

# Kentucky

By Charles H. Cassis and Lindsey L. Howard

## What triggers an insurer's duty to defend?

Under Kentucky law, “[t]he insurer has a duty to defend if there is any allegation which potentially, possibly or might come within the coverage of the policy[.]” and the determination must be made at the outset of litigation. *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279 (Ky. 1991) (citations omitted). An insurer must compare the allegations in a complaint with the terms of an insurance policy to determine whether it has a duty to defend its insured. *Id.* at 279. The “terms of insurance contracts have no technical meaning in law and are to be interpreted according to the usage of the average man and as they would be read and understood by him[.]” *Id.* at 280. Where the terms of an insurance contract are clear and unambiguous, Kentucky courts apply the ordinary meaning of the words chosen by the insurer. *Id.* To the contrary, where an ambiguity in the insurance contract exists, Kentucky courts apply a “rule of interpretation known as the reasonable expectation doctrine, which resolves an insurance-policy ambiguity in favor of the insured’s reasonable expectation.” *True v. Raines*, 99 S.W.3d 439, 443 (Ky. 2003). It is important to note, however, that the rule of strict construction against an insurer does not mean that every doubt must be resolved against it and does not interfere with the rule that the policy must receive a reasonable interpretation consistent with the parties’ object and intent or narrowly expressed in the plain meaning or language of the contract. *Brown v. Ind. Ins. Co.*, 184 S.W.3d 528 (Ky. 2005). Finally, “[o]nly actual ambiguities, not fanciful ones, will trigger application of the doctrine.” *Id.*

Although Kentucky courts have never squarely addressed who can tender a claim to an insurer so as

to trigger the duty to defend, the United States Court of Appeals for the Sixth Circuit determined that, regardless of whether the insured, another insurer, or a third-party claimant places the insurer on notice of a claim, the duty to defend is triggered. *See LM Ins. Corp. v. Canal Ins. Co.*, 523 F. App’x 329, 338 (6th Cir. 2013) (applying Kentucky law).

## What type of proceedings must an insurer defend?

In Kentucky, an insurer’s duty to defend a suit against its insured is “separate and distinct from the obligation to pay any claim,” and the insurer “must defend any suit in which the language of the complaint would bring it within the policy coverage regardless of the merit of the action.” *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279 (Ky. 1991) (quoting *Wolford v. Wolford*, 662 S.W.2d 835, 838 (Ky. 1984)). In *Aetna Casualty & Surety Co. v. Commonwealth*, the Supreme Court of Kentucky held that the term “suit” is susceptible to more than one interpretation, “[a]nd thus, such ambiguity must be resolved in favor of the insured’s reasonable expectations.” 179 S.W.3d 830, 837 (Ky. 2005). Accordingly, the Supreme Court rejected the insurer’s attempt to avoid its duty to defend “by clinging to an archaic definition of ‘suit,’” deemed an administrative proceeding a “suit,” and implied that a potentially responsible party (PRP) letter from a state agency would also qualify, since each “marks the beginning of adversarial administrative legal proceedings that seek to impose liability upon an insured, and a reasonable person” would expect a defense. *Id.* (quoting *Johnson Controls, Inc. v. Emp’rs Ins. of Wausau*, 665 N.W.2d 257 (Wis. 2003)).

## When is extrinsic evidence used to determine whether an insurer has a duty to defend?

Kentucky has never squarely addressed whether facts outside the four corners of a complaint should, must or may be considered by the insurer when making an initial coverage determination. However, the Sixth Circuit, applying Kentucky law, has held that the determination of the duty to defend “must be made at the outset of litigation by reference to the complaint and known facts.” *Lenning v. Commercial Union Ins. Co.*, 260 F.3d 574, 581 (6th Cir. 2001) (citing *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279 (Ky. 1991)); see also *KSPED LLC v. Va. Sur. Co., Inc.*, Nos. 12-6618/13-5015, 2014 U.S. App. Lexis 10443, at \*13 (6th Cir. 2014) (applying Kentucky law). Kentucky courts implicitly hold that an insurer should not look outside a complaint which clearly triggers coverage to attempt to avoid a duty to defend. See *Pizza Magia Intern., LLC v. Assurance Co. of Am.*, 447 F. Supp. 2d 766 (W.D. Ky. Aug. 3, 2006). This is because “[p]ermitting an insurer to ignore facts, known to it at the time it decided whether to defend, that establish the potential for coverage could render the duty to defend narrower than the duty to indemnify.” *KSPED LLC*, 2014 U.S. App. Lexis 10443, at \*14 (internal citations omitted) (applying Kentucky law). “Moreover, ignoring known facts inappropriately conditions the duty to defend on the ‘draftsmanship skills or whims of the plaintiff in the underlying action.’” *Id.*

## What is the scope of an insurer’s duty to defend?

The court in *James Brown Foundation* implied that if an insurer’s policy is triggered by even one claim in the complaint, the insurer has a duty to defend the entire action even if other claims may be excluded. 814 S.W.2d at 279 (“The insurance company must defend *any suit* in which the language of the complaint would bring it within the policy coverage regardless of the merit of the action.”) (emphasis added). The insurer’s duty to defend can continue even after payment of the policy limits and continue

on through appeal if there are reasonable grounds for appeal. See, e.g., *Ursprung v. Safeco Ins. Co. of Am.*, 497 S.W.2d 726, 730–31 (Ky. Ct. App. 1973); *Wilcox v. Board of Edu.*, 779 S.W.2d 221, 223 (Ky. Ct. App. 1989); *Am. Physical Assurances Corp. v. Schmidt*, 187 S.W.3d 313, 319 (Ky. 2006). An insurer must pay for the defense of the insured, and “[t]he fact that the prosecution of an appeal would place an additional cost burden upon the insurer has no bearing on the obligation to appeal, as this duty is one which flows from the responsibility to represent the assured in good faith.” *Id.* The duty to defend does not end until the insurer establishes that the liability is in fact not covered by the policy. *Ky. Assoc. of Counties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 635 (Ky. 2005).

## When is an insurer responsible for pre-tender defense costs?

Under Kentucky law, an insurer’s duty to defend the insured begins when “there is any allegation in the complaint which potentially, possibly or might come within the coverages of the policy.” *O’Bannon v. Aetna Cas. & Sur. Co.*, 678 S.W.2d 390, 392 (Ky. 1984). The insurer owes defense costs to the insured beginning on the date that the duty to defend was triggered, regardless of whether the insured formally tendered a coverage claim. *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 598 F.3d 257, 273–75 (6th Cir. 2010). Moreover, if the duty to defend has been triggered by a claim, an insurer cannot avoid responsibility for defense costs incurred pre-tender unless it can prove it has been prejudiced by the late tender. *Id.* Where an insurer attempts to avoid its obligations to an insured on the basis of the insured’s failure to notify the insurer of the claim, “Kentucky law places the burden on the insurer to bring forward proof that it has been prejudiced by any delay in notification of a claim by the insured.” *Id.* (citing *Jones v. Bituminous Cas.*, 821 S.W.2d 798, 801–03 (Ky. 1991)). While some jurisdictions assume prejudice to the insurer, freeing them of the obligation to pay pre-tender defense costs, an insurer in Kentucky may not avoid pre-tender defense costs without meeting its burden to show prejudice due to late notice. *Id.*

## What is the extent of an insurer's obligation to defend when other insurers also have a duty to defend?

In 1977, the Kentucky Supreme Court established the principle that, where more than one insurer issued a policy for the same, overlapping or consecutive policy period, the policy provisions control priority. *Am. Auto Ins. Co. v. Bartlett*, 560 S.W.2d 6 (Ky. 1977). “The defense clause in the contract is a contractual right of the insured for which he has paid a premium, regardless of other insurance or of any primary or excess coverage[.]” *Wolford v. Wolford*, 662 S.W.2d 835, 838 (Ky. 1984). Thus, in a contest between two insurers, “the liability for a loss should be determined by the terms of the respective policies.” *State Farm Mut. Auto. Ins. Co. v. Register*, 583 S.W.2d 705, 706–07 (Ky. Ct. App. 1979).

Where multiple policies cover the same “loss,” a court must determine which policy, if any, is primary and which is excess; or, if two policies are excess, how the damages should be applied as between them. Historically, “other insurance” provisions have been upheld as valid under Kentucky law. *See Calvert Fire Ins. Co. v. Stafford*, 437 S.W.2d 176, 179 (Ky. 1969). Not surprisingly, where more than one policy of insurance is at issue, the policies’ “other insurance” provisions often conflict with one another. Generally, Kentucky courts apply the rule of repugnancy where “other insurance” clauses conflict, and benefits between the policies are prorated according to the coverage limits of each policy. *See Ohio Cas. Ins. Co. v. State Farm Mut. Auto. Ins. Co.*, 511 S.W.2d 671 (Ky. 1974); *see also Great Am. Ins. Co. v. Lawyers Mut. Ins. Co. of Ky.*, 492 F. Supp. 2d 709 (W.D. Ky. June 18, 2007) (applying the two-step approach to repugnant clauses in a dispute regarding coverage for a legal malpractice claim). Under this approach, the court must first examine each policy, and if “the two policies are indistinguishable in meaning and intent, [and] one cannot rationally choose between them [they are held] to be mutually repugnant and must be disregarded.” *Ky. Farm Bur. Mut. Ins. Co. v. Shelter Mut. Ins. Co.*, 326 S.W.3d 803, 807 (Ky. 2010) (quoting *Travelers Indem. Co. v. Chapell*, 246 So. 2d 498, 504 (Miss. 1971)).

Once step one is resolved, and the court finds the competing clauses to be mutually repugnant, there are three primary options for pro-rata apportionment: policy limits, premiums paid, and the equal share limit. Under the policy limits approach, the court calculates the loss amount between each insurer in accordance with the maximum coverage limits of each insurance policy. The second approach allocates the loss based on the amount of the premium paid by each insured to each insurer. The third approach is a multi-step method, with the loss initially apportioned equally between two insurers until the lesser coverage is exhausted. Thereafter, the remaining loss is absorbed by the insurance company with the larger policy, up to its policy limits.

*Id.* (citations omitted) (citing *Reliance Ins. Co. v. St. Paul Surplus Lines Ins. Co.*, 753 F.2d 1288, 1291 (4th Cir. 1985)). In Kentucky, when a policy containing a pro rata “other insurance” clause conflicts with a policy having an excess “other insurance” clause, the policy with the pro rata provision is applied first and the excess policy becomes effective when the other policy is exhausted. *See Hartford Ins. Co. v. Ky. Farm Bur. Ins. Co.*, 766 S.W.2d 75, 77 (Ky. Ct. App. 1989).

However, in *Farm Bureau Insurance Co. v. Shelter Mutual Insurance Co.*, the Kentucky Supreme Court rejected the mutual repugnancy rule as the default approach in all conflicts between insurers relative to auto insurance coverage disputes. 326 S.W.3d 803, 811 (Ky. 2010). Guided by the policies underlying the Kentucky Motor Vehicle Reparations Act (MVRA), the *Shelter* court determined that primary liability should be on the insurance covering the vehicle. *Id.* (“We glean from the legislative intent underlying the MVRA that the General Assembly intended, that in instances where both the vehicle owner and non-owner driver are separately insured, the vehicle owner’s insurance shall be primary.”) The *Shelter* court clarified that its opinion represents an exception, rather than an outright rejection, to the general bifurcated approach. *Owners Ins., Co. v. State Auto Prop. & Cas. Co.*, 977 F. Supp. 2d 708 (W.D. Ky. Oct. 8, 2013).

## When is there a right to independent counsel?

The Kentucky Bar Association (“KBA”) describes the relationship between the insurer, the insured, and the attorney (who is retained by the insurer to represent the insured) as a tripartite relationship. In the tripartite relationship, the attorney’s client is the insured, not the insurer. KBA E-378 (1995). When the insurer provides a defense under a reservation of rights, there exists the possibility of an impermissible conflict of interest. KBA E-410 (1999). In such a situation, the attorney must analyze the situation under KRPC 1.7(b), the general conflict of interest rule. *Id.* If the representation of the client may be materially limited by the attorney’s responsibilities to the insurer, the attorney may not represent the insured unless the attorney “reasonably believes the representation will not be adversely affected” and the insured consents after consultation. KRPC 1.7(b). However, an attorney cannot properly ask for such an agreement or provide representation on the basis of the client’s consent if “a disinterested lawyer would conclude that the client should not agree to the representation under the circumstances.” Comment 4 to KRPC 1.7.

“In applying this rule, the attorney must consider his or her relationship with the [i]nsurer as well as the reason for the reservation of rights to decide whether the client’s representation ‘may be materially limited.’” KBA E-410 (quoting KRPC 1.7(b)). Insurers issue reservations of rights for several reasons: when the recovery against the insured may exceed the policy limits; when the plaintiff asserts multiple claims against the insured, one or more of which may not be covered by the policy; when no coverage is due because of the nature of the claim or the facts; or because of a misstatement on the application for insurance. *Id.* For some of these reasons, the attorney may properly conclude that the representation of the insured would not be materially limited. *Id.* However, if the reason for the reservation of rights involves facts and theories to be developed in the matter in which the attorney represents the insured, then the attorney may have a conflict of interest that cannot be waived by the insured client. *Id.* In such a situation, independent counsel may be

required pursuant to the rules of professional conduct. *Id.* Moreover, in Kentucky, an insured is not required to accept a defense offered by the insurer under a reservation of rights. *Med. Protective Co. of Fort Wayne, Indiana v. Davis*, 581 S.W.2d 25, 26 (Ky. Ct. App. 1979). This is because “when the insurer reserves a right to assert its non-liability for payment there is little or no reason to require the insured to surrender defense of the claim to a company which asserts that it has no obligation to satisfy the claim.” *Id.* In such a situation, the insured may refuse the proffered defense and conduct his or her own defense at his or her own expense. *Id.* However, the insurer will be bound by the results of the insured’s defense (good or bad) absent a finding that the insured acted fraudulently or collusively in defending (or failing to defend) the claim. *Id.* at 25–27.

## What right of recoupment of defense costs exists for an insurer?

Kentucky courts have not yet addressed the issue of whether an insurer may reserve the right to seek reimbursement of defense or indemnity payments from its insured. However, the United States Court of Appeals for the Sixth Circuit opined that Kentucky would follow the majority rule of other jurisdictions, allowing an insurer to unilaterally reserve the right to seek reimbursement for indemnity payments in the event that it is determined that the claim was not, in fact, covered by the policy. *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 598 F.3d 257, 269 (6th Cir. 2010). Pursuant to *Hillerich & Bradsby Co.*, the court explained that a right to reimbursement arises under an implied-in-fact contract theory, which allows an insurer to seek reimbursement when “(1) the insurer has timely asserted a reservation of rights; (2) the insurer has notified the insured of its intent to seek reimbursement; and (3) the insured has meaningful control of the defense and negotiation process.” *Id.* at 268 (quoting *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, No. 3:05-CV-533-H, 2006 U.S. Dist. Lexis 62016, at \*8 (W.D. Ky. Aug. 28, 2006)). The Sixth Circuit noted that “[a]llowing insurers to reserve a right to seek reimbursement in at least some limited circumstances where it is done expressly and where the

insured retains meaningful control over the defense encourages settlements when coverage is uncertain, while not permitting unjust enrichment to the insured who demands settlement but refuses to recognize a right to reimbursement.” *Id.* at 269.

Likewise, the United States District Court for the Western District of Kentucky determined that an insurer similarly may recoup defense costs from its insured if it is later determined that the insurer did not have a duty to defend, provided that the parties expressly agreed through a reservation of rights that the insurer had such a reimbursement right. *Emp’rs Reinsurance Corp. v. Mut. Ins. Co.*, No. 3:05-CV-556-S, 2006 U.S. Dist. Lexis 73472, at \*11–12 (W.D. Ky. Sept. 22, 2006). Although acknowledging that no Kentucky state court has yet addressed the issue, the district court was swayed by the Sixth Circuit’s decision in *United National Insurance Co. v. SST Fitness Corp.*, 309 F.3d 914, 918–19 (6th Cir. 2002), in which the court applied Ohio law to find that insurers may recoup defense costs where the parties have expressly agreed through a reservation of rights that the insurer has the right to recoup its defense costs if coverage is later found not to exist. The district court in *Employers Reinsurance* found that, by acquiescing to the defense provided by the insurers, the insured assented to the insurers’ reservation of rights, and therefore the insurers could recoup their defense costs. 2006 U.S. Dist. Lexis 73472, at \*12.

### **What are the consequences of an insurer’s wrongful failure to defend?**

Where an insurer owes a primary duty to defend the insured and breaches that duty, the insurer is responsible for “all damages naturally flowing from the failure to provide a defense. This includes ‘damages’ for reimbursement of defense costs and expenses.” *Aetna Cas. & Sur. Co. v. Commonwealth*, 179 S.W.3d 830, 841 (Ky. 2005); *see also Travelers’ Ins. Co. v. Henderson Cotton Mills*, 85 S.W. 1090 (Ky. Ct. App. 1905). Moreover, since an insurer’s failure to provide a defense may constitute bad faith, the insurer may be liable for a judgment beyond its policy limits. *Eskridge v. Educator & Exec. Insurers, Inc.*, 677 S.W.2d 887, 889 (Ky. 1984). Under *Cincinnati Insurance v. Vance*, an insurer may deny coverage

and refuse to provide a defense, but if that denial is found to be wrongful, the insurer becomes responsible for the entire amount of any verdict rendered against the insured without regard to policy limits. 730 S.W.2d 521 (Ky. 1987).

Because Kentucky imposes a broad duty to defend on insurers, insurers have common law and statutory duties of good faith. A common law bad faith cause of action arises under the implied covenant of good faith inherent in every contract, and a finding of bad faith can result in an award of punitive damages against an insurer. *See Grundy v. Manchester Ins. & Indem. Co.*, 425 S.W.2d 735, 737 (Ky. 1968). Under common law, an insurer has a duty to act in good faith and must have a reasonable basis for its position on coverage and actions in handling a claim. *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993). Moreover, an insurer may be held to have acted in bad faith for refusing to defend or defending improperly, even if the decision is based on a mistaken, though good faith, belief that coverage did not extend to the claim. *See Eskridge v. Educator & Exec. Insurers, Inc.*, 677 S.W.2d 887, 889 (Ky. 1984); *see also Aetna Cas. & Sur. Co.*, 179 S.W.3d at 841.

Kentucky has also adopted the Unfair Claims Settlement Practices Act (“UCSPA”), KRS §304.12-230 *et seq.* (LexisNexis 2008), which “imposes what is generally known as the duty of good faith and fair dealing owed by an insurer to an insured or to another person bringing a claim under an insurance policy.” *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 515 (Ky. 2006). While the UCSPA was never intended to provide a private right of action, the Kentucky Supreme Court decided in *State Farm Mutual Automobile Insurance Co. v. Reeder* that by combining the UCSPA with KRS §446.070, a remedy for “a person injured by the violation of any statute” was created. 763 S.W.2d 116 (Ky. 1988). As such, the UCSPA makes it statutory bad faith for an insurer to commit any one of fourteen (14) specified acts or omissions, and provides a private cause of action for any insured injured as a result. KRS §304.12-230. Finally, in *Stevens v. Motorist Mutual Insurance Co.*, the Kentucky Supreme Court determined that the Kentucky Consumer Protection Act, KRS §367.170, constitutes another potential source for a “bad faith”

claim against an insurer in the context of a first-party claim. 759 S.W.2d 819, 820 (Ky. 1988).

Regardless of whether a bad-faith claim arises under common law or under the UCSPA, an actionable claim for bad faith in Kentucky requires an insured to demonstrate the existence of the following factors:

[A]n insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.... [A]n insurer is... entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.

*Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993) (quoting *Fed. Kemper Ins. Co. v. Hornback*, 711 S.W.2d 844, 846–47 (Liebson, J., dissenting) (affirmed in *Curry v. Fireman's Fund Ins. Co.*, 784 S.W.2d 176 (Ky. 1989))). The same principles apply to third-party bad faith claims as to first-party claims. *Id.* at 890. Moreover, technical violations of the UCSPA do not form the basis of a claim; rather, before a violation of the UCSPA exists, there must be sufficient evidence to warrant punitive damages. *See id.* The Kentucky Supreme Court, in *Motorist Mutual v. Glass*, clarified that a claim for bad faith under the UCSPA may only be maintained if there is sufficient evidence to sustain a verdict for punitive damages based upon a finding that the conduct of the defendant was based upon evil motive or reckless indifference. 996 S.W.2d 437 (Ky. 1999).

### **What terminates an insurer's duty to defend?**

“In Kentucky, an insurer has a duty to defend if there is an allegation which might come within the coverage terms of the insurance policy, but this duty ends once the insurer established that the liability is in fact not covered by the policy.” *Ky. Ass'n of Coun-*

*ties All Lines Fund Trust v. McClendon*, 157 S.W.3d 626, 635 (Ky. 2005). Where an insurance company undertakes a defense on behalf of its insured, “the loss of the right by the insured to control and manage the case is itself a prejudice” which will estop the insurer from thereafter denying liability under the policy. *Am. Cas. Co. of Reading, Pa. v. Shely*, 234 S.W.2d 303, 305 (Ky. Ct. App. 1950). “In order to prevent the waiver from taking effect, it is necessary that the insurer promptly give unequivocal notice that it is defending the action under a reservation of all defenses which it may have by reason of the policy provisions.” *W. Farm Bureau Mut. Ins. Co. v. Danville Const. Co.*, 463 S.W.2d 125, 127 (Ky. Ct. App. 1971) (quoting *Beam v. State Farm Mut. Auto. Ins. Co.*, 269 F.2d 151, 155 (6th Cir. 1959) (internal citations omitted)). However, an insurer “is not estopped from withdrawing from the defense of an action ‘if its action does not result in any prejudice to the [putative] insured.’” *Cincinnati Ins. Co. v. Vance*, 730 S.W.2d 521, 523 (Ky. 1987) (quoting *Universal Underwriters Ins. Co. v. Travelers Ins. Co.*, 451 S.W.2d 616, 622 (Ky. Ct. App. 1970)).

An insurer is not required to issue a reservation of rights letter or to defend an insured under a reservation of rights to preserve its coverage defenses. Rather, the insurer may simply deny coverage before any prejudice to the insured occurs, and then litigate the coverage issues at the conclusion of the underlying tort litigation, at its own risk. *Cincinnati Ins. Co. v. Vance*, 730 S.W.2d 521, 524 (Ky. 1987).

### **If there is no duty to defend, can the insurer have a duty to indemnify?**

Kentucky courts hold that the “duty to defend is separate and distinct from the obligation to pay any claim.” *James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co.*, 814 S.W.2d 273, 279 (Ky. 1991). “The duty to indemnify is narrower than the duty to defend because it only arises when there is an actual basis for the insured's liability to a third party.” *Travelers Prop. Cas. Co. of Am. v. Hillerich & Bradsby Co.*, 598 F.3d 257, 269 (6th Cir. 2010) (citing *James Graham Brown Found.*, 814 S.W.2d at 279–80). Where claims against an insured are potentially within coverage, a duty to defend exists

even if the ultimate duty to indemnify does not exist. *Aetna Cas. & Sur. Co. v. Commonwealth*, 179 S.W.3d 830 (Ky. 2006). Accordingly, “[i]f there is no duty to defend, then there is no duty to indemnify because the duty to defend is broader.” *Nautilus Ins. Co. v. Structure Builders & Riggers Mach. Moving Div., LLC*, 784 F. Supp. 2d 767, 771 (E.D. Ky. Mar. 24, 2011).

### **Are there any other notable cases or issues regarding the duty to defend that are important to the law of this state?**

Pursuant to Kentucky law, “an insurer may not deny coverage because the insured failed to provide prompt notice of loss unless the insurer can prove that it is reasonably probable that it suffered substantial prejudice from the delay in notice.” *Jones v. Bituminous Cas. Corp.*, 821 S.W.2d 798, 802–03 (Ky. 1991). In Kentucky, the insurer must establish that the outcome would have been different had it received timely notice. *Old Republic Ins. Co. v. Underwriters Safety and Claims, Inc.*, 306 F. App’x 250 (6th Cir. 2009). In *Old Republic*, the Sixth Circuit opined that if an insurer establishes that an insurer might have achieved “a more favorable result” if it had been given notice of the claim, then sufficient prejudice is established to deny coverage. *Id.*

In addition to lack of notice and prejudice, Kentucky law recognizes that fraud and collusion are also valid defenses which may be interposed by an insurance company when sued on a judgment obtained against its insured. *O’Bannon v. Aetna Cas. & Sur. Co.*, 678 S.W.2d 390 (Ky. 1984). Notably, in *O’Bannon*, the insurer had notice of the suit against

its insured but refused to defend. *Id.* However, recently the Kentucky Supreme Court addressed whether a defendant in an action may settle with the plaintiff, pursuant to an agreement by the plaintiff to forebear execution against the defendant, and in return assign the defendants’ negligence claim against a non-party to the plaintiff. *Id.* The Supreme Court agreed that a plaintiff and defendant may enter into such an arrangement. *Id.* Initially, the plaintiff in an action on the assigned claim bears the burden of establishing that the defendant was, in fact, liable. *Id.*

However, the Supreme Court reaffirmed that a party who is being sued pursuant to the assignment may defend the claim on the grounds of fraud, collusion or unreasonableness. *See Associated Ins. Service, Inc. v. Garcia*, 307 S.W.3d 58 (Ky. 2010). The Court stated that “[t]he risk of collusion in these types of arrangements is certainly heightened when the tortfeasor not only assigns claims, *but also stipulates the extent of damages.*” *Id.* at 67 (emphasis added). The Supreme Court noted that the risk is heightened because the defendant has no motivation to defend the claim or to defend the amount of damages when there is no risk of execution. “The risk is particularly heightened when the [third party] had no opportunity to contest the judgment or award.” *Id.*

---

#### AUTHORS

**Charles H. Cassis** | Goldberg Simpson LLC | 502.589.4440 | ccassis@goldbergsimpson.com

**Lindsey L. Howard** | Goldberg Simpson LLC | 502.589.4440 | lhoward@goldbergsimpson.com