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Kentucky Law Survey: Insurance

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Insurance

BY RICHARD H. UNDERWOOD*

INTRODUCTION

This Survey will examine recent Kentucky decisions on insurance law issues, and comment on the latest crop of cases relating to the application and construction of the Kentucky Motor Vehicle Reparations Act (MVRA).¹ In addition, this Survey will discuss proposed unfair claims settlement practices legislation, which is once again generating interest in the Commonwealth.²

I. UNFAIR CLAIMS SETTLEMENT PRACTICES

Recently, a trend toward judicial expansion of the tort of "insurer's bad faith" has developed.³ In addition, there has been widespread adoption of parallel legislation defining "unfair claims settlement practices."⁴

As early as 1947 the National Association of Insurance Commissioners (NAIC) drafted a Model Unfair Trade Practices Act. A successor Model Act was adopted in 1971.⁵ At last count, thirty-two states had adopted the Act in whole or in part.⁶ While some insurers may view the proliferation of such statutes with alarm,

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¹ For other recent Surveys of Kentucky insurance law see Savage, *Kentucky Law Survey—Insurance*, 66 KY. L.J. 631 (1977-78); Straub, *Kentucky Law Survey—Insurance*, 68 KY. L.J. 587 (1979-80); Underwood, *Kentucky Law Survey—Insurance*, 70 KY. L.J. 255 (1981-82).

² Such legislation was nearly enacted in the last session of the General Assembly and a recommendation was recently made that the National Association of Insurance Commissioners (NAIC) Model Law be prefiled for consideration in the 1984 session. Letter from Patrick Watts, Esq., Counsel, Department of Insurance (Aug. 2, 1983). The new bill in the legislature is currently referred to as 84-BR-237 (1984), and is sponsored by Representatives Cline and Foster.

³ See Underwood, *The Doctor and His Lawyer: Conflicts of Interest*, 30 U. KAN. L. REV. 385 (1982), reprinted in 32 DEF. L.J. 25 (1983).

⁴ See Best, *Statutes and Regulations Controlling Life and Health Insurance Claims Practices*, 29 DEF. L.J. 115 (1980) for a valuable survey of the subject.

⁵ *Id.* at 152-61 app.

⁶ *Id.* at 117-18. Best notes that six additional states have adopted non-uniform legislation, and that other states have proceeded by way of administrative regulations. *Id.* at 120-26.

other commentators have advanced more balanced, if qualified, views. For example, an "insider" in the insurance industry recently opined:

[A]bsent the availability of severe sanctions for a single violation of a single prohibition, the long list of disapproved practices is more of a helpful guide to pitfalls to be avoided than it is a threat. Some insurers may be engaging in prohibited practices without having considered the inappropriateness of the practice. A review of the list would . . . improve the quality of the insurer's claim administration. Even though some practices may be prohibited in a State in which the insurer does no business, avoiding those practices could reduce consumer complaints and lawsuits. In addition, compliance with all those rules should go a long way toward eliminating any chance of behaving in such a way as would be construed to justify an award of punitive damages.⁷

On the other hand, the "availability of severe sanctions for a single violation of a single prohibition" probably led to the demise of House Bill 360, the proposed Kentucky Unfair Claims Settlement Practices Act, which failed to clear a Senate committee after approval by the House in the last session of the General Assembly.⁸

The "unfair claims settlement practices" prohibited by House Bill 360 are similar to those set forth in the Model Act, which will be considered in the 1984 session as Bill 84-BR-237.⁹ However, House Bill 360 contained several interesting and controversial subsections which are not contained in the new proposal. Unfortunately, the deletion of these subsections may simply shift the most controversial questions concerning such legislation from the legislature to the courts.

Section 1(3) of House Bill 360 contained a list of thirteen "unfair claims settlement practices" in subsections (a) through (m). These subsections correspond to numbered subsections of the act now under consideration. The only differences between the types of practices listed in the old and new proposals is the inclusion of

⁷ *Id.* at 151.

⁸ H.R. 360, 1982 Reg. Sess. (introduced by Rep. Jim LeMaster).

⁹ Compare 84-BR-234 with Uniform Claims Settlement Practice Model Regulation, reprinted in Best, *supra* note 4, at 162-66 app.

one additional "unfair act" in the new proposal,¹⁰ and the deletion of a catch-all prohibiting "any other act or practice in connection with claims settlement which is unfair or deceptive."¹¹

A. *Old Wine In A New Bottle?*

At least one of the practices listed in these proposed acts is already grounds for imposing extracontractual liability on insurers under Kentucky law. A number of other listed practices have some counterpart in Kentucky statutes or case law. Accordingly, many of the legislatively defined "unfair practices" should generate little controversy. Consider the following "unfair claims settlement practices" listed in both House Bill 360 (lettered), and proposed bill 84-BR-237 (numbered):

(f)(6) Not attempt in good faith to effectuate prompt, fair and equitable settlement of claims in which liability has become reasonably clear;

. . . .

(h)(8) Attempt to settle a claim for less than the amount to which a reasonable person would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;

(i)(9) Attempt to settle on the basis of an application which was altered without notice to or knowledge or consent of the insured;

At least with regard to third party claims, the first of the above subsections reflects established Kentucky case law regarding the consequences of an insurer's failure to exercise good faith in deciding whether to litigate or settle an action in which a plaintiff's claims exceed the policy limits (the so-called "excess case").¹² A "bad faith" refusal to settle the third party plaintiff's tort claim against the insured may result in the insurer's liability for the judgment, not only up to the policy limits, but also for any excess judg-

¹⁰ See 84-BR-237 § 1(12).

¹¹ H.R. 360, *supra* note 8, at § 1(n).

¹² See, e.g., *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493 (Ky. 1975). For a discussion of *Grundy* see Comment, *Wrongful Refusal to Settle: The Implications of Grundy in Kentucky*, 65 Ky. L.J. 220 (1976-77).

ment above the policy limits.¹³ Moreover, the acts add little that is new by suggesting that a wrongful refusal to settle a first party claim (i.e., an insured's claim under a life, property, health, or disability insurance policy) is also "unfair,"¹⁴ although Kentucky courts have been reluctant to recognize extracontractual liability in the context of first party claims.¹⁵

The second of the above subsections is consistent with the recent decision in *Continental Casualty Co. v. Smith*,¹⁶ in which ambiguous promotional materials induced an insurance applicant to believe that the income from her business was insured, as opposed to her individual wage or salary.¹⁷ In the course of holding that the pamphlets and fliers supplied by the insurer should be deemed part of the policy, the court observed that "[t]o hold otherwise 'would be sustaining a fraud that no court of conscience could sanction.'"¹⁸

Finally, the last of the above subsections is consistent with Kentucky Revised Statutes (KRS) section 304.14-090, which provides in pertinent part:

(1) Any application for insurance in writing by the applicant shall be altered solely by the applicant or by his written consent.

...

....

(3) An insurer issuing a policy upon an application which has been unlawfully altered by its officer, employe, or agent shall not

¹³ 531 S.W.2d at 498. This doctrine will not be applied in the absence of a settlement offer for the policy limits or less. See *Cooper v. Automobile Club Ins. Co.*, 638 S.W.2d 280, 281 (Ky. Ct. App. 1981).

¹⁴ See *Wabash Life Ins. Co. v. Maguire*, 461 S.W.2d 916, 920 (Ky. 1970) ("Viewing this case in perspective, it seems remarkable to us that a reputable insurance carrier, with as little justification as we can find in this record, would subject the beneficiary of its policies to the burden of litigating her claim to a court of last resort.").

¹⁵ See *Deaton v. Allstate Ins. Co.*, 548 S.W.2d 162, 164-65 (Ky. Ct. App. 1977). But see *Feathers v. State Farm Fire & Casualty Co.*, No. 83-CA-158-MR (Ky. Ct. App. Aug. 5, 1983); noted in *Harvey & Wiseman, First Party Bad Faith: Common Law Remedies and a Proposed Legislative Solution*, 72 Ky. L.J. 141 (1983-84) (although this case purports to recognize first party bad faith, the opinion was issued after settlement of the case and filing of a motion to dismiss the appeal); *Hoskins v. Aetna Life Ins. Co.*, 52 U.S.L.W. 2169 (Ohio Aug. 24, 1983) (recognizing first party bad faith).

¹⁶ 617 S.W.2d 48 (Ky. Ct. App. 1980).

¹⁷ *Id.* at 50.

¹⁸ *Id.* at 51 (quoting *Southern Mutual Life Ins. Co. v. Montague*, 2 S.W. 443 (Ky. 1887)).

have available in any action arising out of such policy, any defense based upon the fact of such alteration, or as to any item which was so altered.¹⁹

It would be misleading to suggest, on the basis of this handful of examples, that the proposed legislation might not clarify, and in some cases greatly expand, the scope and extent of insurer's liability under existing law.²⁰ Instead, I would suggest that the perennial opposition to unfair claims practices legislation invariably focuses on the expansion of the number of claimants with standing to seek tort remedies against insurers, and the severity of express or implied sanctions applied to single instances of "unfair" conduct, rather than on the practices of the insurer that are prohibited.

B. *Potential Sources of Resistance to the Proposed Legislation*

1. *First and "Fourth Party" Bad Faith*

Section 1(3) of House Bill 360 would have made it an "unfair claims settlement practice" for a "person"²¹ to "willfully" commit any of the designated offenses which results in injury to first or third party claimants. As mentioned above, Kentucky has been reluctant to recognize a claim for first party "bad faith."²² A good

¹⁹ For a case applying this statute, see *Anderson v. Zurich Ins. Co.*, 614 S.W.2d 246, 247 (Ky. 1980).

²⁰ *Cf.* National Law Journal, Sept. 7, 1981, at 7, col. 2 (reporting a \$3.25 million jury award under the California Unfair Claims Practice Act, against an insurer who denied the claims of two women "simply because they were blacks and were represented by a Jewish lawyer").

²¹ At the risk of appearing partisan, I must recommend that the legislature consider the myriad of problems and tactical abuses that will arise if insurance defense counsel are deemed "persons" who may be sued along with their insurer clients for alleged "unfair practices." See Kornblum, *Royal Globe v. Superior Court: Its Impact on Litigation Involving Insurers*, 29 DEF. L.J. 355, 371-72 (1980).

²² See note 15 *supra* and accompanying text. *Deaton v. Allstate Ins. Co.*, 548 S.W.2d at 162, treated the subject rather summarily, stating:

A first party claim gives rise to a contract action.

Manchester, however, deals with a third party claim against the insurer and not with a first party claim against an insurer as in the present case. . . . [T]he measure of recovery for failure to pay money due under the contract is the amount agreed to be paid. Therefore, no recovery for punitive damages, as sought by the appellants, can be had, nor consequential damages such as attorney fees, witness fees, etc.

Id. at 164. *But see* *Feathers v. State Farm Fire & Casualty Co.*, No. 83-CA-158-MR.

statement of the differences between first and third party claims for "bad faith" was advanced in *Santilli v. State Farm Life Insurance Co.*,²³ in which the court surveyed the available case law:

Plaintiff seeks to have this court recognize a cause of action for tortious breach of an insurer's duty of "good faith and fair dealing" when dealing with its insured. This is a distinct tort which has recently emerged in California and has subsequently found favor in some other jurisdictions. . . .

This tort developed as an outgrowth of the cause of action for an insurer's bad faith refusal to settle within the coverage limits of a liability insurance policy.

However, although the two situations are somewhat similar, there is a distinct difference between liability insurance and other types of policies which should not be overlooked.

When an insured purchases liability insurance, he relinquishes his right to control any litigation brought against him for conduct which is covered under the policy, and he loses his right to negotiate a settlement with the opposing party. Moreover, when the settlement value of a case approaches the policy limits, it becomes increasingly more tempting for the insurer to gamble on the results of litigation, for in refusing to settle under such circumstances, the insurer stands to lose little and gain much. The insured, however, has a strong interest in settlement so as to avoid a judgment in excess of his coverage. Because of this conflict, courts have held insurers to a high duty of good faith and fair dealing when conducting settlement negotiations on behalf of their insured.

Such considerations are not applicable outside the field of liability insurance. In cases involving the insurer's duty to pay under policies for theft, fire, health, disability or life insurance, the unique relationship which gives rise to the special duty of liability insurers to attempt to settle within their policy limits does not arise. The insured, or his beneficiary, is not subject to the imposition of excess liability, and his rights and responsibilities are limited to those set forth in his contract.²⁴

At the same time, the *Santilli* court noted a line of cases allowing claims for first party "bad faith":

²³ 562 P.2d 965 (Or. 1977).

²⁴ *Id.* at 969 (citations omitted).

On the other hand, it has been argued that the huge financial reserves of large insurance companies give them an advantageous bargaining position when dealing with injured policyholders who are suddenly faced with the ruinous bills which they purchased insurance to avoid. . . . Apparently, some insurance companies have taken advantage of this superior bargaining position and have sought to force their insureds to settle for significantly less than they were entitled to through deliberate patterns of harassment and delay.²⁵

The drafters of House Bill 360 apparently concluded that the second line of cases was more persuasive. The bill not only recognized a first party claimant's standing to complain of single acts "willfully committed,"²⁶ but also provided for awards of compensatory damages²⁷ and attorney's fees.²⁸ Moreover, the proposed statute did not rule out punitive damages in "appropriate" cases.²⁹

Most of the critics of House Bill 360 presumably would agree that the "unfair practices" enumerated in the act not only needlessly delay the settlement of first party claims, but also work substantial hardship on first party claimants who may be forced to incur crushing expenses to obtain the security they thought they purchased in the first instance. However, the concerns of the insurance industry in resisting a major change in the prevailing law are not devoid of merit when such changes carry with them the potential for draconian and punitive jury verdicts.³⁰

²⁵ *Id.* at 969-70 & n.5 (citations omitted) (citing *McDowell v. Union Mut. Life Ins. Co.*, 404 F. Supp. 136, 141 (C.D. Cal. 1975); *Silberg v. California Life Ins. Co.*, 521 P.2d 1103 (Cal. 1974); *Gruenberg v. Aetna Ins. Co.*, 510 P.2d 1032 (Cal. 1973); *Richardson v. Employers Liab. Assurance Corp.*, 102 Cal. Rptr. 547 (Ct. App. 1972); *Fletcher v. Western Nat'l Life Ins. Co.*, 89 Cal. Rptr. 78 (Ct. App. 1970); *Annot.*, 47 A.L.R.3d 286 (1970).

Cf. A Litigator's War on Bad Faith, National Law Journal, Jan. 19, 1981, at 1, col. 4 (reporting a decision under the California Unfair Claims Practices Act in which it was alleged that an insurer was denying claims under a health insurance policy to make up for \$4.5 million loss it had suffered).

²⁶ H.R. 360, *supra* note 8, at §§ 1(1)(a), (3).

²⁷ H.R. 360 §§ 1(5)(b), 5(b).

²⁸ *Id.* at § 1(5)(b).

²⁹ *Id. Cf. Ford Motor Co. v. Mayes*, 575 S.W.2d 480, 487 (Ky. Ct. App. 1978) (allowing plaintiff to collect punitive damages in Consumer Protection Act, KY. REV. STAT. § 367.220(1) (Bobbs-Merrill 1981) [hereinafter cited as KRS], suit, where breach of contract also involves tortious conduct).

³⁰ *See, e.g., You're in Good Hands with . . . the Right Jury*, National Law Journal, Sept. 20, 1982, at 43, col. 2 (reporting a \$15,000 compensatory and \$3.5 million punitive

House Bill 360 also provided for direct claims or causes of action against an insurer by third party tort claimants.³¹ In the few jurisdictions already permitting such claims to proceed, the direct third party claim is referred to disparagingly as the "fourth party bad faith claim," in part because it is viewed as incongruous to allow a stranger to sue an insurer with whom he has not contracted.³²

The drafters of House Bill 360 may not have contemplated making any radical change in the common law of third party "bad faith," as Kentucky law already approves the assignment of an insured's claim against the insurer for "bad faith" in full or partial settlement of any excess judgment against the insured personally.³³ House Bill 360 stipulated that "no third party claimant shall bring an action under this subsection until any action between the third party claimant and the insured is concluded."³⁴ This provision would have prohibited joinder of the insurer until the underlying tort action was concluded. At first blush, it would appear that House Bill 360 would have done no more than allow the successful tort plaintiff to proceed directly against the insurer and recover any excess judgment without taking a formal assignment.³⁵ However, by not limiting proposed third party claims to "excess" cases,³⁶

damages award against an insurer who offered an unsatisfactory cash settlement for damages to the insured's automobile). See also J. O'CONNELL, *THE LAWSUIT LOTTERY* (1979):

The reasons punitive damages are often asked for although very rarely enacted are illustrative of the manipulative, deceptive, subterranean world of tort litigation. Plaintiffs' lawyers request them. . . . (1) to inflame the jury against the defendant by the very terms of the accusation, regardless of whether the defendant's conduct in fact justifies the accusation; . . . (3) to get evidence of the defendant's income and net worth before the jury, supposedly to help it decide how big a verdict will "punish" him, but in fact to implant the idea of the defendant's wealth. . . .

Id. at 27-28.

³¹ H.R. 360, *supra* note 8, at § 1(5).

³² Cf. Allen, *Insurance Bad Faith Law: The Need for Legislative Intervention*, 13 PAC. L.J. 833, 834-35 (1982) (noting that in a case of "third party bad faith" only the insured or his assignee may sue the insurer).

³³ See *Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968).

³⁴ H.R. 360, *supra* note 8, at § 1(5)(f).

³⁵ Successful prosecution of a third party claim for the "excess" would presumably moot the insured's claim for the "excess." Of course, some jurisdictions permit the insured to recover other consequential damages, such as damages for "mental suffering." See *Crisci v. Security Ins. Co.*, 426 P.2d 173, 178-79 (Cal. 1967). If such a claim were not assigned it could still be prosecuted by the insured.

³⁶ See *Good Times for 'Bad Faith'*, National Law Journal, July 11, 1983, at 10, col. 2.

the bill left the outer limits of third party "bad faith" uncertain, and "subject to the convincing art of the trial lawyer."³⁷

2. *The Model Act and Bill 84-BR-237*

The new bill that has been prefiled as Bill 84-BR-237 contains the same list of "unfair claims settlement practices" contained in the Model Act. The principal weaknesses of both are the absence of any express remedies or enforcement mechanisms, and the definition of substantive offenses solely in terms of conduct that is "committed or performed with such frequency as to indicate a general business practice."³⁸ It is expected that this watered-down version of the act will survive opposition from the insurance industry and be passed by the General Assembly. However, before adopting the proposed statute, the legislature should consider whether private rights of action might be implied from its prohibitions, and whether judicial recognition of such private rights of action would be desirable.

There is precedent for the recognition of implied private rights of action under unfair claims settlement practices legislation. For example, in *Royal Globe Insurance Co. v. Superior Court of Butte County*,³⁹ the Supreme Court of California held that a third party claimant in a personal injury case could pursue an implied private right of action against the defendant's insurer for a violation of the California Unfair Practices Act.⁴⁰ The substantive violations of the Act set forth in the complaint included reference to subsection (h)(5) of the California statute, which prohibits a "person" from: "(h) *Knowingly committing or performing with such frequency as to indicate a general business practice* any of the following unfair claims settlement practices: . . . (5) Not attempting in good faith to effectuate prompt, fair, and equitable settlements of claims in which liability has become reasonably clear."⁴¹ In con-

³⁷ Underwood, *supra* note 3, at 386 (citing Rumberger, Kisk & Wall, *Justice Holmes and the Trial Lawyer: Malicious Prosecution, Bad Faith and . . . Excellence*, 16 FORUM 627, 629 (1981)).

³⁸ 84-BR-237 § 1.

³⁹ 592 P.2d 329 (Cal. 1979).

⁴⁰ *Id.* at 332.

⁴¹ *Id.* at 331 n.1 (emphasis added) (quoting Cal. Ins. Code § 790.03(h) (West Supp. 1983)).

cluding that a private right of action could be implied from these provisions, the California court apparently took into account the weakness of the enforcement mechanism provided in the statute⁴²—a small fine for willful violation of any cease and desist order issued by the Commissioner of Insurance.⁴³ Since the decision in *Royal Globe*, the California courts have recognized implied private rights of action in other insurance claims contexts,⁴⁴ and have encouraged the filing of such claims by allowing punitive damages to be awarded in cases involving “undue and oppressive disregard of [claimants’ rights].”⁴⁵

A court will be more likely to imply private rights of action from unfair claims settlement practices legislation when the statute under consideration provides for inadequate enforcement or deterrence.⁴⁶ Bill 84-BR-237 is certainly “toothless” in this regard. In addition, Kentucky law favors the recognition of private rights of action on behalf of persons injured by reason of violations of state statutes.⁴⁷

However, if Bill 84-BR-237 is not amended, the introductory sentence of Section 1 of the Act will present some difficulties of construction for an implied right of action. Specifically, the proposed language appears to exclude single violations of the statute which are “knowingly” or “willfully” committed, but which are not committed “with such frequency as to indicate a general business practice.”⁴⁸ Accordingly, the proposed Kentucky statute

⁴² See Best, *supra* note 4, at 127.

⁴³ Cal. Ins. Code § 790.07 (West Supp. 1983) (Fines range from \$50 up to \$500 for willful violation of a cease and desist order. Otherwise, there are no sanctions for violation of the statutes).

⁴⁴ See, e.g., *Chodos v. Insurance Co. of North Am.*, 178 Cal. Rptr. 831, 838 (Ct. App. 1981) (automobile insurer breached implied covenant of good faith and fair dealing by failing to reasonably reimburse insured after agreeing to allow the insured to settle a property damage claim).

⁴⁵ *Delos v. Farmers Ins. Group*, 155 Cal. Rptr. 843, 857 (Ct. App. 1979).

⁴⁶ Cf. *Cosmopolitan Mut. Ins. Co. v. Nassau Ins. Co.*, 417 N.Y.S.2d 835, 836 (1979); *Cohen v. New York Property Ins. Underwriting Ass’n*, 410 N.Y.S.2d 597, 602 (N.Y. App. Div. 1978) (statute performing the deterrent function of punitive damages obviates the necessity for suing for punitive damages).

⁴⁷ KRS § 446.070 (1975) provides: “A person injured by the violation of any statute may recover from the offender such damages as he sustained by reason of the violation, although a penalty or forfeiture is imposed for such violation.”

⁴⁸ H.R. 360, *supra* note 8, at § 1(3). Compare this with the text of the California statute in the text accompanying note 41 *supra*. See also *Review of Selected 1975 California Legislation*, 7 PAC. L.J. 237, 484 (1976).

may not admit to the same construction given the California statute in *Royal Globe*. Rather than simply "pass the buck" to the courts, the legislature should address the issue of private remedies directly.

3. *A Proposal*

If it is agreed that the "unfair practices" enumerated in Bill 84-BR-237 needlessly delay the settlement of insurance claims and work a substantial hardship on a significant number of policyholders and third party claimants in the Commonwealth, there is little justification for the absence of express remedies in the proposed legislation. If agency action to police unfair practices cannot be funded, or is deemed an insufficient deterrent, then private rights of action should be recognized expressly. That is not to say that an amended statute must be drafted in such a way as to allow for disproportionate awards of compensatory and punitive damages. The legislature might, for example, adopt the proposed bill with amendments that permit awards of attorney's fees,⁴⁹ interest penalties, or both, for the successful prosecution of first party claims. Third party actions for "excess liability" for "bad faith" could then be prosecuted in accordance with existing case law. Adoption of such an amended bill might eliminate the need for judicial expansion of the tort of "bad faith" and provide a deterrent sufficient to obviate the need for new administrative machinery.

II. THE CONTRACTUAL COMMITMENT

A. *Coverage and Exclusions*

In an effort to protect themselves from "fraudulent applicants seeking coverage for known diseases,"⁵⁰ many health and hospitalization insurers include a provision in their policies "excluding or postponing coverage of an illness originating prior to the issuance of the policy or within a stated time during which the policy is effective."⁵¹ In *Inter-Ocean Insurance Co. v. Engler*,⁵² the court of appeals was faced with the task of interpreting such a pro-

⁴⁹ Similar legislation is surveyed in Best, *supra* note 4, at 133-34.

⁵⁰ *Mutual Hosp. Ins., Inc. v. Klapper*, 288 N.E.2d 279, 282 (Ind. Ct. App. 1972).

⁵¹ *Annot.*, 94 A.L.R.3d 990, 995 (1979).

⁵² 632 S.W.2d 459 (Ky. Ct. App. 1982).

vision in a cancer insurance policy. The provision denied coverage for treatment if the disease "first manifested itself" within ninety days after the policy's effective date.⁵³

In *Engler*, the insured had procured a cancer policy effective July 6, 1979. During the same month the insured was being treated by his family doctor for pneumonia. Chest x-rays were taken, and by September 27, 1979 (within the ninety-day exclusion period) that doctor had noted a lesion on the insured's lung and had referred the insured to a thoracic surgeon. However, the lesion was not diagnosed by microscopic examination to be cancer until an operation as performed on October 6. At issue in the case was whether the disease had "first manifested itself" prior to the expiration of the ninety day exclusion period, or whether a definite diagnosis had to have been made or communicated to the insured within the exclusion period to defeat the claim.⁵⁴

After noting that the highest court of Kentucky had not yet interpreted the phrase "first manifests itself," the court of appeals adopted a test that is growing in popularity⁵⁵ in other jurisdictions:

[I]n order for an insurer to defeat an insured's claim for health insurance benefits on the ground that the insured's covered disease first manifested itself within a specified exclusion period, the insurer has the burden of proving that sufficient symptoms of the disease are present within the specified period that a physician would be led to diagnose the disease.⁵⁶

Under this standard, the insured receives some consideration, inasmuch as latent but unascertainable conditions will not fall within the exclusion. On the other hand, the exclusion may be applied in some cases in which the exact nature of the disease is not diagnosed within the exclusion period (the disease need only have been "diagnosable")⁵⁷, and the insured may have had no knowledge of the presence of the disease until after the expiration of that period.

⁵³ *Id.* at 459.

⁵⁴ *Id.* at 463.

⁵⁵ *Id.* at 461. The test adopted has been described as the "majority" view. *Mutual Hosp. Ins., Inc. v. Klapper*, 288 N.E.2d at 282.

⁵⁶ 632 S.W.2d at 461 (quoting *McDaniel v. State Farm Mut. Ins. Co.*, 591 P.2d 1094 (Kan. Ct. App. 1979)).

⁵⁷ See *McDaniel v. State Farm Mut. Ins. Co.*, 591 P.2d at 1096-98.

A summary judgment in favor of the insured's estate was granted by the trial judge in *Engler*, although neither of the insured's physicians had been asked whether the insured had sufficient symptoms of cancer during the ninety day period to lead them to a diagnosis of cancer, and in spite of the defendant's consulting physician's testimony that the x-ray showing a lesion was sufficient to make such a diagnosis "until proven otherwise."⁵⁸ Under these circumstances, the court of appeals held that there was a genuine issue of material fact as to whether the cancer had "first manifested itself" within ninety days of the issuance of the policy, and summary judgment for the plaintiff was reversed.⁵⁹

In another effort to limit their exposure, accident insurers attempt to avoid paying claims for losses resulting "principally or in any considerable measure from bodily infirmity or disease."⁶⁰ The typical policy attempts to do this by defining coverage in terms of any loss "resulting directly, independently and exclusively of all other causes from bodily injuries effected solely by accident."⁶¹ Cases construing such policy language are legion and often impossible to reconcile.

The court of appeals interpreted this type of clause in the context of a policy providing for the payment of benefits for temporary or permanent disability in *Colonial Life & Accident Insurance Co. v. Weartz*.⁶² Weartz, the insured, slipped while carrying a bathtub at his workplace and suffered a back injury.⁶³ After surgery failed to alleviate the condition, his physicians certified to Colonial that the insured had been totally disabled as a direct result of the accident, independently of all other causes.⁶⁴ However, after paying benefits for some time, Colonial terminated Weartz's benefits and litigation followed.⁶⁵ At trial Colonial relied upon certain testimony given by Weartz's orthopedist that his disability was fifty percent due to a pre-existing back condition. However, the evidence also

⁵⁸ 632 S.W.2d at 463.

⁵⁹ *Id.* at 463.

⁶⁰ See W. VANCE, *INSURANCE* 976 (3d ed. 1951).

⁶¹ *Colonial Life & Accident Ins. Co. v. Weartz*, 636 S.W.2d 891, 892 (Ky. Ct. App. 1982). Several variations of this clause are discussed in VANCE, *supra* note 60, at 976-78.

⁶² 636 S.W.2d at 891.

⁶³ *Id.* at 892.

⁶⁴ *Id.*

⁶⁵ *Id.*

showed that the insured had not complained of any back problems prior to his accident and that this pre-existing condition might never have caused any problems.⁶⁶ Moreover, the orthopedist also testified that the "pre-existing and dormant non-disabling condition . . . was a pre-disposing factor . . . [but] [t]he injury was the cause [of his disability]."⁶⁷ In addition, the orthopedist had originally referred to his fifty percent allocation in the context of a proceeding seeking worker's compensation benefits.⁶⁸ The jury returned a verdict for Weartz.

On appeal, Colonial contended that the orthopedist's testimony established, as a matter of law, that Weartz's disability did not result "independently and exclusively of all other causes" from his accident.⁶⁹ The court of appeals affirmed the jury's verdict and rejected the insurer's contention, relying upon *Continental Casualty Co. v. Freeman*,⁷⁰ a decision by the former Court of Appeals which surveyed the varying constructions given to similar exclusions in accident and disability policies.⁷¹ After noting the "divergence of viewpoints" regarding the application of such exclusions, the Court in *Freeman* stated that the problem in any case "is to define the degree of importance the contributing causal factor must have had in order to negate the accidental injury's having been the 'sole,' 'exclusive' or 'independent' cause of the disability."⁷² The Court admitted that in its statement of the problem it was departing from a literal construction of the word "independently."⁷³ However, such a departure is consistent with the consumer's reasonable expectations, and allowed the Court to formulate a workable test of causation:

[A] pre-existing infirmity or disease is not to be considered as a cause unless it substantially contributed to the disability or loss. . . . [A] "pre-disposition" or "susceptibility" to injury, whether it results from congenital weakness or from previous illness or

⁶⁶ *Id.* at 893.

⁶⁷ *Id.* at 894.

⁶⁸ *Id.*

⁶⁹ *Id.* at 893.

⁷⁰ 481 S.W.2d 309 (Ky. 1972).

⁷¹ *Id.* at 314-15.

⁷² *Id.* at 313.

⁷³ *Id.*

injury, does not necessarily amount to a substantial contributing cause. A mere "relationship" of undetermined degree is not enough.⁷⁴

When the court of appeals applied this standard to the facts in *Weartz*, it had little difficulty concluding that "reasonable minds could [have] differ[ed] as to whether Weartz's pre-existing back condition substantially contributed to his disability,"⁷⁵ meaning the question was one for the jury. The court also noted the possible inaccuracy of opinions regarding percentages of causation in the context of worker's compensation proceedings:

In many instances these opinions are nothing more than educated guesses. Therefore, we decline to find that when they are expressed in a proceeding outside the context of workers' compensation such as the case at bar, they are conclusive evidence as to the extent to which a preexisting disease or condition has contributed to a person's physical disability. Medical evidence other than a doctor's opinion formulated solely for worker's compensation purposes is necessary to conclusively establish that a preexisting condition or disease has substantially contributed to and hence is a legal cause of a person's total disability.⁷⁶

The difficulty of interpreting and applying policy language to the facts of a particular case was also illustrated in the recent case of *Foster v. Allstate Insurance Co.*,⁷⁷ which involved the liability coverage of a homeowner's insurance policy in the context of an insured's activities as a babysitter. In *Foster*, the insureds, husband and wife, obtained a homeowner's policy insuring their new home. In applying for the policy they truthfully stated that there was no business or professional activity on the insured premises. Sometime later, however, the insured wife began babysitting the infant son of a Mr. and Mrs. Trujillo for \$35 per week. Tragically, the infant Trujillo was fatally injured in a fall on the premises, and a negligence action was brought against the insured wife.⁷⁸ The in-

⁷⁴ *Id.* at 314.

⁷⁵ 636 S.W.2d at 894.

⁷⁶ *Id.*

⁷⁷ 637 S.W.2d 655 (Ky. Ct. App. 1981).

⁷⁸ *Id.* at 656.

surer sought and obtained a declaratory judgment that the liability protection of the policy did not apply "to bodily injury or property damage arising out of business pursuits of any Insured except activities therein which are ordinarily incident to non-business pursuits."⁷⁹

The trial judge found the above exclusion to prevent recovery on the policy.⁸⁰ The court of appeals assumed that babysitting was a "business pursuit," and then considered two "reasonable" constructions of the statute:

[1] that an accident which occurs in the carrying on of a business pursuit is excluded from coverage unless that accident occurs while the insured, although engaged in carrying on a business pursuit, is also engaged in activities which are ordinarily incident to nonbusiness pursuits [i.e., child care],⁸¹ or

[2] that an accident which occurs in the carrying on of a business pursuit is excluded from coverage unless the accident occurs while the insured is engaged in an activity which is not ordinarily incident to the business pursuit.⁸²

Having concluded that both constructions were reasonable, the court applied the doctrine of *contra proferentem*,⁸³ and adopted the construction most favorable to the insured.⁸⁴

B. *Cancellation By Substitution*

"According to the majority rule, the mere procuring of substitute insurance with an intent to replace an existing perma-

⁷⁹ *Id.*

⁸⁰ *Id.* at 657.

⁸¹ *Id.* at 657 (citing *Crane v. State Farm Fire & Casualty Co.*, 485 P.2d 1129 (Cal. 1971)). Obviously, this was the construction advanced by the insured.

⁸² 637 S.W.2d at 657 (citing *Stanley v. American Fires & Casualty Co.*, 361 So. 2d 1030 (Ala. 1978)).

⁸³ This refers to the principle that a contract will be construed against the one who wrote it. See BLACK'S LAW DICTIONARY 296 (5th ed. 1979).

⁸⁴ 637 S.W.2d at 657. Other cases involving "coverage" issues, which were decided during the Survey period but are not discussed at length in this Survey include *Breeding v. Massachusetts Indem. & Life Ins. Co.*, 633 S.W.2d 717 (Ky. 1982) (insurer's failures to comply with KRS § 304.18-080(2) estopped insurer from relying on an exclusion); *California Union Ins. Co. v. Spade*, 642 S.W.2d 582 (Ky. 1982) (construing the coverage and non-coverage provisions of a contractor's equipment policy); *American Interinsurance Exch. v. Norton*, 631 S.W.2d 851 (Ky. Ct. App. 1982) (transfer of possession of motor vehicle pursuant to an agreement of sale denied transferee status of an insured).

ment policy, but without an intent to acquire additional insurance, does not cancel the existing policy.”⁸⁵ The Kentucky Court of Appeals recently adopted this position in *The Travelers Insurance Co. v. Motorists Mutual Insurance Co.*⁸⁶ In *Travelers*, the insured owned a service station, and insured it with Motorists Mutual for \$35,000.⁸⁷ The policy had an expiration date of October 28, 1980. On October 16, 1980, the insured sold the property to one Napier under a land contract which required Napier to insure the property for not less than \$65,000, payable to the sellers.⁸⁸ Napier obtained a policy from Travelers on October 22, 1980.⁸⁹

When the property was destroyed by fire on October 27, 1980, after Travelers had become bound, but before the Motorists policy had expired, a dispute arose as to which policy covered the loss. Travelers demanded that the loss be pro-rated between the insurers, but Motorists sought to apply the doctrine of cancellation by substitution.⁹⁰

The evidence demonstrated that the sellers, Motorists' insureds, did not intend to continue the Motorists policy after its expiration date and had intended that Travelers provide the only coverage.⁹¹ However, the record contained no evidence of an intent to cancel the Motorists policy prior to its expiration date.⁹² Distinguishing *Potomac Insurance Co. v. Motorists Mutual Insurance Co.*,⁹³ which involved the cancellation by substitution of a *binder*,⁹⁴ and noting that the Motorists policy contained no provision that procurement of other coverage would effect cancellation of the policy, the court of appeals ruled that liability for the loss should be pro-rated between the two companies.⁹⁵

⁸⁵ Underwood, *supra* note 1, at 260.

⁸⁶ 649 S.W.2d 414 (Ky. Ct. App. 1982), *discretionary rev. denied*, 30 Ky. L. SUMM. 4, at 15 (Ky. Mar. 23, 1983) [hereinafter cited as KLS].

⁸⁷ *Id.*

⁸⁸ *Id.*

⁸⁹ *Id.*

⁹⁰ *Id.* at 415.

⁹¹ *Id.* at 414.

⁹² *Id.*

⁹³ 598 S.W.2d 461 (Ky. Ct. App. 1979), *discretionary rev. denied*, 27 KLS 7, at 12 (Ky. May 29, 1980). For a discussion of this case, see Underwood, *supra* note 1, at 260-61.

⁹⁴ A binder is “a temporary contract of insurance providing immediate coverage until a permanent policy can be obtained.” Underwood, *supra* note 1, at 260.

⁹⁵ 649 S.W.2d at 415.

III. MOTOR VEHICLE REPAIRS ACT

Cases decided during the Survey period relating to the interpretation and construction of the Motor Vehicle Repairs Act (MVRA)⁹⁶ will be analyzed by organizing them according to subject matter.

A. Application—Who Is Entitled To Basic Reparation Benefits

1. Persons Injured While Privately Engaged In Normal Vehicular Repair Work

Under the MVRA, basic reparation benefits (BRB) are defined as "benefits providing reimbursement for net loss suffered through injury arising out of the operation, maintenance or use of a motor vehicle."⁹⁷ Furthermore, KRS section 304.39-030(1) provides "[i]f the accident causing injury occurs in this Commonwealth every person suffering loss from injury arising out of maintenance or use of a motor vehicle has a right to basic reparation benefits."⁹⁸

In the recent case of *Commercial Union Assurance Companies v. Howard*,⁹⁹ the question before the Kentucky Supreme Court was whether "a standard insurance policy issued pursuant to the requirements of the Kentucky [MVRA] afford[s] coverage to an injured policyholder who is injured while attempting to repair his own vehicle while parked in his own driveway."¹⁰⁰

At first blush, it would seem that an injury suffered during a repair operation should be viewed as "arising out of maintenance . . . of a motor vehicle."¹⁰¹ At least one court has suggested that the matter is that simple.¹⁰² However, "maintenance" is not defined in the Kentucky MVRA,¹⁰³ and its everyday meaning is sufficiently

⁹⁶ KRS §§ 304.39-010 to -340 (1981 & Cum. Supp. 1982).

⁹⁷ KRS § 304.39-020(2) (Cum. Supp. 1982).

⁹⁸ KRS § 304.39-030(1) (Cum. Supp. 1982).

⁹⁹ 637 S.W.2d 647 (Ky. 1982).

¹⁰⁰ *Id.* at 648.

¹⁰¹ KRS § 304.39-030(1) (1981).

¹⁰² See *Auto-Owners Ins. Co. v. Pridgen*, 339 So. 2d 1164 (Fla. Dist. Ct. App. 1976) (plaintiff was found to be engaged in the "maintenance" of his jeep when his hand was sandwiched between a trailer and the backup light of his jeep while he was attempting to disconnect a wire).

¹⁰³ *But cf.* KRS § 304.39-020(16) (Cum. Supp. 1982) (defines "maintaining a motor vehicle").

flexible to encompass activities for which the cost of automobile insurance might not be expected to be allocated. In *Commercial Union* the Kentucky Supreme Court concluded that, in the absence of any clear statement by the legislature to the contrary, automobile insurance coverage should not be extended to cover accidents that do not relate to the "driving" of a vehicle. The Court stated: "Mr. Howard was not utilizing his truck *as a vehicle* at the time he received his injuries. It would seem that other relevant types of insurance coverage [such as health insurance and home owner's insurance] could have been available to him under the circumstances."¹⁰⁴ This narrow construction of the statute may make sense as a matter of policy. But, the Court's analysis of the language of the statute was somewhat circuitous. Specifically, instead of giving the word "maintenance" a special meaning,¹⁰⁵ and rather than conceding that KRS section 304.39-020(6)(i) suggests that vehicular repair "off . . . business premises" could be a "use of a motor vehicle,"¹⁰⁶ the Court began its analysis with the definition of "maintaining a motor vehicle," found in KRS section 304.39-020(16): " 'Maintaining a motor vehicle' means having legal custody, possession or responsibility for a motor vehicle by one other than an owner or operator."¹⁰⁷

After observing that this definition "clearly does *not* include" repair or service of a motor vehicle,¹⁰⁸ the Court opined that the real question was whether the legislature intended the word "maintenance" to have a different definition in different parts of the statute.¹⁰⁹ Unfortunately, the Court did not, and perhaps could not, provide an answer to this question, after suggesting that it was the linchpin of its analysis.

¹⁰⁴ 637 S.W.2d at 649 (emphasis in original).

¹⁰⁵ Cf. *Green v. Moore*, 135 S.W.2d 682, 683 (Ky. 1939) ("Unless there is something in the act plainly indicating a contrary sense in which the language was employed, the usual and ordinary meaning of the words will be attributed to them."); KRS § 446.080(4) (1975).

¹⁰⁶ Cf. Note, *Kentucky No-Fault: An Analysis and Interpretation*, 65 Ky. L.J. 465, 483 (1976-77) ("[i]f the driver of a tow truck is injured on the highway while servicing or repairing an automobile . . . [he is] within the definition of use of a motor vehicle 'as a vehicle' "). Perhaps "off premises" repair by a mechanic on the roadside would be viewed as relating more directly to "driving" the vehicle than a home repair. In addition, other insurance might not be available to compensate the injured victim in the roadside situation.

¹⁰⁷ 637 S.W.2d at 648.

¹⁰⁸ *Id.* at 649 (emphasis in original).

¹⁰⁹ *Id.*

2. *Non-Residents Entitled to BRB*

KRS section 304.39-030(1) provides that "every person suffering loss from injury arising out of maintenance or use of a motor vehicle has a right to basic reparation benefits, unless he has rejected the limitation upon his tort rights as provided in KRS section 304.39-060(4)." However, the latter section suggests that a non-resident from a state without no-fault insurance who has liability coverage¹¹⁰ will be deemed to have rejected no-fault and will not be entitled to BRB.¹¹¹

On the other hand, KRS section 304.39-100(2) provides:

An insurer authorized to transact or transacting business in this Commonwealth shall file with the commissioner of Insurance as a condition of its continued transaction of business within this Commonwealth a form . . . declaring that in *any contract of liability insurance for injury, wherever issued, covering the . . . use of a motor vehicle . . . while the vehicle is in this Commonwealth shall be deemed to provide the basic reparation benefits coverage.*
 . . .¹¹²

If a non-resident insurer complies with this statute, then it is clear that the non-resident insured will be entitled to draw BRB from *his or her insurer* if injured in his or her insured vehicle while that vehicle is in the Commonwealth, absent proof of a rejection of no-fault.¹¹³ However, may a non-resident insured subject *his or her insurer* to BRB obligations arising out of an accident in Kentucky that did not involve the insured vehicle? The Kentucky Court of

¹¹⁰ The liability coverage must be consistent with the requirements of KRS § 304.39-110 (1981), which states the required minimum tort liability insurance. *See* KRS § 304.39-060(4) (Cum. Supp. 1982).

¹¹¹ KRS § 304.39-060(4) states in pertinent part:

[A]ny person who, at the time of an accident, does not have basic reparation insurance but has not formally rejected such limitations of his tort rights and liabilities and has at such time in effect security equivalent to that required by KRS 304.39-110 shall be deemed to have fully rejected such limitations within [the] meaning of this section for that accident only.

See also Note, *supra* note 106, at 487-88.

¹¹² KRS § 304.39-100(2) (1981) (emphasis added).

¹¹³ *Cf. Stinnett v. Mulquin*, 579 S.W.2d 374, 376 (Ky. Ct. App. 1978) (an opportunity to reject statutory limitations on tort right to sue must be afforded before a non-resident injured party can be limited to BRB recovery), *discretionary rev. denied*, 26 KLS 6, at 16 (Ky. Apr. 24, 1979).

Appeals answered this question in the affirmative in *Dairyland Insurance Co. v. Assigned Claims Plan*.¹¹⁴ In that case O'Neal, a resident of Tennessee, was a passenger in an uninsured automobile owned and driven by another Tennessee resident when it was involved in an accident in Simpson County, Kentucky.¹¹⁵ Dairyland, O'Neal's Tennessee insurer, paid BRB to O'Neal under his Tennessee policy until it decided that its BRB obligation should only extend to claims arising from the maintenance or use of O'Neal's vehicle in Kentucky. When Dairyland ceased paying BRB, O'Neal secured additional benefits from the Assigned Claims Plan through Home Insurance Company.¹¹⁶ Home and the Assigned Claims Plan then sought reimbursement from Dairyland.¹¹⁷ Dairyland appealed from a circuit court decision affirming arbitration proceedings which had held that Dairyland was obligated to make such reimbursements.¹¹⁸ The Kentucky Court of Appeals affirmed the circuit court, rejecting Dairyland's argument that the Tennessee policy should be converted into a basic reparation policy only while the insured *vehicle* was being operated in the Commonwealth.¹¹⁹ Specifically, the court concluded that the BRB coverage provided in KRS section 304.93-100(2) follows either the named insured or the insured vehicle, so that BRB is available from the insured non-resident's insurer "for injuries arising out of the maintenance or use of *any* motor vehicle in this jurisdiction."¹²⁰ The court stated that its construction of KRS section 304.39-100(2) was necessary to prevent "discrimination between residents and non-residents" and to insure that the "remedial quality of the statute" would not be thwarted.¹²¹ However, this seems a bit of an overstatement since the issue was not whether BRB would be paid, but who would pay it.

The construction given the statute in *Dairyland* seems questionable from a grammatical point of view, and is inconsistent with

¹¹⁴ 30 KLS 5, at 1 (Ky. Ct. App. Apr. 21, 1983), *discretionary rev. granted*, 30 KLS 11, at 24 (Ky. Sept. 14, 1983).

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ *Id.*

¹¹⁸ *Id.*

¹¹⁹ *Id.* at 2.

¹²⁰ *Id.* at 1 (emphasis added).

¹²¹ *Id.* at 2.

the commentary to the Uniform Motor Vehicle Accident Reparations Act (UMVARA),¹²² section 9 of which provided the model from which KRS section 304.39-100(2) was tailored.¹²³ The commentary clearly indicates that section 9 applies to an insurer if “the only contact of the insurer with this state is that its insured permitted operation of the *insured vehicle* in this State.”¹²⁴ The commentary further states: “[O]peration of the *insured vehicle within the State*, standing alone, should be a sufficient contact allowing the State to impose its substantive laws upon the out-of-State insurer of an out-of-State vehicle.”¹²⁵

The purpose of subsection (c) of UMVARA section 9, according to the commentary, is “to preclude insurers from including provisions in their out-of-State liability contracts which might mislead insureds to suppose they were not protected under their policies for basic reparation benefits *when their vehicles were operated in this State*.”¹²⁶ Thus, the repeated emphasis of the UMVARA commentary is, contrary to the ruling of the court of appeals in *Dairyland*, that the equivalent to KRS section 304.39-100(2) only applies when a non-resident insured’s *vehicle* is operated in the state, either by the insured or with the permission of the insured.¹²⁷

¹²² Uniform Motor Vehicle Accident Reparations Act § 9, 14 U.L.A. 74-76 (1972) [hereinafter cited as UMVARA].

¹²³ UMVARA § 9 provides:

(b) Notwithstanding any contrary provision in it, every contract of liability insurance for injury, wherever issued, covering ownership, maintenance, or use of a *motor vehicle*, except a contract which provides coverage only for liability in excess of required minimum tort liability coverages (section 10), includes basic reparation benefit coverages and minimum security for tort liabilities required by this Act, *while it is in this State*, and qualifies as security covering the vehicle.

(c) An insurer authorized to transact or transacting business in this State may not exclude, in any contract of liability insurance for injury, wherever issued, covering ownership, maintenance, or use of a *motor vehicle*, except a contract providing coverage only for liability in excess of required minimum tort liability coverage (section 10), the basic reparation benefit coverages and required minimum security for tort liabilities required by this Act, *while the vehicle is in this State*.

(emphasis added).

¹²⁴ UMVARA § 9(b) comment (emphasis added).

¹²⁵ *Id.* (emphasis added).

¹²⁶ UMVARA § 9(c) comment (emphasis added).

¹²⁷ *See* UMVARA § 9(b) comment.

The prefatory note to the UMVARA provides additional commentary consistent with the arguments advanced by *Dairyland*, and inconsistent with the court of appeals construction of the Kentucky statute. This note states:

The Act applies to any motor vehicle accident occurring within the State without regard to where any involved vehicle is registered or how long it has been in the State. It converts any motor vehicle liability insurance policy, including one issued elsewhere, into a basic reparation policy *while the insured vehicle is operated in the State*. Also the benefits provided by a policy of basic reparation insurance are applicable to injuries or losses occurring outside of the State to the insured and members of his family and to any occupant of the insured vehicle.¹²⁸

B. *Coordination of Benefits*

1. *Calculation of Net Loss*

One of the criticisms of the fault system of compensation is that its benefits are not coordinated with benefits paid from other sources.¹²⁹ In order to “coordinate benefits” available to an accident victim, the typical no-fault statute modifies the familiar “collateral source rule,” and provides benefits for “net loss.” For example, the UMVARA provides in pertinent part:

“Net loss” means loss less benefits or advantages, from sources other than basic and added reparation insurance, required to be subtracted from loss in calculating net loss.

. . . .

All benefits or advantages a person receives or is entitled to receive because of the injury from social security, workmen’s compensation, and any state-required temporary, nonoccupational disability insurance are subtracted in calculating net loss.¹³⁰

Until recently, the Kentucky MVRA contained a similar provision in KRS section 304.39-120(1) (Calculation of net loss): “All

¹²⁸ UMVARA commissioners’ prefatory note, 14 U.L.A. at 45 (emphasis added).

¹²⁹ See generally J. HENDERSON & R. PEARSON, *THE TORTS PROCESS* 699-705 (1975) (citing STATE OF NEW YORK INSURANCE DEPARTMENT, *AUTOMOBILE INSURANCE . . . FOR WHOSE BENEFIT* 18-38, 40-43 (1970)).

¹³⁰ UMVARA §§ 1(a)(8), 11(a).

benefits or advantages a person receives or is entitled to receive because of the injury from social security and workers' compensation are subtracted in calculating net loss."¹³¹ However, since the last Survey was published, the Kentucky legislature has amended this subsection of the statute to delete social security benefits from the calculation of net loss.¹³²

2. *Survivor's Benefits*

The MVRA provides a decedent's survivors¹³³ with benefits for any compensation (survivor's economic loss)¹³⁴ or services (survivor's replacement services loss)¹³⁵ the decedent would have provided had he or she not died. The MVRA does not provide an automatic accidental death benefit payable to survivors, because the particular survivor must have suffered an actual and compensable loss.¹³⁶ In the recent case of *Holsclaw v. Kenilworth Insurance Company*,¹³⁷ the Kentucky Court of Appeals considered whether decedent's father, as sole shareholder of her corporate employer, could recover survivor's benefits calculated on the basis of the loss of her services to the corporation.¹³⁸ Although there was no evidence that the decedent made direct contributions to the home or the needs of her family, although she did live with her parents, it was contended that she worked for her father's corporation for less than the true value of her services. As a result of her death, some of the services she performed had to be replaced at a higher cost.¹³⁹ The court of appeals agreed that decedent's father was a

¹³¹ KRS § 304.39-120(1) (1981).

¹³² See KRS § 304.39-120 (Cum. Supp. 1982).

¹³³ A "survivor" is "one entitled to receive benefits by reason of the death of another person." KRS § 304.39-020(14) (Cum. Supp. 1982).

¹³⁴ "Survivor's economic loss" means loss after decedent's death of contributions of things of economic value to his survivors, not including services they would have received from the decedent if he had not suffered the fatal injury, less expenses of the survivors avoided by reason of decedent's death." KRS § 304.39-020(5)(d) (Cum. Supp. 1982).

¹³⁵ "Replacement service loss" means expenses reasonably incurred in obtaining ordinary and necessary services in lieu of those the injured person would have performed, not for income but for the benefit of himself or his family, if he had not been injured." KRS § 304.39-020(5)(c) (Cum. Supp. 1982).

¹³⁶ See *Aetna Ins. Co. v. Thompson*, 27 KLS 9, at 10 (Ky. Ct. App. July 11, 1980), *aff'd*, 614 S.W.2d 537 (Ky. 1981).

¹³⁷ 644 S.W.2d 353 (Ky. Ct. App. 1982).

¹³⁸ *Holsclaw v. Kenilworth Ins. Co.*, 644 S.W.2d at 355.

¹³⁹ *Id.* at 354.

survivor, but also agreed with the court below that the loss in question was a loss to the corporation, and not to the survivor directly, thus preventing recovery.¹⁴⁰

3. *Interest and Attorney's Fees*

Several provisions of the MVRA encourage the insurer to make prompt payment of BRB. Specifically, "[b]enefits payments are overdue if not paid within thirty (30) days after the reparation obligor receives reasonable proof of the fact and amount of the loss realized."¹⁴¹ Overdue payments bear interest at twelve percent per annum, and if the obligor's delay was without reasonable foundation, the rate of interest is increased to eighteen percent per annum.¹⁴² In addition to these penalties, a court may award the claimant a reasonable attorney's fee if overdue benefits are recovered after a denial or delay without reasonable foundation.¹⁴³

An award of both an eighteen percent penalty and attorney's fees to the reparation obligee was approved in *Kentucky Farm Bureau Mutual Insurance Company v. Roberts*.¹⁴⁴ Subsequently, the trial court imposed an additional attorney's fee to cover the representation of the reparation obligee on appeal. The reparation obligor then argued that this additional award improperly penalized the exercise of its first appeal as of right, in violation of Section 115 of the Constitution of Kentucky.¹⁴⁵ The Supreme Court rejected this contention:

KRS 304.39-220 provides for a penalty of reasonable attorneys fees "on a claim or in an action for basic or added reparation benefits . . . if the denial or delay was without reasonable foundation." The only issue of that appeal was the reasonableness of the delay. Until that issue is fully resolved either through the appellate process or through failure to perfect an appeal, the appellee has no basis upon which to enforce her judgment. Had the Court of Appeals determined that the delay was not

¹⁴⁰ *Id.* at 355.

¹⁴¹ KRS § 304.39-210(1) (1981).

¹⁴² KRS § 304.39-210(2) (1981).

¹⁴³ KRS § 304.39-220 (1981).

¹⁴⁴ 603 S.W.2d 498 (Ky. Ct. App. 1980). For a discussion of this case see Underwood, *supra* note 1, at 278.

¹⁴⁵ See *Moore v. Roberts*, 29 KLS 15, at 8 (Ky. Dec. 14, 1982).

unreasonable, then the appellee would not have been able to collect any additional attorney's fees.

The award of the additional fee is not, as suggested by Farm Bureau, a penalty imposed upon its right to appeal, but rather an item of monetary damages allowed by the legislature due to the continuing representation upon the issue of reasonableness. An appeal is always at one's own peril. Clearly KRS 304.39-220 envisages that the fee shall attach to the logical and legal conclusion of litigation.

Therefore, since a portion of this appeal relates to that same issue, the trial court may permit additional attorney's fees for this appeal. . . .¹⁴⁶

4. Subrogation

In *Progressive Casualty Insurance Company v. Kidd*¹⁴⁷ the Kentucky Supreme Court ruled:

[I]f a reparation obligor fails to assert its claim for subrogation by joining as a party in an action commenced by the injured party or fails to seek reimbursement pursuant to KRS § 304.39-030 sixty days after the claim has been presented to the reparation obligor of the secured person, then it may not otherwise recover its BRB payments by way of equitable subrogation or any judicial policy against double recovery.¹⁴⁸

In *Kidd*, the reparation obligor failed to intervene or otherwise prosecute its claim for subrogation. As a result, the injured party was awarded a double recovery. The Supreme Court "reluctantly" held that the injured party could keep the recovery,¹⁴⁹ though the Court expressed the hope that such windfall awards would not be allowed in future cases.¹⁵⁰

The recent case of *Dudas v. Kaczmarek*¹⁵¹ suggests how double recoveries may be avoided in cases in which the insurer fails to intervene or otherwise assert its subrogation rights. In *Dudas*, Kaczmarek sued Dudas for compensation for injuries sustained in

¹⁴⁶ *Id.* at 9.

¹⁴⁷ 602 S.W.2d 416 (Ky. 1980).

¹⁴⁸ Underwood, *supra* note 1, at 278.

¹⁴⁹ 602 S.W.2d at 417.

¹⁵⁰ *Id.* at 418.

¹⁵¹ 652 S.W.2d 868 (Ky. Ct. App. 1983).

a collision between Dudas' automobile, in which Kaczmarek was a passenger, and another vehicle.¹⁵² The driver and owner of the other vehicle were dismissed from the case, and the jury returned a verdict against Dudas and in favor of Kaczmarek for medical and hospital expenses (\$7,894.84), lost wages (\$12,806.24), and pain and suffering (\$5,000), for a total award of \$25,701.08.¹⁵³ The trial judge awarded the total amount of the judgment, allowing no set-off for \$8,008.85 of BRB already paid to Kaczmarek by his insurer for medical expenses and lost wages.¹⁵⁴

The court of appeals held that the defendant properly objected to such a double recovery and substantiated the objection by the filing of an agreed statement establishing the BRB already paid to the plaintiff.¹⁵⁵ The court rejected the contention that the nonrecoverability of BRB had to be pled as an affirmative defense, on the theory that KRS section 304.39-060(2)(a) expressly abolished tort liability "to the extent the basic reparation benefits provided . . . [in the statute] are payable therefor."¹⁵⁶

The *Dudas* court next considered whether the jury's award should have been reduced by the amount of BRB paid (\$8,008.85) or the maximum amount of BRB payable (\$10,000). Because the jury awarded damages for medical expenses and lost wages in excess of \$10,000, and because up to \$10,000 for such items were recoverable as BRB, the court held that the verdict should have been reduced by \$10,000, the maximum amount of tort liability established by the Act and "payable" as BRB.¹⁵⁷ The court reasoned that just because

an individual does not elect to pursue basic reparation benefits to the maximum payable under the Motor Vehicle Reparations Act does not somehow give him an opportunity to obtain the difference between what he has received and the maximum payable in any recovery that he may secure by legal action against a tortfeasor, because by the statute, there is no tort liability on the tortfeasor for the \$10,000 of damages on those elements included

¹⁵² *Id.* at 869.

¹⁵³ *Id.*

¹⁵⁴ *Id.*

¹⁵⁵ *Id.*

¹⁵⁶ *Id.* at 870 (emphasis in original).

¹⁵⁷ *Id.* at 871.

in basic reparation benefits. If the appropriate reparation obligor, see KRS 304.39-050, is not forthcoming in paying basic reparation benefits to the statutory maximum, the injured party has a remedy under the Act to collect them. See KRS 304.39-210, -220, -160. Admittedly, in *Hargett v. Dodson*, *supra*, this Court allowed a plaintiff to recover from a defendant an amount for damages within the maximum payable for basic reparation benefits after reduction by the amount of basic reparation benefits paid. However, in that case, unlike this one, the reparation obligor of the plaintiff was also the obligor of the defendant, and the Court sanctioned that approach to avoid 'a circuitous exercise.' 597 S.W.2d at 153. That technique has no application here.¹⁵⁸

In *Fireman's Fund Insurance Company v. Bennett*,¹⁵⁹ decided in the prior Survey period, the court of appeals held that an insurance carrier which has paid BRB has no right to recover its payments from the tortfeasor in an action for indemnity, independent of its right of subrogation under KRS section 304.39-070.¹⁶⁰ In other words, the statutory method of subrogation provided for in the MVRA is exclusive.¹⁶¹ Because an apparent inconsistency between that opinion and an opinion by another panel of the same court in *United States Fidelity and Guaranty Company v. Gayle*¹⁶² was perceived, the Supreme Court accepted both cases for review, affirming the former case and reversing *Gayle*.¹⁶³

In *Stovall v. Ford*,¹⁶⁴ the court of appeals examined the reparation obligor's right to intervene and assert its subrogation claim in a case in which the plaintiff and reparation obligee faced a dismissal of her claims due to a complete release given to the tort-

¹⁵⁸ *Id.* at 870.

¹⁵⁹ 635 S.W.2d 482 (Ky. Ct. App. 1981), *aff'd sub nom.* Fireman's Fund Ins. Co. v. Government Employees Ins. Co., 635 S.W.2d 475 (Ky. 1982), *cited in* Underwood, *supra*, note 1, at 280.

¹⁶⁰ *Id.* at 484.

¹⁶¹ KRS § 304.39-070(3) (1981) does not preclude an action for reimbursement based on statutory priority, as opposed to fault or the law of torts. See *Affiliated FM Ins. Co. v. Grange Mut. Casualty Co.*, 641 S.W.2d 49 (Ky. Ct. App. 1982).

¹⁶² No. 80-CA-178-D6 (Ky. Ct. App. Sept. 4, 1981), *rev'd*, *Fireman's Fund Ins. Co. v. Government Employees Ins. Co.*, 635 S.W.2d at 475.

¹⁶³ *Fireman's Fund Ins. Co. v. Government Employees Ins. Co.*, 635 S.W.2d at 475.

¹⁶⁴ No. 82-CA-196-MR (Ky. Ct. App. Sept. 10, 1982), *modified*, No. 82-CA-196-MR (Ky. Ct. App. Dec. 10, 1982), *discretionary rev. granted*, 30 KLS 6, at 14 (Ky. May 4, 1983).

feasor's insurance agent in return for the sum of \$420.60.¹⁶⁵ When the defendant moved for summary judgment, the plaintiff was unable to establish a triable issue of fact regarding fraud or estoppel so as to allow her claims to survive the release.¹⁶⁶ Defendant's motion for summary judgment was granted on October 22, 1980, and made final on October 5, 1981. However, the plaintiff insurer had moved to intervene in the action on December 3, 1979, after the motion for summary judgment was filed, but before it was granted. The trial court dismissed Home Insurance Company's motion to intervene as untimely but the court of appeals reversed.¹⁶⁷

The court noted that the insurer's exclusive means to recover basic reparation benefits are intervention or arbitration.¹⁶⁸ In addition, the motion to intervene was filed over ten months before the summary judgment dismissing the plaintiff's complaint was granted. The court held that the filing of a motion for summary judgment does not necessarily prohibit intervention, and that a motion to intervene should not be dismissed as untimely if the rights of the would-be intervenor would be seriously harmed.¹⁶⁹ Because the dismissal of the insured did not involve a determination of the merits, and because there was no indication that the defendant's coverage with his insurer had been exhausted by the small settlement made with plaintiff, there was no reason to deny intervention.¹⁷⁰

Attorneys' fees in subrogation actions were also the subject of several cases decided in the Survey period. KRS section 304.39-070(5) encourages the basic reparation obligor to use the injured secured person's (plaintiff's) attorney as its own counsel in asserting its claim for subrogation.¹⁷¹ This procedure has the ad-

¹⁶⁵ *Id.*, slip op. at 1-2, 4-5.

¹⁶⁶ In addition, plaintiff did not comply with the pleading requirements of CR 9.02. See *id.*, slip op. at 2-3.

¹⁶⁷ No. 82-CA-196-MR, slip op. at 7.

¹⁶⁸ *Id.*, slip op. at 4-5.

¹⁶⁹ See *id.*, slip op. at 5.

¹⁷⁰ *Id.*, slip op. at 6.

¹⁷¹ KRS § 304.39-070(5) (1981) provides:

An attorney representing a secured person in any action filed under KRS 304.39-060 shall be entitled to a reasonable attorneys' fee in the event that reparation benefits paid to said secured person by that secured person's reparation obligor are reimbursed by any insurance carrier on behalf of a tortfeasor who

vantage of keeping the mention of insurance from the jury. However, the statute does not prohibit the carrier from choosing its own counsel.¹⁷²

What is a "reasonable fee" for plaintiff's counsel when separate counsel has been retained by the insurer? In *Meridian Mutual Insurance Company v. Walker*,¹⁷³ the injured party collected \$6,037.76 in BRB from Meridian, and then pursued recovery from the tortfeasor. Meridian intervened in that action to assert its right to subrogation, and hired independent counsel. However, that attorney's participation in the action was so limited that all fees for collecting the subrogated amount were awarded to plaintiff's counsel. The court of appeals affirmed the award.¹⁷⁴

In contrast, in the recent case of *Woodall v. Grange Mutual Casualty Company*,¹⁷⁵ independent counsel did not sit idly by, though much of his assistance was refused by the plaintiff's counsel, who did not wish to inject insurance into the case at trial through the presence and participation of Grange Mutual's separate counsel. Grange Mutual paid its own attorney \$1000 for his services. After judgment was entered, the defendant's insurer tendered a check for \$3,724.91 (the BRB previously paid by Grange).¹⁷⁶ At this point plaintiff's counsel, "an attorney representing a secured person [the plaintiff],"¹⁷⁷ demanded and was awarded one-third of this sum as a "mandatory" fee under KRS section 304.39-070. Although the court of appeals reversed that award after laying down a series of guidelines to be considered in arriving at a "reasonable mandatory fee," the Supreme Court affirmed the award.¹⁷⁸ Rejecting the court of appeals guidelines, the Supreme Court held that the amount of fees awarded under the statute should be set aside only for an abuse of the trial judge's

is the defendant in any such action filed by the said secured person or in the event such potential "action" is settled by said potential tortfeasor's insurance carrier on his behalf prior to the filing of any such suit.

¹⁷² See *Meridian Mut. Ins. Co. v. Walker*, 602 S.W.2d 181, 182 (Ky. Ct. App. 1980).

¹⁷³ *Id.* See also Underwood, *supra* note 1, at 281.

¹⁷⁴ 602 S.W.2d at 183.

¹⁷⁵ 648 S.W.2d 871 (Ky. 1983).

¹⁷⁶ *Id.* at 872.

¹⁷⁷ KRS § 304.39-070(5) (1981).

¹⁷⁸ 648 S.W.2d at 873.

discretion.¹⁷⁹ The particular award in *Woodall* was not viewed as “unreasonable.”¹⁸⁰

A second case involving the application of KRS section 304.39-070(5) arose from an amusing situation in which the same insurer had insured both the plaintiff and the defendant.¹⁸¹ After paying BRB to plaintiff, State Farm moved to intervene to assert its subrogation rights, only to learn that it was the defendant’s insurer. To pursue its subrogation claim would be to pursue itself. Recognizing that no good could come from such a procedural imbroglio, State Farm moved as intervening plaintiff and intervening defendant to dismiss the intervening complaint.¹⁸² Not surprisingly, an agreed order was entered.¹⁸³ The jury subsequently awarded plaintiff \$10,944.96, of which \$3,444.96 represented medical expenses and lost wages. The trial court then allowed defendant a credit for \$3,135.23, the amount of BRB previously paid to plaintiff by State Farm.¹⁸⁴ The problem arose when plaintiff’s attorney demanded and received an attorney fee of \$1,048.08 pursuant to KRS section 304.39-070(5). Not surprisingly, the court of appeals concluded the statute was inapplicable in a case in which no reparation benefits are reimbursed.¹⁸⁵

C. *Threshold*

In essence, KRS section 304.39-060(2)(a) “abolishes” tort liability for economic losses payable as BRB (up to \$10,000), and for damages for non-economic losses (pain, suffering, mental anguish and inconvenience) unless the plaintiff can meet one of the conditions [the “threshold”] of KRS section 304.39-060(2)(b).¹⁸⁶ In *D&B Coal Company v. Farmer*,¹⁸⁷ a unanimous Supreme Court held that a passenger of a motor vehicle on the public roadways of Kentucky “uses” a motor vehicle and is presumed to have ac-

¹⁷⁹ *Id.*

¹⁸⁰ *See id.*

¹⁸¹ *See State Farm Mut. Auto. Ins. Co. v. Beard*, 636 S.W.2d 26 (Ky. Ct. App. 1982).

¹⁸² *Id.* at 27.

¹⁸³ *Id.*

¹⁸⁴ *Id.* at 27.

¹⁸⁵ *Id.*

¹⁸⁶ KRS § 304.39-060(2)(a), (b) (Cum. Supp. 1982).

¹⁸⁷ 613 S.W.2d 853 (Ky. 1981).

cepted no fault,¹⁸⁸ though he or she may not be a "user" of a motor vehicle as that term is defined by KRS section 304.39-020(15).¹⁸⁹ Accordingly, the plaintiff passenger bears the burden of proving that he or she has filed an appropriate rejection form with the Department of Insurance to avoid the application of provisions of the "no-fault" statute to his or her tort claims.¹⁹⁰ *D&B Coal Company v. Farmer* appears to stand for the proposition that a passenger must also meet the "threshold" of KRS section 304.39-060(2)(b),¹⁹¹ but the recent case of *Atkins v. Schroader*¹⁹² provides room to question that premise.

In *Atkins v. Schroader*, Atkins was a passenger in a vehicle driven by Trabue. She was injured when that vehicle collided with another driven by Schroader. In her action against Schroader and Trabue she contended that she was not a "user" of a motor vehicle within the meaning of the Act,¹⁹³ although as a passenger she was "using" a motor vehicle under the doctrine of *D&B Coal Company*. Defendant moved for summary judgment on the grounds that Atkins (1) was "using" a vehicle as a passenger, (2) had not produced an appropriate rejection form exempting her from "no-fault," and (3) had not met the "threshold" requirement of KRS section 304.39-060(2)(b). The trial court granted the motion.¹⁹⁴

On appeal the court of appeals affirmed in part and reversed in part. After agreeing with the trial court that the plaintiff was deemed or presumed to have accepted the provisions of the MVRA, the court reversed the decision of the trial judge to the extent that it dismissed all of her claims.¹⁹⁵ Specifically, the court relied on KRS section 304.39-060(2)(c), which provides that the limitations on tort liability contained in KRS section 304.39-060(2)(b) [the "threshold"] do not apply

¹⁸⁸ See KRS § 304.39-060(1) (Cum. Supp. 1982).

¹⁸⁹ The current definition of "user" is found at KRS § 304.39-020(15) (Cum. Supp. 1982). A "user" is defined as "a person who resides in a household in which any person owns or maintains a motor vehicle." *Id.*

¹⁹⁰ See 613 S.W.2d at 854.

¹⁹¹ See Underwood, *supra* note 1, at 283-84.

¹⁹² 29 KLS 14, at 6 (Ky. Ct. App. Nov. 19, 1982), *aff'd*, 657 S.W.2d 945 (Ky. 1983).

¹⁹³ KRS § 304.39-020(15).

¹⁹⁴ 29 KLS 14, at 6.

¹⁹⁵ *Id.* at 7.

for injury to a person who is not an owner, operator, maintainer or user of a motor vehicle within subsection (1) of this section [dealing with persons who are deemed to have accepted the act], nor for injury to the passenger of a motorcycle arising out of the maintenance or use of such motorcycle.¹⁹⁶

The court concluded that the term "user" in this subsection must be limited to the class of users described in KRS section 304.39-020(15). In other words, one may "use" a motor vehicle as a passenger, and be presumed to have accepted no-fault pursuant to KRS section 304.39-060(b), but at the same time not meet the requirements of KRS section 304.39-020(15) and not be a "user" for purposes of KRS section 304.39-060(2)(c). Such a person would thus not be subject to the threshold requirements.¹⁹⁷

In *Atkins* there was no dispute that the plaintiff was not an owner, operator, maintainer or "user" of a motor vehicle, within the meaning of KRS section 304.39-020(15). Accordingly, although she did not allege in her complaint damages exceeding \$10,000 and could therefore not establish a claim for economic damages exceeding the maximum for BRB benefits,¹⁹⁸ she could nevertheless pursue a claim for non-economic detriment (damages for pain and suffering), by virtue of KRS section 304.39-060(2)(c), which exempted her from the "threshold".¹⁹⁹

¹⁹⁶ KRS § 304.39-060(2)(c).

¹⁹⁷ 29 KLS 14, at 7.

¹⁹⁸ See KRS § 304.39-060(2)(a) (Cum. Supp. 1982).

¹⁹⁹ This construction of the act is consistent with the former Court of Appeals decision in *Fann v. McGuffey*, 534 S.W.2d 770, 774 (Ky. Ct. App. 1975). The case can also be reconciled with *D & B Coal Co. v. Farmer*, 613 S.W.2d at 853. In the latter case the Kentucky Supreme Court reversed a plaintiff's judgment for non-economic, as well as economic damages which led the author to conclude that "a passenger must meet the threshold." *Id.* at 854. However, the Court added a footnote which pointed out that plaintiff had an operator's license, and was therefore subject to the limitations on tort recovery. *Id.* at n.3. If this was the reason for the dismissal of *all* of the plaintiff's claims (including his successful claim for pain and suffering) it seems odd that this was not set out in the text of the opinion and made the basis of the Court's decision.

