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Commonwealth of Kentucky

Court of Appeals

NO. 2013-CA-000338-MR

THE INDIANA INSURANCE COMPANY — APPELLANT

v.

APPEAL FROM CAMPBELL CIRCUIT COURT
HONORABLE FRED A. STINE, V, JUDGE
ACTION NO. 09-CI-01175

JAMES DEMETRE — APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: COMBS, STUMBO AND THOMPSON, JUDGES.

THOMPSON, JUDGE: Indiana Insurance Company appeals from a judgment entered following a jury verdict in favor of its insured, James Demetre. The jury found Indiana Insurance violated Kentucky's Unfair Claims Settlement Practices Act and Kentucky's Consumer Protection Act and breached its contract by failing to perform as required by the contract, breaching its fiduciary duties owed Demetre or violating the implied covenant of good faith and fair dealing in the insurance

contract. The jury awarded Demetre $925,000 for emotional pain and suffering, stress, worry, anxiety or mental anguish and $2.5 million in punitive damages.

After entry of the judgment, Demetre filed a motion for attorney fees and expenses and expert expenses and costs under the Consumer Protection Act. The trial court denied attorney fees if the judgment is affirmed on appeal in its entirety. Although the trial court's order provided for attorney fees in the event the judgment is reversed in part, because we are affirming the judgment in its entirety, we need not reiterate that portion of the trial court's order.

Indiana Insurance presents the following arguments: (1) the trial court erred in not granting Indiana Insurance's motion for directed verdict and motion for judgment notwithstanding the verdict (JNOV) on Demetre's claims for breach of contract and violations of the Unfair Claims Settlement Practices Act and the Consumer Protection Act; (2) the evidence of Demetre's emotional distress was insufficient to support an award; (3) the jury instructions were erroneous because Demetre was permitted to recover tort damages for breach of contract and did not properly instruct the jury on the proper standard for an award of damages for emotional distress damages; (4) the trial court erred when it excluded the testimony of two witnesses because they were not timely disclosed to Demetre's counsel; (5) the punitive damages award was excessive; and (6) the trial court's award of contingent, unliquidated attorney fees was error.

FACTS

In 2006, Demetre contracted with Indiana Insurance to insure his home, automobile and provide an excess umbrella insurance policy. Together, the bundled policies provided $2.5 million in liability coverage.

In April 2008, Demetre added liability coverage for two additional parcels of real estate he and his wife owned in Kenton and Campbell Counties. A gas station had been operated on the Campbell County property. Although the gas station no longer existed and the underground storage tanks had been removed, at the time Demetre procured insurance, state environmental agencies were monitoring the property. Demetre testified that when he applied for insurance, he informed the Indiana Insurance agent the Campbell County property was a vacant lot on which a gas station had been located.

Coverage for the additional two lots was authorized by Indiana Insurance and Demetre paid premiums. The policies were renewed multiple times including during the course of this litigation.

Mahannare Harris, her six children, and adult partner, (the Harris family) moved into a home adjacent to the Campbell County property in 2004. In September 2008, Demetre received a letter from an attorney representing Harris alleging members of the Harris family suffered injuries from gasoline fumes emanating from Demetre's property and their real property suffered a loss in fair market value.

On September 11, 2008, Demetre notified Indiana Insurance of the Harris family's claims. Upon receipt of Demetre's notice, the claim file was

assigned to Allen Geisinger who alerted Indiana Insurance's special claims unit (SCU). Geisinger quickly received a response from the SCU stating "there may be no coverage." On November 24, 2008, a field investigator was assigned to determine whether Demetre was aware of the loss prior to insuring the Campbell County property. There was testimony Indiana Insurance did nothing to investigate the Harris family's claims.

On March 27, 2009, Indiana Insurance transferred the claims file to adjuster Karen Glardon. At trial, Glardon admitted she did not investigate the Harris family's claims during the 182 days she handled the file.

With the Harris family's claims remaining unresolved by Indiana Insurance, the Harris family filed a complaint against Demetre on August 14, 2009, alleging gasoline contaminants seeped onto the Harris property causing them physical injury and rendering the home worthless. The Harris family also sued Indiana Insurance for third-party bad faith.

Indiana Insurance selected attorney Tim Schenkel to defend Demetre and attorney Don Lane to defend Indiana Insurance. Indiana Insurance advised Demetre its defense of him was subject to a reservation of rights based on Demetre's possible knowledge of the contamination on the Campbell County property prior to insuring it with Indiana Insurance.

On September 25, 2009, Indiana Insurance transferred the coverage and liability files and the bad faith file to adjuster James Magi, a member of the

SCU who handled environmental claims. The evidence at trial indicated Magi had closed 72% of all insurance claims assigned to him without payment.

On October 6, 2009, Schenkel requested that Magi hire an expert to determine the status of the Campbell County property with state regulatory agencies. An associate of Schenkel spoke to an environmental engineer and learned Demetre's property was being investigated. Because state regulatory agencies determined the property did not pose a threat to the environment needing corrective action, in a memorandum, the associate informed Schenkel it was unlikely the Harris family's claims against Demetre would prevail.

On December 11, 2009, Magi sent a letter to Demetre advising him Indiana Insurance would continue to defend him until it determined that coverage existed. Soon after that letter, Indiana separated the Harris family's claims file, the bad faith file and the coverage file. The Harris family's claims file was assigned to a different adjuster and Magi retained the coverage and bad faith files.

Over two years after receiving the Harris family's claims, on January 25, 2010, Indiana Insurance filed a declaratory judgment action against Demetre. It asserted there was no coverage because Demetre may have known of the contamination of the Campbell County property prior to insuring the property and urged the trial court to recognize the loss-in-progress doctrine. Although the theory had not been recognized in Kentucky, the federal court in *Pizza Magia Intern., LLC v. Assurance Co. of America*, 447 F.Supp.2d 766, 776 (W.D.Ky.

2006), concluded Kentucky would adopt the doctrine, which it described as follows:

> [T]he loss-in-progress doctrine precludes coverage where the insured is aware of a threat of loss so immediate that it might fairly be said that the loss was in progress and that the insured knew it at the time the policy was issued or applied for. As defined here, the loss-in-progress doctrine, does not apply only where the insured knows that a lawsuit has been filed against it or that it has incurred actual legal liability. Rather, the doctrine may apply where the insured has subjective knowledge of the damages that could underlie a legal claim against it.

Id. (internal quotations and citations omitted). After the trial court denied Indiana Insurance's motion for summary judgment because the application of the doctrine depended on issues of fact, Indiana Insurance abandoned its defense of no coverage.

Demetre became dissatisfied with Schenkel's representation and, represented by personal counsel, filed a motion to discharge him. On March 7, 2011, Schenkel requested leave to withdraw because of a "conflict of interest." The motion was granted and Indiana Insurance retained new counsel for Demetre.

Indiana Insurance then launched a time-on-loss defense in a cross-claim against Demetre in an attempt to apportion any of the Harris family's damages to a time period outside the policy's effective date. On June 29, 2011, Indiana Insurance filed a second cross-claim against Demetre and, on November 7, 2011, filed a third cross-claim. Under the time-on-loss theory, Indiana Insurance contended Demetre would be liable for 50% of any personal injury damages and

two-thirds of any property damages awarded in the Harris family's litigation. When questioned at trial, Magi admitted there was no evidence to support Indiana Insurance's theory the Harris family sustained injury between 2004 and 2008.

After two years of battling the coverage issue with Indiana Insurance, on November 14, 2011, Demtere filed a cross-claim against Indiana Insurance. He alleged violation of the Unfair Claims Settlement Practices Act and the Consumer Protection Act as well as breach of contract based on implied covenants of good faith and fair dealing.

Meanwhile, Demetre's newly appointed counsel began to investigate the merits of the Harris family's claims. In addition to attending depositions, he arranged independent medical exams and inspections of the Harris home by experts. As did prior counsel, defense counsel concluded the Harris family's claims had little merit and nominal value. More than three years after receiving notice of the Harris family's claims and more than two years after the Harris family's litigation commenced, on December 20, 2011, Indiana Insurance settled with the Harris family for $165,000. With the coverage issue resolved by the settlement, Indiana Insurance's pending cross-claim against Demetre for declaratory judgment was dismissed on February 17, 2012.

The case proceeded to trial on Demetre's claims against Indiana Insurance. Demetre testified he suffered mental anguish and anxiety caused by Indiana Insurance's fight against coverage and the financial cost of litigating against his insurance company. He testified he was stressed by the litigation and

worried about impending bankruptcy if coverage was denied. Demetre further testified he expended $397,541.04 in legal fees from August 27, 2009, when he executed a fee contract to force Indiana Insurance to provide coverage and February 17, 2012, when Indiana Insurance's final cross-claim against Demetre was dismissed. There was no expert testimony presented concerning the severity of his emotional distress.

Demetre presented the expert testimony of Carl Grayson, who was critical of Indiana Insurance's failure to expeditiously resolve the coverage issues and the Harris family's claims. While Grayson agreed Indiana Insurance could properly defend under a reservation of rights and a declaratory judgment action is a proper means to resolve coverage issues, he opined the time taken to investigate the claims against Demetre and to resolve the coverage issue was inordinate. He was critical of Schenkel's representation of Demetre, pointing out the delay in deposing the Harris family and hiring experts.

The jury also heard extensive testimony regarding the involvement of Magi in the case and Indiana Insurance's pursuit of a defense of no coverage rather than defending the Harris family's claims. However, Demetre admitted Indiana Insurance had never denied coverage, and had defended him and indemnified him.

At the conclusion of Demetre's case, Indiana Insurance moved for a directed verdict because the evidence demonstrated Indiana Insurance provided Demetre a defense and indemnification. It further argued there was insufficient evidence of Demetre's alleged emotional distress. The motion was denied.

Because the jury heard evidence regarding events that occurred in the coverage litigation and the Harris family litigation, Indiana Insurance sought to introduce the testimony of attorneys Schenkel and Lane. The purpose of their testimony was to rebut the suggestion by Demetre that their conduct in representing Demetre and Indiana Insurance were acts of bad faith attributable to Indiana Insurance. After the trial court denied the request on the basis Indiana Insurance had not identified the witnesses as required by the court's discovery order, their testimony was admitted by avowal.

The trial court again denied Indiana Insurance's motion for directed verdict at the close of the evidence and the case was submitted to the jury. The jury was instructed on breach of contract including breach of an implied covenant of good faith and fair dealing; violation of the Unfair Claims Settlement Practices Act; and violation of the Consumer Protection Act. The jury found for Demetre on all three theories.

Indiana Insurance filed a motion for a JNOV or for a new trial. The motion was denied. After the circuit court's order pertaining to attorney fees was entered, Indiana Insurance appealed.

INDIANA INSURANCE'S CLAIM IT WAS ENTITLED TO A DIRECTED VERDIT OR JNOV

Indiana Insurance maintains it was entitled to a directed verdict or JNOV on all of Demetre's claims. Our standard of review is set forth in *Taylor v. Kennedy*, 700 S.W.2d 415, 416 (Ky.App. 1985):

> In ruling on either a motion for a directed verdict or [JNOV], a trial court is under a duty to consider the evidence in the strongest possible light in favor of the party opposing the motion. Furthermore, it is required to give the opposing party the advantage of every fair and reasonable inference which can be drawn from the evidence. And, it is precluded from entering either a directed verdict or [JNOV] unless there is a complete absence of proof on a material issue in the action, or if no disputed issue of fact exists upon which reasonable men could differ.

At the heart of Demetre's three theories of recovery is Indiana Insurance's failure to timely investigate the Harris family's claims and offer assistance to Schenkel in providing effective legal counsel. He contends the evidence sufficiently established Indiana Insurance willfully chose to protect its own interests and, without legal or factual basis, repeatedly filed declaratory judgment actions against him. Demetre points to his own testimony that as a result, he incurred legal fees and suffered emotional distress.

Indiana Insurance argues it cannot be liable as a matter of law under any theories advanced because it provided defense counsel to Demetre and indemnification in compliance with the insurance policy provisions. To the extent it relies solely on its satisfaction of the express policy provisions, Indiana Insurance's argument misses the mark. This is not a breach of contract action but is premised on three theories of bad faith, two based on statutory law and one on common law. We explain the law as it developed.

"In every contract, there is an implied covenant of good faith and fair dealing." *Ranier v. Mount Sterling Nat. Bank*, 812 S.W.2d 154, 156 (Ky. 1991).

However, in *Federal Kemper Ins. Co. v. Hornback*, 711 S.W.2d 844, 845 (Ky. 1986), our Supreme Court rejected the notion an insurer owes fiduciary duties to its insured including good faith and fair dealing the breach of which would constitute a tort and, instead, held an insured's remedy was limited to breach of contract. The law expressed in *Federal Kemper* would soon be modified based on statutory law and, eventually, overruled.

The first recognition that an insurer may be liable for tort damages was in *Stevens v. Motorists Mut. Ins. Co.*, 759 S.W.2d 819 (Ky. 1988). The Court addressed whether an insured could maintain a private cause of action under the Consumer Protection Act for bad faith against his own insurer. Kentucky Revised Statutes (KRS) 367.220(1) provides in part:

> Any person who purchases or leases goods or services primarily for personal, family or household purposes and thereby suffers any ascertainable loss of money or property, real or personal, as a result of the use or employment by another person of a method, act or practice declared unlawful by KRS 367.170, may bring an action.... Nothing in this subsection shall be construed to limit a person's right to seek punitive damages where appropriate.

The Court held the purchase of insurance was a service as provided for in the Act which provides a statutory cause of action for bad faith by an insured against his own insurer. *Stevens*, 759 S.W.2d at 821. In the year following *Stevens*, the Court found yet another statutory remedy existed for an insured injured by the bad faith of its insurer under Kentucky's Unfair Claims Settlement Practices Act.

KRS 304.12-230 sets forth the conduct by an insurer that violates the Act. The provisions relevant to the present case are as follows:

> It is an unfair claims settlement practice for any person to commit or perform any of the following acts or omissions:
>
> (1) Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
>
> (2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
>
> (3) Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
>
> (4) Refusing to pay claims without conducting a reasonable investigation based upon all available information;
>
> (5) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
>
> (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear[.]

In *State Farm Mutual Auto. Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988), the Court recognized a statutory bad faith action for violation of the Act. Like *Stevens*, when *Reeder* was decided, *Federal Kemper* remained good law and there was no common law cause of action in Kentucky for first-party bad faith. Repeating its reasoning in *Stevens*, the Court found *Federal Kemper* did not preclude a tort action under the Act, noting "the legislature can enact a law creating

a cause of action where none existed at common law." *Id*. at 118. The Court held the legislature had done just that by enacting the Unfair Claims Settlement Practices Act. *Id*. Unfortunately, as in *Stevens*, it did not provide the elements required to prove bad faith.

Soon after *Reeder*, the holding in *Federal Kemper* was questioned and the concept of the common law theory of bad faith by an insured against his or her insurance carrier emerged as the common law in Kentucky. In *Curry v. Fireman's Fund Ins. Co.,* 784 S.W.2d 176, 178 (Ky. 1989), the Court recognized the action is a tort independent of the contract. Pronouncing a departure from its prior holding, the Court overruled *Federal Kemper,* and held an insurer cannot "deny payment without any justification, attempt unfair compromise by exploiting the policyholder's economic circumstance, and delay payment by litigation with no greater possible detriment than payment of the amount justly owed plus interest." *Id*. The Court reasoned:

> In this society, first party insurance coverage against a host of risks is recognized as essential. From cradle to grave individuals willingly pay premiums to insurance companies to obtain financial protection against property and personal loss. Without a reasonable means to assure prompt and bargained-for compensation when disaster strikes, the peace of mind bought and paid for is illusory. The rule in *Federal Kemper* is unjust and, despite its recency, should not be perpetuated.

Id. However, as in *Stevens* and *Reeder,* the Court offered little insight into the elements necessary to establish bad faith. It would later recognize its oversight in *Wittmer v. Jones,* 864 S.W.2d 885 (Ky. 1993).

In *Wittmer*, the Court attempted to explain "the mechanics involved in applying" *Stevens, Reeder* and *Curry*. *Id*. at 886. The Court "gathered all of the bad faith liability theories under one roof and established a test applicable to all bad faith actions, whether brought by a first-party claimant or a third-party claimant, and whether premised upon common law theory or a statutory violation." *Davidson v. American Freightways, Inc*., 25 S.W.3d 94, 100 (Ky. 2000). The plaintiff must prove: (1) the insurer is obligated to pay the claim under the terms of the policy; (2) the insurer lacks a reasonable basis in law or fact for denying the claim; and (3) the insurer knowingly or recklessly denied the claim without a reasonable basis. *Wittmer*, 864 S.W.2d at 890. It cautioned that "an insurer is entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts." *Id*. (quoting Leibson, J., dissenting, *Federal Kemper,* 711 S.W.2d at 846-47).

The Court emphasized mere "technical violation" of the Unfair Claims Settlement Practices Act or negligence is not sufficient to warrant submission of the case to the jury.

> The essence of the question as to whether the dispute is merely contractual or whether there are tortious elements justifying an award of punitive damages depends first on whether there is proof of bad faith and next whether the proof is sufficient for the jury to conclude that there was conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others.
>
> This means there must be sufficient evidence of intentional misconduct or reckless disregard of the rights of an insured or a claimant to warrant submitting the

> right to award punitive damages to the jury. If there is such evidence, the jury should award consequential damages and may award punitive damages. The jury's decision as to whether to award punitive damages remains discretionary because the nature of punitive damages is such that the decision is always a matter within the jury's discretion.

Id. at 890 (quoting *Federal Kemper*, 711 S.W.2d at 848)(internal quotations and citations omitted). Under the Court's one-roof approach, the same threshold must be met whether the claim is under the Unfair Claims Settlement Practices Act, the Consumer Protection Act, or common law bad faith.

Demetre had three possible theories upon which to base his bad faith claim. The question is whether he produced sufficient evidence under any, or all, of these theories to submit the case to the jury. We examine the evidence keeping in mind "[i]nadvertence, sloppiness, or tardiness will not suffice; instead, the element of malice or flagrant malfeasance must be shown." *United Services Auto. Ass'n. v. Bult*, 183 S.W.3d 181, 186 (Ky.App. 2003).

Indiana Insurance argues Demetre never presented a claim for benefits to Indiana Insurance. If correct, Indiana Insurance could not be liable under any of the theories advanced because nothing would have triggered Indiana's statutory or common law duties. However, it is incorrect.

As an insured, Demetre made a claim for the benefits purchased under the Indiana Insurance policy when he notified Indiana Insurance of the Harris family's claims. As explained in *Knotts v. Zurich Ins. Co*., 197 S.W.3d 512, 530 (Ky. 2006), a claim includes a demand for benefits under an insurance policy.

A more legally persuasive and factually sustainable argument is that because Indiana Insurance provided a defense to Demetre and ultimate indemnification, it cannot be liable for bad faith. To put the issue succinctly, can an insurer absolve itself from liability for bad faith by defending under a reservation of rights and ultimately providing coverage for its insured in litigation filed by a third party? We decline to adopt a blanket rule shielding an insurer from bad faith in such circumstances and conclude the issue is better approached on a case-by-case basis.

We begin by noting this situation creates a judicial paradox. If there is any allegation in a complaint against an insured potentially covered under the insured's policy of insurance, the insurer has a duty to defend. However, through a reservation of rights, an insurer may offer to defend while contesting coverage. *Simpsonville Wrecker Service, Inc. v. Empire Fire and Marine Ins. Co*., 793 S.W.2d 825, 830 (Ky.App. 1989). The paradox is the insurance company is asserting its right to reserve its defense of no coverage while complying with its duty to defend its insured.

Similar facts were presented in *Guaranty Nat. Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997). The insureds filed a bad faith action against Guaranty National after it defended them against a wrongful death action under a reservation of rights and filed a declaratory judgment action on the coverage issue. Shortly after the trial court determined there was coverage, Guaranty National settled the claim against its insureds.

The insureds filed a bad faith action claiming the decision to defend under a reservation of rights constituted outrageous conduct. Guaranty National argued the practical ramifications of permitting the claim to proceed:

> [P]roviding of a defense and the complete indemnification of a claim under a policy of insurance is not indicative of evil motive or reckless indifference ... it is a clear indication of good faith, caution, and prudence. If filing a reservation of rights is the basis of bad faith, then the flood gates for litigation are wide open when an insurer even dares to raise the coverage question, let alone litigate it.

Id. 948. The Court agreed and held Guaranty National's defense under a reservation of rights and its decision to maintain an independent action to determine coverage did not meet the high threshold established in *Wittmer* to sustain a bad faith action. *Id*. at 949. It declined to "deprive an insurer of its election to explore its legal remedy." *Id*. Based on *Guaranty Nat.* and the elements necessary to establish bad faith, we conclude providing a defense under a reservation of rights and seeking a declaratory judgment regarding coverage is not alone bad faith conduct. An insurance carrier is not required to "pay bogus claims or abandon legitimate defenses." *Curry*, 784 S.W.2d at 178.

However, the Court was also not inclined to preclude a bad faith action where the bad faith threshold is met. It stated:

> Some may argue that the insurer, by notifying its insured that it is defending under a reservation of rights and filing a declaratory judgment action, is automatically absolved of bad faith. We do not so hold. Clearly, one can envision factual situations where an insurer could abuse its legal prerogative in requesting a court to

> determine coverage issues. Those may well be addressed through a motion under Civil Rule 11 or, in certain circumstances, an action for bad faith.

Guaranty Nat., 953 S.W.2d at 949.

In *Knotts*, our Supreme Court recognized adversarial litigation between an insurer and insured makes it difficult for the insurer to fulfill its duties under KRS 304.12-230. *Knotts*, 197 S.W.3d at 515. Nevertheless, the insurers' duties continue to apply before and during litigation. *Id*. at 517. To avoid hampering an insurer's litigation rights, the Court fashioned an evidentiary rule permitting post-filing settlement conduct by the insurer as evidence of bad faith but not evidence of the insurer's counsel's trial tactics. *Id*. at 523.

Based on the case law, it is the rule that an insurer cannot simply defend under a reservation of rights and force its insured to litigate the issue of coverage and, after coverage is established, then claim no harm, no foul. The very reason an insured purchases insurance is "to assure prompt and bargained-for compensation when disaster strikes[.]" *Curry*, 784 S.W.2d at 178. The insurer "should do nothing that jeopardizes the insured's security under the policy. It should not force an insured to go [through] needless adversarial hoops to achieve its rights under the policy." *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368, 376 (Ky. 2000) (quoting *Zilisch v. State Farm*, 196 Ariz. 234, 995 P.2d 276, 280 (2000)). In first-party bad faith actions, the inquiry the court must make before submitting the case to the jury is "whether there is sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation, and processing of the claim,

the insurer acted unreasonably and either knew or was conscious of the fact that its conduct was unreasonable." *Id*.

Applying the law to the present case and viewing the facts most favorably to Demetre, we conclude the trial court properly submitted the case to the jury and properly denied Indiana Insurance's motion for a JNOV. It cannot be ignored that the jury heard evidence Demetre informed Indiana Insurance that a gas station had been operated on the property when he applied for insurance. Despite this obvious red flag warning of possible liability, Indiana Insurance issued the policy and accepted Demetre's premiums. Additionally, there was evidence that when Demetre notified Indiana Insurance of the Harris family's claims, Indiana Insurance immediately set in motion its defense of no coverage and did nothing to protect the security of its insured through promptly investigating the merits of the Harris family's claims. Certainly, it could have defended its interest and protected Demetre at the same time.

After the Harris family filed an action against Demetre and a bad faith action against Indiana Insurance, Indiana Insurance hired counsel to represent Demetre. However, there was evidence from which the jury could conclude Schenkel was not functioning as Demetre's independent legal counsel but was at all times controlled by Indiana Insurance adjusters who had the intent of denying coverage. We have previously held an insurer cannot shield itself from its own bad faith actions by retaining legal counsel for its insured. "[I]t remains ultimately responsible for its own non-delegable statutory duty to properly investigate claims

and adjust them in harmony with the terms and conditions of its policy." *Hamilton Mut. Ins. Co. of Cincinnati v. Buttery*, 220 S.W.3d 287, 294 (Ky.App. 2007). It was the conduct of Indiana Insurance, not the adequacy of Schenkel's representation, that evidenced bad faith.

Contrary to Indiana Insurance's claim it acted in good faith and dealt fairly with its insured, even after being informed that the Harris family's claims had no merit, Indiana Insurance did not retain an expert or investigate the claim. Until new counsel was retained to represent Demetre and after Demetre had been forced to hire personal counsel to defend him in Indiana Insurance's declaratory judgment actions, the Harris family's claims were investigated and quickly resolved. By that time, there was evidence that the peace of mind Demetre bargained for in procuring insurance was merely illusory.

Based on the evidence, we affirm the jury's findings that Indiana Insurance violated the implied covenant of good faith and fair dealing and violated the Unfair Claims Settlement Practices Act. However, whether Indiana Insurance violated the Consumer Protection Act requires additional analysis.

Although *Stevens* established that a first-party bad faith action may be maintained under the Act because insurance is a service, a person alleging a violation of its provisions must suffer "any ascertainable loss of money or property[.]" KRS. 367.220(1). Indiana Insurance maintains Demetre did not suffer an ascertainable loss because his only damages were emotional distress and attorney fees.

Indiana Insurance points out other jurisdictions have held damages for emotional distress are non-economic losses and are not ascertainable losses under their Consumer Protection Acts. *See Pagliara v. Johnston Barton Proctor & Rose, LLP*, 708 F.3d 813, 820 (6th Cir. 2013); *Di Teresi v. Stamford Health System, Inc.*, 149 Conn. App. 502, 510-12, 88 A.3d 1280, 1284-85 (2014). Properly, it also points out attorney fees incurred in prosecuting a Consumer Protection Act action cannot be considered an ascertainable loss because "ascertainable loss" is a prerequisite to maintaining the action.

However, we agree with Demetre that attorney fees incurred due to unfair, fraudulent or tortious conduct by an insurer is an ascertainable loss. The Consumer Protection Act is "a statute which has the broadest application in order to give Kentucky consumers the broadest possible protection for allegedly illegal acts." *Stevens*, 759 S.W.2d at 821. When forced to defend a declaratory judgment action and employ counsel, the expenditure of money is an economic loss. Because Demetre testified he incurred legal fees to defend against Indiana Insurance's litigation of the coverage issue, we conclude there was sufficient evidence of an ascertainable loss to submit the case to the jury under the Consumer Protection Act.

The jury's verdict on liability under all three causes of action is affirmed. We now turn to the award of damages for emotional distress.

INDIANA INSURANCE'S CLAIM DEMETRE WAS REQUIRED TO PRODUCE EXPERT TESTIMONY THAT HIS EMOTIONAL DISTRESS WAS SEVERE

Osborne v. Keeney, 399 S.W.3d 1 (Ky. 2012), was rendered after the jury returned its verdict but while Indiana Insurance's motion for JNOV was pending. Indiana Insurance contends that under *Osborne*, Demetre could not recover damages for his emotional distress because he did not provide expert testimony his distress was severe. A brief recitation of the facts in *Osborne* is warranted.

Brenda Osborne was sitting on a couch in her home when a plane crashed through her roof and damaged her home and its contents. However, no debris struck Osborne and she was not physically injured. Osborne retained counsel to represent her in litigation against the pilot and counsel filed an action in state court that was later removed to federal court. The federal court dismissed the claim based on the statute of limitations.

Osborne then filed an action against her counsel asserting legal malpractice, breach of contract, and fraud and deceit. The jury returned a verdict in Osborne's favor and awarded damages, including $250,000 for mental anguish. In the context of these facts, our Supreme Court took the opportunity to depart from the impact rule in claims for negligent infliction of emotional distress (NIED).

Prior to *Osborne*, the rule was "an action will not lie for fright, shock[,] or mental anguish which is unaccompanied by physical contact or injury." *Id*. at 14 (quoting *Deutsch v. Shein*, 597 S.W.2d 141, 145-46 (Ky. 1980). Three reasons

justified the rule: "the damages resulting from the fright are too remote; that fright caused by negligence not being itself a cause of action, none of its consequences can give a cause of action; and that to open the courts to this character of case would tend to promote fraud and the presentation of claims for injuries beyond the capacity of juries to properly assess." *Id*. at 15 (quoting *Louisville & N.R. Co. v. Roberts,* 207 Ky. 310, 269 S.W. 333, 334 (1925)). Noting the impact rule had been departed from by the overwhelming majority of jurisdictions, the Court expressly abandoned the rule.

The Court observed the impact rule had potentially harsh consequences and had proven to be inconsistently applied. *Id*. The Court found a more just approach, and one that would allow legitimate NIED claims to survive absent an impact, is to analyze NIED claims under general negligence principles. "That is to say that the plaintiff must present evidence of the recognized elements of a common law negligence claim: (1) the defendant owed a duty of care to the plaintiff, (2) breach of that duty, (3) injury to the plaintiff, and (4) legal causation between the defendant's breach and the plaintiff's injury." *Id*. at 17. However, quieting criticism that its holding would promote frivolous and conjured NIED claims, the Court followed Tennessee law and held a stand-alone NIED claim cannot survive without proof that the emotional injury is severe or serious. "A 'serious' or 'severe' emotional injury occurs where a reasonable person, normally constituted, would not be expected to endure the mental stress engendered by the circumstances of the case." *Id*. The Court held a plaintiff "must present expert

medical or scientific proof to support the claimed injury or impairment." *Id*. at 18. Thus, while impact is no longer required in NIED cases and, therefore, the door is open for plaintiff's previously denied recovery, the standard of proof is heightened.

To avoid application of the new rule fortuitously to Osborne's claim and those that followed, the Court held its ruling is to be retroactively applied to: "(1) the present case; (2) all cases tried or retried after the date of filing of this opinion; and all cases, pending, including appeals, in which the issue has been preserved." *Id*. at 24.

Based on *Osborne*, Indiana Insurance maintains that because Demetre did not present expert medical or scientific testimony to establish his emotional distress was severe or serious, the damages awarded must be vacated. The initial question is whether Indiana Insurance preserved the issue for review. We believe it did.

Indiana Insurance first presented the issue of the sufficiency of Demetre's proof of emotional distress damages in a supplemental memorandum filed prior to trial where it stated Demetre was precluded from such damages because he had not presented an expert to testify regarding the nature and severity of his emotional distress and he would be the sole witness at trial to testify regarding his distress. It again presented the issue of Demetre's proof regarding emotional distress in its motions for directed verdict and JNOV. To further preserve the issue, after *Osborne* was rendered, Indiana Insurance brought the case to the trial court's attention. The issue is properly before this Court.

As we write, little Kentucky appellate law has been written regarding the scope and ramifications of *Osborne*. However, after the parties' briefs were filed, our Supreme Court denied discretionary review in *Keaton v. G.C. Williams Funeral Home, Inc*., 436 S.W.3d 538 (Ky.App. 2013).

In *Keaton*, the plaintiffs filed an action for negligence, intentional infliction of emotional distress (IIED), fraud, negligent misrepresentation, breach of contract, and violation of the Kentucky Consumer Protection Act after the plaintiffs' relative was buried in a cemetery plot different than that provided for in the contract with the cemetery. This Court held summary judgment was properly granted on all claims, including the statutory claim under the Consumer Protection Act.

Summary judgment was affirmed as to the negligence claim and IIED claims based on the lack of affirmative evidence of any severe emotional distress as required by *Osborne*. *Id*. at 544. However, summary judgment on the claim under the Consumer Protection Act was based on entirely different reasoning. Specifically, it was held the family did not have standing under the Act and that the acts alleged were not of the type protected by the Consumer Protection Act. *Id*. at 546.

In contrast, we have held Demetre's claims under the Unfair Claims Settlement Practices Act and the Consumer Protection Act properly survived Indiana Insurance's motion for JNOV. The jury found Indian Insurance liable under all three theories advanced, including his statutory claims. Therefore, whether *Osborne* applies to statutory claims where emotional distress damages

have been traditionally permitted is not resolved by *Keaton*. Because we are delving into an area of the law in its infancy in this Commonwealth and believe it unwise to unnecessarily limit or broaden the scope of *Osborne*, we limit our discussion to Demetre's action under the Uniform Claims Settlement Practices Act.[1]

The question is whether the heightened proof requirements in *Osborne* extends to bad faith claims under the Unfair Claims Settlement Practices Act where damages for mental anguish and anxiety have been traditionally permitted without an impact and without expert testimony. As noted in *FB Ins. Co. v. Jones*, 864 S.W.2d 926, 929 (Ky.App. 1993), the Unfair Claims Settlement Practices Act prohibits behavior that is egregious. Consequently, damages are available as permitted by KRS 446.070 which states: "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." In *FB Insurance*, the Court held those damages include damages for anxiety and mental anguish in claims pursuant to KRS 304.12-230. *FB Insurance*, 864 S.W.2d at 929.

In *Motorists Mutual Ins. Co. v. Glass*, 996 S.W.2d 437, 454 (Ky. 1997), the Court not only confirmed that damages for anxiety and mental anguish are recoverable in statutory bad faith claims, but it also set forth the proof required:

[1] Indiana Insurance cites unpublished federal decisions applying *Osborne* in contexts other than statutory bad faith claims. We are not bound by those decisions predicting how Kentucky appellate courts would rule and do not find them persuasive on a factual basis.

"[E]ntitlement to such damages requires either direct or circumstantial evidence from which the jury could infer that anxiety or mental anguish in fact occurred." *Id*.

Although written in the context of a violation of the Kentucky Civil Rights Act, our Supreme Court has distinguished between statutory actions where emotional distress damages are recoverable and the elements of the tort of IIED which requires the distress be severe. In *Childers Oil Co., Inc. v. Adkins*, 256 S.W.3d 19, 28 (Ky. 2008), the Court expressly rejected any requirement that the plaintiff prove her emotional distress was severe. It pointed out the action was not filed as an IIED claim but was an action under the Kentucky Civil Rights Act. It held the plaintiff's testimony alone supported an award for anxiety and mental anguish and, because such damages were permissible, the question was simply whether the damages were excessive. *Id*.

Osborne did not alter the law cited. A claim brought under the Unfair Claims Settlement Practices Act is not a NIED or an IIED claim; it is a claim under the Act for compensatory damages, which include damages for emotional distress. In other words, emotional pain and suffering, stress, worry, anxiety or mental anguish are not elements of the cause of action but are consequences of the insurer's violation of the Act for which the insured is entitled to be compensated.

Tennessee, a jurisdiction expressly relied upon in *Osborne* when adopting the heightened standard of proof in NIED claims, limits the heightened standard of proof to stand-alone NIED claims. In *Estate of Amos v. Vanderbilt University*, 62

S.W.3d 133 (Tenn. 2001), the Court explained its holding in *Camper v. Minor*, 915 S.W.2d 437 (Tenn. 1996), requiring a heightened standard of proof in NIED cases. The Court clarified the same standard is not required in parasitic claims of emotional distress.

> Vanderbilt contends that *Camper*'s requirements of expert medical or scientific proof and serious or severe injury extend to all negligence claims resulting in emotional injury. We disagree. The special proof requirements in *Camper* are a unique safeguard to ensure the reliability of "stand-alone" negligent infliction of emotional distress claims. The subjective nature of "stand-alone" emotional injuries creates a risk for fraudulent claims. The risk of a fraudulent claim is less, however, in a case in which a claim for emotional injury damages is one of multiple claims for damages. When emotional damages are a "parasitic" consequence of negligent conduct that results in multiple types of damages, there is no need to impose special pleading or proof requirements that apply to "stand-alone" emotional distress claims.

Estate of Amos, 62 S.W.3d at 136-37 (internal quotations, parentheses, and citations omitted).

The concerns of the *Osborne* Court of fictitious actions are not present in those filed pursuant to the Unfair Claims Settlement Practices Act, an Act liberally construed to effectuate its purpose of protecting the public from unfair trade practices and deceptive acts and practices in the business of insurance. *Reeder*, 763 S.W.2d at 118. As the law has developed, the burden of proof to submit the case to the jury on liability is high. Therefore, the fear that frivolous claims will survive a

directed verdict does not loom in claims under the Unfair Claims Settlement Practices Act.

As the Court noted in *Curry* when overruling *Federal Kemper*, foremost, an insured purchases "peace of mind" from the insurer. *Curry*, 784 S.W.2d at 178. The possibility of damages for emotional distress is a strong deterrent to bad faith actions by an insurance company and may be the only deterrent to unfair and deceptive practices. For the reasons stated, we decline to extend *Osborne's* requirement that emotional distress be proven by expert medical or scientific proof to claims brought pursuant to the Unfair Claims Settlement Practices Act. In such cases, emotional distress may be proven by direct or circumstantial evidence, including the plaintiff's testimony alone.

Here, Demetre testified he suffered stress, worry, anxiety, and mental anguish as result of Indiana Insurance's delay in payment to the Harris family, failure to investigate the Harris family's claims, and its litigation on the defense of no coverage without investigation. As we have stated, such damages were a foreseeable consequence of Indiana Insurance's bad faith actions. The jury could reasonably find Demetre suffered emotional distress as a result of Indiana Insurance's bad faith conduct. The assessment of those damages was properly left to the jury.

JURY INSTRUCTIONS

Indiana Insurance contends the jury was instructed it could award punitive damages if it found Indiana Insurance breached its contract with Demetre.

> Punitive damages are ordinarily not recoverable in a breach of contract action. And an instruction on punitive damages is warranted, in any case, only where the defendant has acted wantonly, or recklessly, or oppressively, or with malice as implies a spirit of mischief or criminal indifference to civil obligations.

Wahba v. Don Corlett Motors, Inc., 573 S.W.2d 357, 360 (Ky.App. 1978) (quoting *Louisville & N.R. Co. v. Jones' Adm'r*, 297 Ky. 528, 180 S.W.2d 555 (1944) (internal quotations and citations omitted)).

As earlier stated, this is not a simple breach of contract action but an action premised on the bad faith actions of Indiana Insurance. However, in the good faith and fair dealing instruction, the jury was also instructed on breach of the terms and conditions of the contract. Therefore, the instruction incorporated breach of contract and the tort elements of bad faith. Despite the intertwining of the contract and tort causes of action in the instruction, Indiana Insurance cannot claim error.

The trial court instructed the jury that it could only award punitive damages if it found that Indiana Insurance violated the Unfair Claims Settlement Practices Act or the Consumer Protection Act. No punitive damages were authorized under the "breach of contract" instruction and, therefore, Indiana Insurance's claimed error is without merit.

Indiana Insurance reasserts its reliance on the heightened standard of proof required in *Osborne* arguing that the jury instruction on damages for mental anguish and stress was erroneous. Notably, the instruction given by the trial court mirrored the instruction in the parties' agreed tendered jury instructions.

Additionally, based on what we have said, the instructions were not required to include any language pertaining to the severity of Demetre's emotional distress.

TESTIMONY OF SCHENKEL AND LANE

Indiana Insurance contends the trial court erred when it excluded the testimony of Schenkel and Lane, the attorneys who represented Demetre and Indiana Insurance, on the basis they were not disclosed as witnesses in the time period specified in the parties' agreed scheduling order. The order provided that all discovery requests be served by February 28, 2012; full, complete and accurate responses be served by March 30, 2012; and all depositions completed by April 30, 2012. After the deadlines passed and Indiana Insurance's motion for summary judgment was denied, Indiana Insurance indicated it would call Schenkel and Lane as witnesses to rebut the suggestion that their conduct in representing their clients were acts of bad faith attributable to Indiana Insurance. With a June 2012 trial date looming, the trial court ruled they could not testify because the time for discovery had passed. Indiana Insurance argues Schenkel and Lane were classic rebuttal witnesses and, after the trial date was moved to September 2012 because of courthouse construction, Demetre had ample time to depose them.

"Pretrial discovery simplifies and clarifies the issues in a case; eliminates or significantly reduces the element of surprise; helps to achieve a balanced search for the truth, which in turn helps to ensure that trials are fair; and it encourages the

settlement of cases." *LaFleur v. Shoney's, Inc*., 83 S.W.3d 474, 478 (Ky. 2002). We have held it is within the trial court's discretion to exclude witnesses as an appropriate consequence for failure to comply with pretrial discovery orders. *Edwards v. State Farm Mut. Auto. Ins. Co*., 389 S.W.3d 641, 643 (Ky.App. 2012). However, a trial court abuses its discretion and commits error if its ruling is "arbitrary, unreasonable, unfair, or unsupported by sound legal principles." *Goodyear Tire and Rubber Co. v. Thompson,* 11 S.W.3d 575, 581 (Ky. 2000).

We agree with Indiana Insurance that a party "is not required to anticipate every shred of evidence that might be presented at trial" and when truly a surprise, rebuttal testimony may be permitted despite that a witness was not timely identified. *Rossi v. CSX Transp., Inc*., 357 S.W.3d 510, 518 (Ky.App. 2010). However, it should not have been a surprise when Demetre introduced evidence concerning Indiana Insurance's control over Schenkel and Lane to demonstrate the insurer's bad faith.

Despite the lack of surprise, once the trial date was rescheduled, Demetre had ample time to depose Schenkel and Lane and, therefore, there could be no disadvantage to Demetre by permitting Indiana Insurance to call them as witnesses and extending the discovery deadline. Indeed, "a balanced search for the truth" would seem to be aided rather than hindered by permitting the identification of witnesses who possess relevant information to the ensuing trial. *LaFleur*, 83 S.W.3d at 478.

Although we agree with Indiana Insurance that the trial court abused its discretion, we will only reverse if the error was prejudicial. To demonstrate prejudicial or reversible error, Indiana Insurance must demonstrate that absent the exclusion of the witnesses, there is a reasonable possibility the jury verdict would have been different. Kentucky Rules of Civil Procedure (CR) 61.01; Kentucky Rules of Evidence (KRE) 103; *Crane v. Commonwealth,* 726 S.W.2d 302, 307 (Ky. 1987).

Indiana Insurance does not cite to the record where the avowal testimony can be found or offer the content of that testimony. The very reason for placing testimony in the record by avowal is to provide the reviewing court with the opportunity to know exactly what testimony was excluded. It is well-settled that an appellate court will not sift through a voluminous record to try to ascertain facts when a party has failed to comply with its obligation under CR 76.12(4)(d)(iv).

Moreover, while Indiana Insurance argues the trial court abused its discretion in excluding Schenkel's and Lane's testimony, it does not argue how the exclusion was prejudicial or demonstrate that the outcome of the trial would have been different. By its failure to cite to the record and argue how specific testimony would have changed the outcome of the jury's verdict, Indiana Insurance has not provided this Court a basis on which to conclude the trial court's error constituted reversible error.

Nevertheless, from our review of the record and keeping in mind the applicable law, there is no reasonable possibility the verdict would have been

different if Schenkel and Lane testified. As noted in our discussion of the evidence supporting the jury's verdict, this case turned on the conduct of Indiana Insurance and not the conduct of Schenkel and Lane. Any error in excluding Schenkel's and Lane's testimony was harmless.

PUNITIVE DAMAGES

Indiana Insurance maintains the punitive damages award was excessive and unconstitutional. Demetre argues Indiana Insurance failed to preserve the issue for review because it did not object to the instruction authorizing punitive damages in the amount of $10,000,000. *Gersh v. Bowman*, 239 S.W.3d 567, 574 (Ky.App. 2007). Because of the constitutional implications of an excessive verdict, we consider Indiana Insurance's argument.

The United States Supreme Court has held an excessive and disproportionate punitive damages award violates the constitutional guarantee of due process under the United States Constitution. *State Farm Mut. Auto. Ins. Co. v Campbell*, 538 U.S. 408, 418, 123 S.Ct. 1513, 1520, 155 L.Ed.2d 585 (2003). In determining whether an award of punitive damages is excessive, three factors are relevant:

> (1) the degree of reprehensibility of the defendant's misconduct, (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award, and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases.

Id. Our review of the excessiveness of a punitive damage award is *de novo. Ragland v. DiGiuro,* 352 S.W.3d 908, 916 (Ky.App. 2010).

The degree of reprehensibility of the defendant's conduct is "the most important indicium of the reasonableness of a punitive damage award[.]" *BMW of North America, Inc. v. Gore*, 517 U.S. 559, 575, 116 S.Ct. 1589, 1599, 134 L.Ed.2d 809 (1996). By enacting the Unfair Claims Settlement Practices Act and the Consumer Protection Act, the legislature sought to deter bad faith conduct by insurers. In this case, there was evidence Indiana Insurance embarked on a course of conduct immediately after receiving notice of the Harris family's claims to deprive Demetre of the benefits owed under his insurance policy.

Moreover, we do not believe the ratio of compensatory damages to punitive damages awarded was unreasonably disproportionate. Finally, the legislature believed bad faith conduct by an insurer in the payment of claims to be reprehensible enough to impose a $10,000 penalty for a violation of the Unfair Claims Settlement Practices Act. KRS 304.99-020. The maximum $10,000 penalty per violation is not an amount "dwarfed" by the $ 2.5 million punitive damage award. *Campbell*, 538 U.S. at 428, 123 S.Ct. at 1526 (the state sanction applicable was a $10,000 fine compared to the $145 million punitive damages award).

ATTORNEY FEES

Demetre requested $1,006,991 in attorney fees, litigation expenses and costs. The trial court fashioned its order so as to permit Demetre to recover for his emotional distress and punitive damages but not receive a windfall by the additional award of attorney fees. The order states in part:

> [S]hould the entire verdict of the jury as rendered be affirmed on appeal, Indiana Insurance Company will not be required to pay any amount toward plaintiff's attorneys' fees. Any other resolution in this particular instance would result in an undeserved windfall for plaintiff's counsel.

Because we affirm the jury's verdict in its entirety, pursuant to the trial court's order, Demetre is not entitled to attorney fees. The alleged error presented by Indiana Insurance is moot.

Based on the forgoing, the order and judgment entered following the jury verdict and order granting in part and denying in part Demetre's motion for attorney fees, expert fees, and litigation expenses are affirmed.

ALL CONCUR.

BRIEFS FOR APPELLANT:

Michael D. Risley
Louisville, Kentucky

Donald L. Miller, II
Kristin M. Lomond
Louisville, Kentucky

ORAL ARGUMENT FOR APPELLANT:

Michael D. Risley
Louisville, Kentucky

BRIEF FOR APPELLEE:

Jeffrey M. Sanders
Covington, Kentucky

Robert E. Sanders
Covington, Kentucky

Kevin C. Burke
Louisville, Kentucky

ORAL ARGUMENT FOR APPELLEE:

Jeffrey M. Sanders
Covington, Kentucky