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NOT TO BE PUBLISHED

Commonwealth of Kentucky

Court of Appeals

NO. 2012-CA-000382-MR

OHIO CASUALTY INSURANCE COMPANY
AND WEST AMERICAN INSURANCE COMPANY — APPELLANTS

v.

APPEAL FROM CAMPBELL CIRCUIT COURT
HONORABLE JULIE REINHARDT WARD, JUDGE
ACTION NO. 08-CI-01819

WELLINGTON PLACE COUNCIL OF
CO-OWNERS HOMEOWNERS ASSOCIATION, INC. — APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: CAPERTON, DIXON AND STUMBO, JUDGES.

STUMBO, JUDGE: Ohio Casualty Insurance Company and West American Insurance Company appeal from an Amended Order and Judgment of the Campbell Circuit Court granting Summary Judgment in favor of Wellington Place Council of Co-Owners Homeowners Association, Inc. The Appellants argue that

the circuit court improperly failed to apply an intervening decision of the Kentucky Supreme Court establishing that negligent or faulty construction claims are not "occurrences" triggering coverage under a builder's commercial general liability policy. We find no error in the circuit court's conclusion that the Appellants' failure to issue a timely reservation of rights letter constituted a waiver of, or estoppel from, their right to assert coverage defenses including those of noncoverage. Accordingly, we affirm the Amended Order and Judgment of the Campbell Circuit Court.

From 1997 until 2002, Wellington Builders, LLC, The Erpenbeck Company, Inc., and The Erpenbeck Development Company constructed a condominium complex in Campbell County, Kentucky. The development consisted of approximately 11 buildings and 132 condominium units. These entities, referred to in the record as the "Erpenbeck Defendants", were insured by Appellants Ohio Casualty Insurance Company and West American Insurance Company ("Ohio Casualty") under general liability policies providing $2 million per year in commercial coverage, and $10 million per year under umbrella policies.

Wellington Place Council of Co-Owners Homeowners Association, Inc. ("Wellington Place") is a homeowners association representing individual condominium owners. In or around 2006, Wellington Place noticed problems with the foundation and the lower level units in one of the residential buildings. It notified Ohio Casualty, which subsequently paid more than $170,000 for repairs in 2007.

In 2008, Wellington Place notified Ohio Casualty of additional construction problems at the development. Ohio Casualty retained the law firm of Droder & Miller to investigate the claim and provide a structural engineer's report. The parties would later stipulate that the report identified construction problems and concluded that other buildings would experience significant problems in the future. In 2008, Droder & Miller notified Wellington Place that the 2008 claims were denied because they fell outside the statute of limitations/repose.

Based on Ohio Casualty's denial of Wellington Place's claims, Wellington Place instituted the instant action against the Erpenbeck Defendants alleging negligence, and against Ohio Casualty alleging common law bad faith and violation of the Unfair Claims Settlement Practices Act. Droder & Miller and Ohio Casualty continued to investigate the claims as the litigation proceeded, and in 2010 the Erpenbeck Defendants unsuccessfully moved for Summary Judgment. In April, 2010, the parties engaged in mediation and reached a settlement resolving all claims brought by Wellington Place in the 2008 Complaint. The settlement resulted in a $3.8 million stipulated judgment in favor of Wellington Place on its claims against the Erpenbeck Defendants. Additionally, Wellington Place and Ohio Casualty agreed to continue litigating coverage issues via cross-motions for Summary Judgment.

In 2009, and prior to the settlement, Wellington Place requested that Ohio Casualty produce any Reservation of Rights letter tendered by it to the Erpenbeck Defendants. After Ohio Casualty refused the production, the court granted

Wellington Place's subsequent motion to compel. Discovery then revealed that no Reservation of Rights letter had been issued as of 2009. It was only in May, 2010, and approximately two years after Ohio Casualty received notice of Wellington Place's claims, that Ohio Casualty issued a Reservation of Rights letter.

The parties then filed cross-motions for summary judgment as to coverage. Thereafter, the trial court sustained Wellington Place's motion upon determining that Ohio Casualty waived or was otherwise estopped from asserting any coverage defenses, including those of noncoverage, because it failed to issue a Reservation of Rights letter until 17 months after Wellington Place filed its Complaint. After Ohio Casualty moved for reconsideration, the court rendered an Order on March 2, 2011, holding in relevant part that a change in the law, namely *Cincinnati Ins. Co. v. Motorist Mut. Ins. Co.*, 306 S.W.3d 69 (Ky. 2010), did not absolve Ohio Casualty of its failure to issue a Reservation of Rights letter in a timely manner. *Cincinnati Ins. Co.* changed the law by holding that coverage under a Commercial General Liability ("CGL") policy is not triggered by mere faulty workmanship.[1]

[1] The Court noted the broad ramifications of a holding that mere faulty workmanship *would* trigger coverage, stating that:

> [I]nsurance policies would become performance bonds or guarantees because any claim of poor workmanship would fall within the policy's definition of an accidental occurrence so long as there was not proof that the policyholder intentionally engaged in faulty workmanship. This is a point made by other courts. Instead, we agree with the Supreme Court of South Carolina that refusing to find faulty workmanship, standing alone, constitutes an "occurrence" under a CGL policy "ensures that ultimate liability falls to the one who performs negligent work… instead of the insurance carrier. It will also encourage contractors to choose their subcontractors more carefully instead of having to seek indemnification from the subcontractors after their work fails to meet the requirements of the contract."

After Ohio Casualty appealed these decisions, the matter was remanded and an Amended Order and Judgment was rendered in January, 2012, awarding post-judgment interest at the rate of 12% commencing on March 2, 2011. This appeal followed.

Ohio Casualty now argues that the trial court erred by failing to apply the holding in *Cincinnati Ins. Co.*, which was rendered during the pendency of the instant action. Ohio Casualty maintains that *Cincinnati Ins. Co.* is factually indistinguishable from the present matter, and should operate to relieve it from liability under the instant facts. The trial court ruled that its failure to tender a Reservations of Rights letter constituted a waiver of any coverage defenses, including noncoverage. Ohio Casualty maintains that in so doing the court effectively created an insurance contract and/or enlarged the scope of insurance coverage in violation of Kentucky law.

Ohio Casualty additionally argues that it neither waived nor is estopped from asserting its coverage defenses since Wellington Place agreed to permit the assertion of all coverage defenses and was not otherwise prejudiced by the assertion of those defenses. They also maintain, *arguendo*, that if coverage is determined to have been properly triggered, the circuit court erred in failing to pro-rate damages, and that interest should have accrued from the final Order on January 30, 2012, rather than the Amended Order of March 2, 2011. In sum, Ohio Casualty characterize their claims of error in two questions: 1) does the intervening

Cincinnati Ins. Co., 306 S.W.3d at 75 (footnotes omitted).

decision of the Kentucky Supreme Court, which changed existing insurance law, apply to pending coverage litigation throughout the Commonwealth, and 2) does Ohio Casualty's failure to issue a Reservation of Rights letter for 17 months bar it from relying on the Kentucky Supreme Court decision?

The corpus of Ohio Casualty's claim of error centers on language contained in the court's March 2, 2011 Order, and incorporated by reference in the January 30, 2012 Amended Order and Judgment. The court addressed the issue of untimeliness of the Reservation of Rights letter thusly:

> The Court finds that the reservation of rights letter was not timely issued. In its previous order, the Court cited American Cas. Co. of Reading, Pa. v. Shely, [314 Ky. 80,] 234 S.W.2d 303, 304 ([Ky.] 1950), which indicates that a reservation of rights letter must be issued upon "knowledge of a ground of forfeiture or noncompliance under the policy[.]" However, this refers to knowledge of facts specific to the case, not knowledge of legal developments. This is clarified when Shely goes on to cite 81 A.L.R. 1327, stating that an insurance company is required to issue a reservation of rights letter when the insured has "knowledge of facts making the accident, injury, etc., outside the coverage of the policy [.]" *Id*. at 304 - 305. In this case it is not alleged that any new facts have been revealed regarding the actions of the insured. Instead, the Defendants allege only that there has been a change in the law which should allow them to deny coverage under the policy. Moreover, a reservation of rights letter is required in order to combat prejudice to the other party, not to protect the insurer. *Id*. at 305. Although there was a change in the law, this does not lessen the prejudice to the Plaintiffs. Because the Defendants waited more than 17 months to issue a reservation of rights letter, the Court finds that it was not timely issued.
>
> The Court also finds that the Defendants are incorrect in their assertion that a reservation of rights letter is not

> required because the issue is one of noncoverage under the terms of the policy itself and not merely a defense. Case law cited in the Court's prior order directly contradicts Defendants' argument. In Hood v. Coldway Carriers, Inc., 405 S.W.2d 672 (Ky. 1965), the court specifically held that if a reservation of right letter has not been issued, estoppel or waiver may be used even to extend coverage past the terms of the policy. In that case, the insurance company undertook the defense of a case without issuing a reservation of rights. It then tried to assert a defense of noncoverage because the policy contained express language prohibiting coverage for the owner of a leased vehicle. The court disagreed with that argument, holding that the defense of noncoverage had been waived, even though it was undisputed that the case involved the owner of a leased vehicle and would have been excluded under the terms of the policy. In the instant case, this Court finds that a reservation of rights letter is required even though the Defendants are arguing that there is no coverage under the terms of the policy. Because of this, the Defendants have waived their defense of noncompliance.

As to the first question raised by Ohio Casualty, to wit, whether the intervening Kentucky Supreme Court decision in *Cincinnati Ins. Co.* applies to pending coverage litigation, we must answer this question in the affirmative. Wellington Place concedes this point at page 21 of its Appellate Brief, though it notes that *Cincinnati Ins. Co.* has only been applied to those pending actions where Reservation of Rights letters were issued. See for example, *Ryan v. Acuity*, 2012 WL 3047198 (Ky. App. July 27, 2012).

The second and pivotal question, then, is whether Ohio Casualty's failure to issue a Reservation of Rights letter in a timely manner operates to bar it from raising a defense based on *Cincinnati Ins. Co.* We agree with the circuit court's

conclusion that if a Reservation of Rights letter has not been issued, estoppel or waiver may be used even to extend coverage past the terms of the policy. In *Hood*, *supra*, to which the circuit court cited, the Kentucky Supreme Court characterized the issue as "whether [the insurer] American is precluded from asserting that Hood was not covered by the policy since it had defended the suit against him without first securing a reservation of rights." *Hood,* 405 S.W.2d at 673. In answering this question in the affirmative, the Kentucky Supreme Court noted that this was true even though the insured party, Hood, was expressly *excluded* from coverage as the owner or lessor of a leased vehicle. That is to say, American's failure to issue a Reservation of Rights precluded it from asserting the defense that the coverage did not apply to Hood, even though this effectively expanded the policy coverage to include Hood in his capacity of owner/lessor. Similarly in the matter at bar, Ohio Casualty's failure to issue a Reservation of Rights in a timely manner now precludes it from asserting the defense that coverage does not apply in light of *Cincinnati Ins. Co.*, even if the practical effect is to enlarge the scope of coverage beyond the four corners of the policy.

Ohio Casualty makes a compelling argument that it could not have anticipated the need for a Reservation of Rights as it could not have known that *Cincinnati Ins. Co.* would be rendered during the course of litigation. While this is true, the burden rests solely with Ohio Casualty, not the insured or 3rd party beneficiaries or assignees, to reserve the insurer's right to claim that coverage was not triggered. That is to say, Ohio Casualty's failure to anticipate all future

contingencies and defenses, including the possibility of intervening appellate decisions, should not be imputed to the insured or 3rd party beneficiaries, and should not operate to remove the protection of the insured that the Reservation of Rights provides. The very purpose of a Reservation of Rights is to combat prejudice to the insured, and not to protect the insurer. *Shely*, 234 S.W.2d at 305.

In sum, we conclude that though intervening case law such as *Cincinnati Ins. Co.* is to be given effect during litigation, an insurer's failure to reserve in a timely manner the right to assert policy defenses operates to preclude the application of the intervening case law as defense. Additionally, we do not find persuasive Ohio Casualty's contention that it neither waived nor is equitably estopped form asserting its coverage defense since its insured agreed to permit the assertion of all coverage defense. The failure to issue a Reservation of Rights in a timely manner precludes Ohio Casualty's policy defenses, and we find no error on this issue.

Ohio Casualty also contends that even if it is estopped from relying on the intervening case law, Wellington Place does not have standing as a third party to assert the estoppel doctrine. Ohio Casualty maintains that though Wellington Place does have the right to seek coverage, it does not have the right to assert the putative insured's contract defenses without an unequivocal assignment of those rights from the insured. It rejects Wellington Place's argument that this matter was not preserved for appellate review, contending that this issue was subsumed in the

larger issue of whether the Erpenbeck Defendants had assigned their rights to Wellington Place.

Wellington Place has the requisite standing to assert waiver and estoppel. It is uncontroverted that once an injured party secures a judgment against an insured, it may move forward with those claims against the insurer. *State Auto. Mut. Ins. Co. v. Empire Fire & Marine Ins. Co.*, 808 S.W.2d 805 (Ky. 1991). In so doing, it has rights no greater or lesser than those of the insured. *Tharp v. Security Ins. Co. of New Haven, Conn.*, 405 S.W.2d 760 (Ky. 1966). An "injured party generally stands in the shoes of the insured." *Id.* The parties entered into a Stipulated Judgment as to coverage; therefore, Wellington Place may assert claims against Ohio Casualty as if it stood in the shoes of the Erpenbeck Defendants. We find no error.

Ohio Casualty next argues that even if coverage was properly triggered, the circuit court erred in failing to pro-rate damages. In support of this argument, Ohio Casualty contends that there was not an "occurrence" during the term of any of the insurance policies at issue, and that the circuit court erred in failing to so rule based on its refusal to apply *Cincinnati Ins. Co.* Having determined, however, that the circuit court properly found that Ohio Casualty waived or was otherwise estopped from asserting the defense of noncoverage, we find no error on this issue.

Lastly, Ohio Casualty maintains that the circuit court erred in its January 30, 2012 Amended Order and Judgment by holding that statutory interest would apply from March 2, 2011, rather than the date of the Final Order on January 30, 2012.

In support of this argument, Ohio Casualty directs our attention to KRS 360.040, which provides that a judgment shall bear 12% interest compounded annually from its date. Ohio Casualty contends that the court's initial orders dated February 3, 2011, and March 2, 2011, were interlocutory and not final; therefore, the interest should have been calculated from the date of the Final Order rendered on January 30, 2012.

The March 2, 2011 Order, from which date the circuit court began applying interest, sustained Wellington Place's Motion for Summary Judgment. We conclude therefore that it was a "judgment" for purposes of applying KRS 360.040. Ohio Casualty appealed from this judgment and posted a supersedeas bond. Though the matter resulted in further proceedings, including a subsequent Final Order and Judgment, the March 2, 2011 Summary Judgment disposed of Wellington Place's claim and was not subsequently altered. The application of interest is entrusted to the sound discretion of the trial court. *R.T. Vanderbilt Company, Inc. v. Franklin*, 290 S.W.3d 654 (Ky. App. 2009). We cannot conclude from the record and the law that the circuit court abused its discretion by commencing interest from the March 2, 2011 Summary Judgment, and accordingly find no error.

For the foregoing reasons, we affirm the Amended Order and Judgment of the Campbell Circuit Court.

CAPERTON, JUDGE, CONCURS.

DIXON, JUDGE, CONCURS IN RESULT ONLY.

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