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Commonwealth Of Kentucky

Court of Appeals

NO. 2002-CA-001846-MR

LLOYD KNOTTS AND JACKIE KNOTTS — APPELLANTS

v.

APPEAL FROM JEFFERSON CIRCUIT COURT
HONORABLE TOM MCDONALD, JUDGE
ACTION NO. 97-CI-004443

ZURICH INSURANCE COMPANY,
ZURICH AMERICAN COMPANIES AND
ZURICH AMERICAN INSURANCE COMPANY
OF ILLINOIS — APPELLEES

OPINION
AFFIRMING
** ** ** ** **

BEFORE: KNOPF, TACKETT, AND VANMETER, JUDGES.

TACKETT, JUDGE: Lloyd Knotts and Jackie Knotts appeal from a summary judgment entered in favor of Zurich Insurance Company in the Knottses' bad faith action against Zurich for an alleged failure to promptly settle a claim. The circuit court held that the Unfair Claims Settlement Practices Act, Kentucky Revised Statute (KRS) 304.12-230, does not apply once litigation begins. We agree, and affirm.

Lloyd Knotts was injured at a job site when he was working as an independent contractor on the premises of Zurich's insured, Lawson-Mardon, Inc. The accident took place on November 10, 1992. Knotts filed suit on January 14, 1993. Prior to filing suit, the attorney for Knotts sent a letter on November 30, 1992, to the insured demanding payment of all medical expenses and future therapy for Knotts, and full payment for the job he was working on when the injury occurred. The letter further stated that "[a]fter Mr. Knotts reaches maximum medical improvement, we will negotiate conclusion of this matter. If this proposal is not satisfactory to you, please let us know so we can proceed with litigation." This letter was evidently sent to Zurich, and on December 10, 1992, Zurich responded to the demand by sending a letter acknowledging the attorney's representation of Knotts and stating "We are in the initial stages of our investigation of this accident. Therefore, as you may well understand, we are not in a position to discuss liability. . . . [A]s we are not Mr. Knott's [sic] workers compensation carrier, we cannot make payment of his medical expenses as you requested . . . ." Knotts' attorney then advised his client, in a letter dated December 18, 1992, "I recommend beginning suit right away. It looks like they are going to stall us."

The underlying action went to trial, and Knotts was awarded $1,202,104.29 in damages, reduced by 20% after apportionment of liability to Knotts for his own negligence. That verdict and damages award was affirmed by this Court in 1996. Litigation commenced on this bad faith action in 1997. The circuit court granted summary judgment in Zurich's favor after concluding that the statute upon which the claim is based, the UCSPA, does not apply to conduct that occurs after litigation commences. This appeal followed.

The statute in question, KRS 304.12-230, reads as follows in its entirety:

> 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;

(7) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;
(8) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application;
(9) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;
(10) Making claims payments to insureds or beneficiaries not accompanied by statement setting forth the coverage under which the payments are being made;
(11) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;
(12) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;
(13) Failing to promptly settle claims, where liability has become reasonably clear, under one (1) portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;
(14) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement; or
(15) Failing to comply with the decision of an independent review entity to provide coverage for a covered person as a result of an external review in accordance with KRS

304.17A-621, 304.17A-623, and 304.17A-625.

The circuit court concluded, based on the language of the statute, that the legislature did not intend for the statute to regulate anything but conduct of insurance companies in adjustment of claims, as distinct from conduct during litigation. The circuit court stated in its opinion that if the legislature "had intended to have the statute regulate litigation conduct it could clearly have provided so . . . by adding such language." The court added, "the rationale behind the UCSPA is to give an incentive to the insurance companies to efficiently and quickly facilitate settlement of claims, preventing unnecessary costs and avoiding litigation fees, which aids in judicial efficiency. Once the Plaintiff files the claim, the incentive provided by the statute to settle the claims is removed."

To reach this decision, the circuit court turned to cases from other jurisdictions which addressed similar questions. For example, the court discussed the case of Timberlake Construction Co. v. USF&G, 71 F.3d 335 (10th Cir. 1995), in which a similar statute was considered. The court in Timberlake held that except in same instances, evidence of litigation conduct should not be admitted as proof of bad faith on the grounds of public policy. "To hold otherwise, would deny insurance attorneys from 'zealously and effectively' advocating

on behalf of their clients." Record on Appeal ("R.A.") at 1891. The court in Timberlake reasoned that once litigation commences, other rules, particularly the Rules of Civil Procedure, provide redress for improper conduct of litigants.

The circuit court also considered the case of Premium Finance Co. v. Employers Reinsurance Corp., 761 F.Supp. 450 (W.D. La. 1991), which involved another similar statute. The court in Premium Finance determined that the purpose of the statute was to provide an incentive to insurance companies to quickly resolve claims and avoid litigation costs. The court in that case stated that it would be duplicative for the statute to apply post-litigation, since the incentive to settle claims would no longer exist.

Considering those cases and others, the court determined that "the statute should control only those matters involved in adjusting claims or pre-litigation conduct and should not be extended to conduct once litigation begins. Here, that would mean Zurich's conduct is only relevant . . . from the date of the accident . . . until the date suit was initiated . . . ." R.A. at 1892.

At the outset, we note that the circuit court's conclusion that the statute was unambiguous in its treatment of "claims" as distinct from litigation is correct. The statute clearly distinguishes "claims" from "litigation", and does not

include language that indicates a contrary intent. As the circuit court has correctly noted, the General Assembly could easily have stated that the statute was intended to apply to litigation as well as pre-litigation claims adjustment, but did not. It is a maxim of statutory construction that

> it is not our function "to add to or subtract from the legislative enactment nor discover meaning not reasonably ascertainable from the language used." We are directed to follow the clear language of the statute and when "plain and unambiguous" words are employed, we must apply those terms "without resort to any construction or interpretation."

Smith v. Commonwealth, Ky. App., 41 S.W.3d 458, 460 (2001) (citations omitted).

On appeal, the Appellants argue that the circuit court's conclusion was erroneous, and attempt several different arguments to reach this conclusion. We reject each one in turn.

First, they argue that the holding is contrary to the public policy of the Commonwealth, claiming that interpreting the statute as the circuit court did frustrates the intended purpose of the statute. We disagree. The intended purpose of the statute is reasonably clear from the plain language of the statute. That purpose is to regulate the claims adjustment process, and provide protection to the general public by encouraging settlement of claims without litigation. We do not agree with the Appellants' assertion that the purpose of the

statute would be frustrated by not extending the statute to cover litigation conduct, because as other courts have pointed out, there are rules in place to protect parties from needless litigation. We likewise reject the contention that affirming the circuit court's holding would only encourage insurance companies to "make litigation – not settlement – a goal of claims adjusting, knowing that nothing they did after the date of filing could constitute bad faith." We do not agree with the Appellants' assertion, given that everything the insurance company does prior to the institution of litigation would still be subject to the UCSPA's provisions. Rather, the insurance company would be obligated to deal fairly with claimants prior to the institution of litigation, knowing that stalling the claimant into filing suit could backfire in a later bad faith action. We therefore reject this contention.

Next, the Appellants claim that because the conduct complained of does not involve the litigation conduct of the litigants or their counsel, the UCSPA should be held to apply. Essentially, the Appellants argue that because Zurich refused to settle the case even though, the Appellants claim, liability was reasonably clear, Zurich violated the UCSPA. We also note that the Appellants' claim that they are not criticizing the litigation conduct of Zurich is inaccurate, because among the Appellants' contentions in this action is that Zurich pursued a

frivolous appeal in the underlying case, something that cannot be described as anything other than litigation conduct. Zurich responds by stating that once the formal litigation process is begun, lawyer conduct is inextricably intertwined with that of the client during the course of the process. To extend the UCSPA to post-litigation conduct, says Zurich, would violate the Kentucky Constitution's separation of powers scheme established in Sections 27 and 28, because it means that the General Assembly would have attempted to regulate the conduct of attorneys, something that is expressly reserved to the Supreme Court in Section 116 of the Constitution. Further, Zurich states, Section 51's prohibition that "no law . . . shall relate to more than one subject, and that subject shall be expressed in the title" would be violated if the statute were extended to litigation conduct, because the statute falls under the title "Insurance" but would also regulate persons who are not insurance companies. Merely because these particular plaintiffs are not claiming that the company's attorneys did anything wrong, they argue, does not change the fact that the application of the statute post-litigation would violate the Constitution because any litigant thereafter could challenge litigation conduct once the precedent is set. We agree that the statute cannot be so interpreted without violating the Constitution.

The Appellants contend that established case law recognizes a right to sue for bad faith conduct even after litigation had commenced, citing two cases decided prior to the enactment of the UCSPA, State Farm Mut. Ins. Co. v. Marcum, Ky., 420 S.W.2d 113 (1967) and Grundy v. Manchester Ins. and Indemnity Co., Ky., 425 S.W.2d 735 (1968) and one case, Wittmer v. Jones, Ky., 864 S.W.2d 885 (1993), decided after the statute's enactment. In Wittmer, the issue of the statute's applicability to post-litigation conduct was not addressed at all, and so Wittmer is not relevant to our determination here. Likewise, the two cases decided prior to the UCSPA are not relevant, because the UCSPA's enactment supersedes their holdings. We therefore do not recognize these cited cases as binding authority in this matter.

Likewise, we do not agree with Appellants with respect to the import of the holding of Farmland Mut. Ins. Co. v. Johnson, Ky., 36 S.W.3d 368 (2000), in which Farmland had argued that the amount of its obligation was "fairly debatable" under the circumstances. One of the claims in Farmland was that the insurer forced the insured to initiate litigation by offering an amount substantially less than the amount ultimately recovered in violation of subsection 7 of the statute, and did not involve conduct after litigation had commenced. We do not agree with

Appellants that Farmland implies that post-litigation conduct can be the subject of an action under the UCSPA.

The Appellants also rely on another out-of-jurisdiction case, White v. Western Title Ins. Co., 710 P.2d 309 (Cal. 1985), which rejected the insurer's contention that "once suit has been filed, the insurer stands in an adversary position to the insured and no longer owes a duty of good faith and fair dealing." *Id*. at 316. However, as Zurich notes, White has been criticized by other California courts, one of which noted that "[t]reatment of White as precedent by the Courts of Appeal has . . . to the extent such is possible by the intermediate appellate courts, limited its application." California Physicians' Service v. Superior Court, 9 Cal. App. 4th 1321, 1328 (1992).

For the foregoing reasons, we affirm the judgment of the Jefferson Circuit Court.

ALL CONCUR.

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