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Commonwealth of Kentucky

Court of Appeals

NO. 2014-CA-001162-MR

BRADLEY AND LEAH SETTLES — APPELLANTS

v.

APPEAL FROM CASEY CIRCUIT COURT
HONORABLE JUDY VANCE, JUDGE
ACTION NO. 13-CI-00024

OWNERS INSURANCE COMPANY — APPELLEE

OPINION
AFFIRMING

** ** ** ** **

BEFORE: D. LAMBERT, MAZE, AND THOMPSON, JUDGES.

MAZE, JUDGE: This appeal arises from the Casey Circuit Court's dismissal of counterclaims brought against Owners Insurance Company (hereinafter "Owners Insurance") by its insured, Bradley and Leah Settles. Owners Insurance sought a declaratory judgment regarding its obligation to cover damages assessed against the Settles in a prior personal injury suit. On appeal, the Settles challenge the

timeliness of the motion to dismiss their counterclaims and the appropriateness of the trial court's decision to grant it. Observing no error in the trial court's order regarding the timing or substance of the motion to dismiss, we affirm.

Background

The underlying facts of this case are not in dispute. On April 12, 2011, Pamela Wilson was injured in a fall at the apartment complex where she lived and which the Settles owned. Wilson later filed suit against the Settles seeking recovery on the theories of premises liability and negligence. Owners Insurance provided legal counsel for the Settles in this suit, participating in settlement negotiations and unsuccessful mediation in September 2012.

During discovery in the underlying case, Wilson revealed an arrangement between herself and the Settles in which she performed work at the apartment building in lieu of rent. As a result of this information, Owners Insurance filed a Petition for Declaratory Judgment on September 13, 2012, alleging that it was not liable for coverage on the premises liability and negligence claims because Wilson was an employee of the Settles at the time of her fall. Owners Insurance based this assertion on two provisions in its policy with the Settles, including one which precluded coverage for "bodily injury to an employee of the insured arising out of and in the course of employment by the insured."

On October 11, 2012, the Settles filed an Answer and Counterclaim in which they alleged that Owners Insurance breached its duty to them under the insurance policy causing them expenses in defending against the declaratory

action. Additionally, the Settles alleged that Owners Insurance acted in bad faith and in violation of the Kentucky Unfair Claims Settlement Practices Act during mediation and subsequent settlement negotiations by rejecting Wilson's final demand without counteroffer and in filing the declaratory action at the time and in the manner that it did.

Owners Insurance filed a timely Reply to the Settles' Counterclaim and asserted several defenses, including the Settles' failure to state a claim upon which relief could be granted. In March 2013, the parties settled the underlying personal injury and premises liability case. Under an Agreed Order of Dismissal, Owners Insurance provided payment of the settlement amount to Wilson.

In November 2013, thirteen months after its Reply to the Settles' Counterclaim, Owners Insurance filed a motion to dismiss the Settles counterclaims for failure to state a claim upon which relief may be granted. After briefing and an April 2014 hearing, the trial court entered an order dismissing. Of note, the trial court found that Owners Insurance did not render its motion to dismiss untimely "by including it in their Answer as opposed to filing a motion" prior to further pleading and discovery. Additionally, the trial court found that Owners Insurance's concerns regarding coverage, which gave rise to the declaratory action, were reasonable and that its conduct in both cases did not constitute bad faith. The Settles now appeal from this order.

Standard of Review

"Since a motion to dismiss for failure to state a claim upon which relief may be granted is a pure question of law, a reviewing court owes no deference to a trial court's determination; instead, an appellate court reviews the issue *de novo*." *South Woodford Water District v. Byrd*, 352 S.W.3d 340, 341 (Ky. App. 2001); *see also Morgan & Pottinger v. Botts*, 348 S.W.3d 599, 601 (Ky. 2011). Our review, like that of the trial court, must also assume the allegations of the Settles' Counterclaim were true. Thus, dismissal is appropriate only where "it appears the pleading party would not be entitled to relief under any set of facts which could be proved in support of his claim." *Pari-Mutuel Clerks' Union of Kentucky v. Kentucky Jockey Club*, 551 S.W.2d 801, 803 (Ky. 1977).

Analysis

The Settles appeal on both procedural and substantive bases. Respectively, they allege that dismissal prior to any discovery was premature and erroneous. We address the question of timeliness first.

The Settles argue that Owners Insurance impermissibly raised its defense in their Reply and later in a motion more than a year later. They cite to that portion of CR[1] 12.02 which states that a motion to dismiss on any of the grounds listed in the Rule "shall be made before pleading if a further pleading is permitted." Accordingly, the Settles claim that the motion to dismiss could not be filed after Owners Insurance's Reply to the Settles' Counterclaim, and was therefore untimely when the motion was filed more than a year later. At the very

[1] Kentucky Rules of Civil Procedure.

least, the Settles argue, the trial court was obligated, but failed, to treat the motion to dismiss as one for summary judgment under CR 12 and CR 56.

The motion to dismiss was timely. CR 12.08(2) states, "[a] defense of failure to state a claim upon which relief can be granted … may be made in any pleading permitted or ordered under Rule 7.01, or by motion for judgment on the pleadings, or at the trial on the merits." In simpler terms, though it may seem in conflict with the language of CR 12.02, under CR 12.08(2), a motion to dismiss for failure to state a claim can be brought at any time up to and during trial. *See* 6 Ky. Prac. R. Civ. Proc. Ann. Rule 12 (West, 2008).

The Settles' observation is correct: Under certain circumstances, a trial court must afford a party ample opportunity to state his claim, despite a pending motion to dismiss. CR 12.02 states,

> If, on a motion asserting the defense that the pleading fails to state a claim upon which relief can be granted, matters outside the pleading are presented to and not excluded by the court, the motion shall be treated as one for summary judgment and disposed of as provided in Rule 56, and all parties shall be given reasonable opportunity to present all material made pertinent to such a motion by Rule 56.

Such "matters outside the pleading" include admissions of counsel, answers to interrogatories, depositions, exhibits, judgments and orders, letters, and transcripts. 6 Ky. Prac. R. Civ. Proc. Ann. Rule 12 (West, 2008). Relying heavily upon this provision, the Settles argue that the trial court's dismissal of their Counterclaim

denied them the ability to conduct discovery and to "present all material" pertinent to their claim under CR 56. We disagree.

Twenty months passed between the Settles' Counterclaim and entry of the trial court's order dismissing its allegations. The Settles explain that they elected to delay prosecution of their counterclaims until settlement of the underlying suit. This was reasonable. However, in the nine months between settlement of Wilson's suit in March 2013 and Owners Insurance's motion to dismiss, the Settles undertook no effort toward discovery. Following the motion to dismiss, the Settles were afforded an evidentiary hearing before the trial court at which the trial court heard arguments in defense of their Counterclaim. Given these facts, we can only conclude that the trial court afforded the Settles the "reasonable opportunity" required under CR 12.02 and CR 56.

Having resolved the largely procedural bases for the Settles' appeal, we proceed to the more substantive questions. These are whether the trial court impermissibly weighed the facts of the case in dismissing it and whether a legal bar to all or a portion of the Settles' counterclaims existed.

The trial court's order included two vital conclusions regarding the Settles' allegations of negligence and bad faith: that Owners had a "reasonable basis" for filing a declaratory action and that its actions did not constitute bad faith. The Settles allege that these conclusions constituted "a premature and improper assessment of the facts[,]" and that their Counterclaim asserted valid tort claims against Owners Insurance.

The Civil Rules provide an avenue for motions to dismiss when a plaintiff has failed to show a right to relief after completing his evidence. 6 Ky. Prac. R. Civ. Proc. Ann. Rule 12 (West, 2008). However, such a motion is viewed with disfavor and rarely granted. *Id*. (*citation omitted*). Hence, it is worth restating that a trial court should not grant a motion to dismiss unless, even viewing the counterclaimants' allegations as true, it appears they would not be entitled to relief under any state of facts that could be proved in support of the claim. *See Pari-Mutuel Clerks' Union*, 551 S.W.2d at 803. In other words, dismissal is improper unless some insurmountable legal bar to recovery exists.

Our Supreme Court has permitted the dismissal of a bad faith claim brought after an insurance company sought to resolve coverage issues via a declaratory action. *See Guarantee Nat. Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997). We agree with the Settles that the majority opinion in *George* did not foreclose the viability of bad faith claims following the filing of a declaratory judgment. Indeed, the Court stated that it could "envision" circumstances where a bad faith claim would be appropriate. *George* at 949. However, the Court concluded that where an insurance company provided a defense to its insured, paid on the underlying claim, but challenged the legitimacy of coverage by filing a declaration of rights action, such conduct did not cross the "threshold" of bad faith. *George* at 949. On the contrary, the trial court refused "to deprive an insurer of its election to explore its legal remedy." *Id*., *citing Empire Fire & Marine v.*

Simpsonville Wrecker, 880 S.W.2d 886 (Ky. App. 1994). The facts in *George* square with those before us, compelling a similar result.

Owners Insurance was entitled to seek a declaratory judgment on the question of its liability under its policy with the Settles. This fact barred the Settles' bad faith claim to the extent that it was based upon Owners Insurance's mere filing of that action. However, the Settles brought their bad faith and negligence claims on other grounds.

The Settles also based their allegations of negligence and bad faith on Owners Insurance's rejection of Wilson's final demand ($23,000) without making a counteroffer and resulting in withdrawal of the offer; the timing of Owners Insurance's filing of its declaratory action (in close proximity to mediation of the underlying tort case); and Owners Insurance's failure to seek dismissal of Wilson's case against them. These questions are largely unaddressed in the trial court's order dismissing; and more importantly, they appear at first blush to be facts which, if proven, could provide a basis for relief.

As possible less harmful alternatives to counsel's decision to file a declaratory action, the Settles offer that counsel could have asserted the "exclusive remedy" provisions under Kentucky's Workers' Compensation Act to effect dismissal of Wilson's suit, or intervened in the underlying negligence suit on behalf of Owners Insurance. According to the Settles' Counterclaim, the timing of counsel's decision to pursue a declaratory judgment regarding coverage

undermined their case against Wilson. This argument fails to recognize a long-held principle in Kentucky law which acts to bar the Settles' remaining claims.

Insurance-related litigation often involves a tripartite relationship between an insured, and insurer, and counsel hired by the latter to represent the interests of the former. In such a relationship, "the interest of the insured and the insurer frequently differ." *Kuhlman Electric Corp. v. Chappell*, 2005 WL 3243498 (Ky. App. 2005), aff'd, *Chappell v. Kuhlman Electric Corp.*, 304 S.W.3d 8 (Ky. 2009). Therefore, our Courts have, and out of necessity, established that, in the context of insurance litigation, "no man can serve two masters[.]" *American Ins. Ass'n v. Kentucky Bar Ass'n*, 917 S.W.2d 568, 571 (Ky. 1996), *citing Kentucky Fair Bd. v. Fowler*, 221 S.W.2d 435 (Ky. 1949). "[T]he defense attorney's primary duty of loyalty lies with the insured, and not the insurer." *Kuhlman* at 18.

Consistent with this vital and long-held principle, the present case was not the proper venue to challenge the decisions of counsel in the underlying negligence action. Owners had no control over counsel's decisions in that case. Furthermore, Owners Insurance's decision to file a declaratory action was very likely the only means of avoiding a conflict of interest while possessing doubts regarding Owners Insurance's liability for the claim. More to the ultimate question on appeal, the well-established principle establishing counsel's sole duty to the Settles and independence from Owners Insurance constituted a legal bar to the Settles' claims of negligence and bad faith.

Conclusion

In weighing dismissal of a claim or counterclaim, it is neither the province of the trial court nor that of a reviewing court to consider whether a party will ultimately prevail on a claim. *City of Louisville v. Stock Yards Bank & Trust Co.*, 843 S.W.2d 327, 328 (Ky. 1992). For this reason, we are very sensitive to – even skeptical of – the summary dismissal of claims. We also remain ever-vigilant against certain tactics employed by insurers which may constitute bad faith or unfair treatment of their insured. Nevertheless, it *is* the province of a trial court to determine whether a legal bar to such claims exists; and in this case, such a bar existed regarding all of the Settles' counterclaims.

Accordingly, dismissal was appropriate. The June 9, 2014 order of the Casey Circuit Court is affirmed.

ALL CONCUR.

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