> *Id.*

<sup>124</sup> *Id.*

<sup>125</sup> *Id.*

<sup>126</sup> *Id.*

<sup>127</sup> *Safeco Ins. Co. v. Ritz*, No. Civ.A. 03-240, 2006 WL 119991 \*8 (E.D. Ky. Jan. 12, 2006).

<sup>128</sup> *TIG Ins. Co. v. Smart School*, 401 F. Supp. 2d 1334, 1338–40 (S.D. Fla. 2005).

<sup>129</sup> *Id.* at 1338.

<sup>130</sup> *Id.*



School, and on June 4, 2004, the court approved a confidential settlement.<sup>131</sup> Subsequently, on September 20, 2004, "P.J.," a parent of "J.J." who was also a student at Smart School, filed suit against Smart School for failing to respond to complaints that Gordon was sexually abusing J.J. from November 2001 until May 2002.<sup>132</sup> On April 2, 2004, Jose Silva, who represented both A.N. and P.J., sent a demand letter to defense counsel inquiring about the available limits with regard to both A.N. and P.J.'s claims.<sup>133</sup> TIG contended that it first learned of P.J.'s claim in May 2004, the same month that it reached a settlement agreement for A.N.<sup>134</sup>

The issue before the court was whether TIG had violated its duty of good faith in protecting Smart School from an excess judgment when it settled with A.N. for an amount that, although confidential, the court admitted exhausted most of the policy's limits.<sup>135</sup> In analyzing the issue, the court laid out four obligations of the insurer to demonstrate good faith when settling with certain claimants to the exclusion of others. These obligations required the insurer to:

- (1) fully investigate all claims arising from a multiple claim accident;
- (2) seek to settle as many claims as possible within the policy limit;
- (3) minimize the magnitude of possible excess judgments against the insured by reasoned claim settlement; and
- (4) keep the insured informed of the claim resolution process.<sup>136</sup>

In granting summary judgment in favor of TIG, the court noted that Smart School had only provided two facts that suggested bad faith by TIG.<sup>137</sup> The first was that TIG knew of P.J.'s claim before the settlement proposal was submitted to the court.<sup>138</sup> The second was that TIG did not inform Smart School when it settled the A.N. lawsuit that TIG's position was that the \$1 million single occurrence limit was applicable to both claims.<sup>139</sup> The court concluded that even if these allegations were true, no reasonable juror could find from only these two facts that TIG had breached its duty of good faith.<sup>140</sup>

The third case the *Ritz* court relied on was *Carter v. State Farm Mutual Automobile Insurance Company*.<sup>141</sup> In *Carter*, Michelle Keefe was at fault in an automobile accident on April 25, 1997, that injured three people, including

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<sup>131</sup> *Id.*

<sup>132</sup> *Id.*

<sup>133</sup> *Id.*

<sup>134</sup> *Id.*

<sup>135</sup> *Id.* at 1337.

<sup>136</sup> *Id.* at 1350 (quoting *Gen. Sec. Nat'l Ins. Co. v. Marsh*, 303 F. Supp. 2d 1321, 1325 (M.D. Fla. 2004)).

<sup>137</sup> *Id.* at 1350–51.

<sup>138</sup> *Id.* at 1351.

<sup>139</sup> *Id.*

<sup>140</sup> *Id.*

<sup>141</sup> *Safeco Ins. Co. v. Ritz*, No. Civ.A. 03-240, 2006 WL 119991, at \*8 (E.D. Ky. Jan. 12, 2006).

Thomas Carter, and killed a fourth.<sup>142</sup> Keefe had a policy with State Farm that had limits of \$50,000 per person and \$100,000 per occurrence.<sup>143</sup> On May 15, 1997, State Farm sent a letter to Carter's attorney suggesting the potential claimants should meet for a settlement conference.<sup>144</sup> Carter's attorney replied that a settlement conference was premature because Carter and another of the injured claimants were still receiving medical treatment and were not sure of the extent of their injuries.<sup>145</sup>

On June 9, 1997, State Farm informed Carter's attorney that it had received a demand from the deceased claimant's estate for \$50,000 and that State Farm must decide that day whether to accept or not.<sup>146</sup> State Farm accepted the settlement with the deceased's estate, leaving only \$50,000 of the policy limits available for the other claimants.<sup>147</sup> Carter then demanded the remaining \$50,000 to settle his claim. State Farm encouraged Carter to engage in global settlement negotiations with the other claimants.<sup>148</sup> Carter, however, refused and State Farm proceeded to settle with two other claimants paying out \$45,000, and tendering an unconditional check to Carter for \$4,000.<sup>149</sup> Carter subsequently filed a suit against State Farm for breaching its duty of good faith and fair dealing.<sup>150</sup>

In affirming the trial court's summary judgment for State Farm, the court of appeals pointed to two facts that supported a finding of good faith. First, the court noted State Farm had requested Carter's participation at a global settlement conference, which Carter denied.<sup>151</sup> Second, State Farm kept other claimants informed with regard to the deceased claimant's demand and subsequent settlement for \$50,000.<sup>152</sup>

A common thread is seen in each of the cases that *Ritz* relied upon. Ultimately, each case turned on, to a varying extent, whether the insurer investigated, communicated the situation to each party, and whether the claimants cooperated. As such, and discussed in greater detail in Part III, an analysis that promotes prompt settlements and protects an insured from an excess judgment must incorporate these elements.

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<sup>142</sup> *Carter v. State Farm Mut. Auto. Ins. Co.*, 33 S.W.3d 369, 370–71 (Tex. App. 2000).

<sup>143</sup> *Id.* at 371.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> *Id.*

<sup>147</sup> *Id.*

<sup>148</sup> *Id.*

<sup>149</sup> *Id.*

<sup>150</sup> *Id.*

<sup>151</sup> *Id.* at 372.

<sup>152</sup> *Id.* at 371.

*C. Approaches to the Duty to Defend Upon Exhaustion of Policy Limits*

After wading through the various bad faith approaches, the issue of whether the insurer's duty to defend continues after exhaustion of the policy limits remains. Kentucky courts have expressed, in dicta, that the duty to defend may continue after exhaustion of the policy limits regardless of the policy's language,<sup>153</sup> despite the majority rule from other jurisdictions that gives deference to the policy's language. Under the majority rule, courts enforce policy language that states that the duty to defend terminates when the policy limits are exhausted.<sup>154</sup> When the policy does not speak to this question, the duty to defend extends to claims that remain or arise after the exhaustion of the policy's limits.<sup>155</sup>

The wide-ranging approaches to whether and how an insurer may settle in good faith with certain claimants to the exclusion of others and whether the duty to defend extends past this point demonstrate that no jurisdiction has yet to find an ideal solution. Each approach has both its advantages and disadvantages, but taken as a whole, these approaches lay an adequate foundation for Kentucky to develop a unique solution that furthers prompt settlements that protect an insured from an excess judgment.

### III. A UNIQUE SOLUTION FOR KENTUCKY

Due to the lack of Kentucky case law on this issue and the prevalence of liability insurance, Kentucky insurers, insureds, and claimants need guidance. Such guidance should address this problem in a way that is consistent with the KUCSPA's promotion of prompt settlements.<sup>156</sup> Furthermore, the solution must also promote the protection of insureds from excess judgments, while providing insurers with sufficient guidance so as to conduct their settlement procedures without worry of a subsequent claim of bad faith.

First and foremost, Kentucky courts should make clear the type of approach that is to be applied in multiple claimants and limited funds situations. Kentucky is arguably a pro rata state based on *Jones*.<sup>157</sup> However, this opinion is outdated and largely irrelevant in light of the rise of bad faith claims for failing to effectuate prompt and fair settlements to claims where liability is reasonably clear. The lengthy process of litigating each potential claim before distributing any of the insurance funds is contrary to the KUCSPA's language seeking prompt settlements.<sup>158</sup> A pro rata approach is also opposed to the duty an insurer owes to its insured in protecting the insured from an excess judgment, because the insured

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<sup>153</sup> See *Am. Physicians Assurances Corp. v. Schmidt*, 187 S.W.3d 313, 319 (Ky. 2006).

<sup>154</sup> See REDEMANN & SMITH, *supra* note 20.

<sup>155</sup> *Id.*

<sup>156</sup> See KY. REV. STAT. ANN. § 304.12-230(6) (2008).

<sup>157</sup> *Underwriters for Lloyds of London v. Jones*, 261 S.W.2d 686, 688 (Ky. 1953).

<sup>158</sup> See § 304.12-230(6).

is not necessarily released from the excess liability that may result from the court's judgment. As such, the pro rata approach serves no current identifiable purpose under Kentucky insurance law.

Instead, Kentucky courts should align themselves with the number of other states that allow insurers to settle claims on a first to settle basis subject to a good faith standard. Allowing insurers this authority will further the purpose of the KUCSPA to effectuate prompt settlements where liability is reasonably clear, instead of applying a pro rata or interpleader approach that is subject to the lengthy process of litigating each individual claim. Furthermore, an established first to settle rule would also facilitate claimants to pursue claims on a timely basis for fear of losing out on the insurance proceeds. This increased pressure on claimants would also result in an increased likelihood of a global settlement among all claimants, which would release the insured thus protecting against an excess judgment.

After establishing Kentucky as a first to settle state, the bad faith analysis should be structured with the goal of facilitating prompt and fair settlements that protect the insured from an excess judgment. This is best done by an analysis that grants greater discretion to an insurer when settling claims where the possibility of multiple claims may exceed the policy limits. It is important to note, however, that this increased discretion should only be available to the insurer when there exists a reasonable likelihood that there will be *multiple* claims, and not in the case of an insurer failing to settle with a single claimant, which is settled Kentucky law.<sup>159</sup> Like the Massachusetts Court of Appeals in *Scott*, this greater discretion is deference to the insurer's business judgment.<sup>160</sup> This deference is best effectuated by adapting Kentucky's bad faith factors in single claimant situations and various other states' factors for determining bad faith in multiple claimant situations into a step-by-step analysis. This step-by-step analysis would place the burden on the insured or claimant to show that the insured failed to meet the standard required for each step the insurer took when it settled with certain claimants to the exclusion of others.

The logical starting point for this analysis, demonstrated by the cases *Ritz* examined, is the insured's investigation of potential claims arising out of a potentially covered occurrence.<sup>161</sup> This standard, however, should be limited to a reasonable investigation by the insurer in multiple claims situations. To require a full investigation suggests that if the insurer were to reasonably investigate, yet for some valid reason overlook a claim where liability is reasonably clear, the insurer would have acted in bad faith.

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<sup>159</sup> See *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 451–53 (Ky. 1997).

<sup>160</sup> See *Scott v. Gallacher*, No. 10-P-209, 2011 WL 93084, \*2 (Mass. App. Ct., Jan. 11, 2011).

<sup>161</sup> See *supra* Section II.B.

Furthermore, a reasonableness standard increases the burden of timely filing a claim on the potential claimant, instead of completely relying on the insurer to contact them. This would also have the effect of not requiring an insurer to extend settlement negotiations to a potential claimant who, otherwise, had no intention of filing a claim. This would, in turn, also limit the insured's exposure by not bringing in potential claimants who did not seek insurance proceeds, thus protecting the insured from an excess judgment.

After a reasonable investigation, the next logical step is to analyze whether the potential claims would lead a reasonable insurer to believe that the aggregate of potential claims would exceed the insured's policy limits. If an insurer reasonably believes that the aggregate of the potential claims would not exceed the policy limits, then the issue of multiple claims and limited funds simply does not exist. If the insurer does reasonably find that the aggregate claims will exceed the policy limits, the next step is to ascertain whether the insurer made reasonable attempts to communicate to both the insured and potential claimants that there exist multiple claims and limited funds. Within this step, the insurer must also give potential claimants a reasonable time to respond before entering into settlement negotiations with those parties that had in fact filed claims. This would further incentivize potential claimants to act timely in filing a claim after being notified of the situation, thus promoting prompt settlements. This would also incentivize the various claimants to seek a global settlement with regard to the limited funds available due to their knowledge that limited funds exist. Additionally, this global settlement would allow the insurer to obtain releases of liability for the insured, thus protecting the insured from an excess judgment.

Under this analysis, if an insurer has sufficiently met the requirements at each stage, yet does not receive cooperation from potential claimants, the insurer has the discretion to settle with the claimants that have timely filed and cooperated in settlement discussions without fear of uncooperative claimants filing a bad faith action against the insurer.

Furthermore, the problem with regard to whether an insurer continues to owe a duty to defend its insured against a claim after exhausting the policy limits must be addressed. As explained earlier, Kentucky courts' past rulings suggest that an insurer could be obligated to defend an insured after the insurer has paid out the policy limits regardless of the terms of the policy.<sup>162</sup> This is contrary, however, to both the majority rule and the plain words of the policy.<sup>163</sup> As such, Kentucky courts should align themselves with the majority in applying a bright-line rule that first looks to whether the policy speaks to whether the duty to defend continues in such situations. If the policy does, then the policy governs. If, however, the policy does not speak to the duty to defend in such situations, the policy should be

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<sup>162</sup> See *supra* Section I.A.

<sup>163</sup> See *supra* Section I.A.

construed in favor of the insured thus extending the insurer's duty to defend the insured in against any remaining or subsequent claims.

#### CONCLUSION

The situation of multiple claims and limited funds has wide reaching implications for the insured, insurer, and potential claimants. Under the current state of Kentucky law, these parties are without sufficient guidance for navigating such a situation. As such, Kentucky courts must resolve this matter. Most importantly, the solution must seek to clarify the implicated parties' rights and obligations. This clarification should promote prompt settlements that protect an insured from an excess judgment, while also providing sufficient guidance to insurers in determining best practices. Firmly establishing Kentucky as a first to settle state is the first step in this process. Next, Kentucky courts should adopt a step-by-step analysis that would facilitate prompt settlements and protect insureds from excess judgments. Adopting steps that grant insurer's increased discretion in multiple claimant situations would further this purpose. Specifically, the steps of: (1) did the insurer perform a reasonable investigation of potential claims; (2) would this reasonable investigation lead a reasonable insurer to believe that the claims exceeded the policy's limits; and (3) did the insurer communicate this situation to both the insured and potential claimants, would grant clarity on this issue while also protecting each party's interests.



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