RENDERED: AUGUST 24, 2017
TO BE PUBLISHED

Supreme Court of Kentucky

FINAL

2015-SC-000107-DG DATE 9/14/17 Kim Redmon, DC

INDIANA INSURANCE COMPANY — APPELLANT

V.

ON REVIEW FROM COURT OF APPEALS
CASE NO. 2013-CA-000338-MR
CAMPBELL CIRCUIT COURT NO. 09-CI-01175

JAMES DEMETRE — APPELLEE

OPINION OF THE COURT BY JUSTICE HUGHES

AFFIRMING

Appellee James Demetre sued his insurer, the Indiana Insurance Company (hereafter "Indiana Insurance"), for bad faith arising from breach of his insurance contract, violation of the Kentucky Unfair Claims Settlement Practices Act, and violation of the Kentucky Consumer Protection Act. These claims stemmed from a vacant property owned by Demetre that had operated decades earlier as a gas station. When Demetre received notice that a family occupying a nearby residence was pursuing environmental claims against him for alleged migration of petroleum and other substances, he notified his liability carrier, Indiana Insurance, which provided a defense and eventually settled the family's claims. Indiana Insurance maintains that, having provided a defense and indemnification, Demetre has no viable bad faith claim but the trial court

and the jury viewed the evidence of what occurred in the more than three years from notice of the family's claims to settlement of their lawsuit in an altogether different light. After an eight-day trial, the jury awarded Demetre $925,000 in emotional distress damages and $2,500,000 in punitive damages. The trial court denied post-trial motions and Indiana Insurance appealed to the Court of Appeals, which rejected Indiana Insurance's allegations of error and affirmed the trial court's judgment in its entirety.

On discretionary review, Indiana Insurance makes the following allegations of error: 1) the trial court erred in not granting its motions for directed verdict and judgment notwithstanding the verdict; 2) there was insufficient evidence of Demetre's emotional distress to sustain the jury's award of damages; and 3) the trial court erred by barring two of Indiana Insurance's witnesses from testifying at trial and by erroneously instructing the jury. The second issue requires us to consider whether expert testimony is necessary to support an emotional distress damage award in a bad faith insurance claim, a potential application (or more accurately extension) of our relatively recent decision in *Osborne v. Keeney*, 399 S.W.3d 1 (Ky. 2012). After careful consideration of the record and law, we affirm the Court of Appeals and thus affirm the trial court's judgment upon jury verdict.

FACTUAL AND PROCEDURAL BACKGROUND

In 2006, Demetre contracted with Indiana Insurance to provide coverage for his condominium residence and automobile. At the same time, Demetre obtained an excess liability or "umbrella" policy to provide him with additional

coverage. These bundled policies provided Demetre with approximately $2,500,000 in liability coverage. Demetre expanded his coverage in 2008 by adding liability coverage for two parcels of real estate, one in Kenton County and the other in Campbell County. Indiana Insurance's coverage of the Campbell County property was the genesis of the case at bar.

Until 1962, the Campbell County property was the site of an active Texaco gas station. The station remained dormant until the 1990s, when efforts were made to remove the station and its fixtures from the property. In 1998, the station's underground gasoline storage tanks were removed and, the next year, the station's building was torn down and all remaining materials were hauled away. As such, when Demetre acquired the Campbell County property from his in-laws in 2000, the property had been reduced to an empty lot. Despite the removal of the gas station and tanks, the Commonwealth of Kentucky's Department for Environmental Protection continued monitoring of the property for some time.

In April 2008, Demetre contacted Indiana Insurance to obtain coverage for the Campbell County property. Demetre informed Gwendolyn Rich, an Indiana Insurance agent, that the lot had previously been the site of a gas station. When later deposed, Rich confirmed that she had informed Indiana Insurance's underwriting department of the lot's prior use as a gas station. Indiana Insurance agreed to insure the Campbell County property and added it to Demetre's liability coverage in April. At this time, a major misstep occurred internally at Indiana Insurance because although the property was insured it

was apparently underwritten as though it was residential property.[1] Shortly thereafter, on June 29, 2008, renewed Demetre's insurance policy for another year.

On September 4, 2008, Demetre received a letter from an attorney representing Mahannare Harris, her partner Dorian Cosby, and Harris's five minor children (collectively, the "Harris family"). The Harris family had moved into a house on a lot adjoining the Campbell County property in 2004. In the letter, Paul Dickman, the lawyer for the Harris family, alleged that members of the family had suffered injuries due to gasoline emissions from the Campbell County property including "significant medical damages" and a loss in the fair market value of their residence. Demetre immediately notified his agent of the letter and, on September 11, 2008, the agent notified Indiana Insurance of the Harris family's claims.

Indiana Insurance initially assigned Demetre's case to adjuster Allen Geisinger. On September 17, 2008, Geisinger sent an "alert" to Indiana Insurance's Special Claims Unit, which handled environmental claims and toxic torts. Eighty-eight minutes later, Geisinger received a response from David Cowles of the Special Claims Unit, instructing him to work with adjuster Paula Matheny and stating that "[i]t appears their (sic) may not be coverage under the Insured's condo policy for this matter."

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[1] There is no suggestion that Demetre misrepresented the Campbell County property as a personal residence. See pp. 13-14 *infra*.

On October 30, 2008, Geisinger sent Demetre a letter by certified mail informing him that Indiana Insurance had questions as to whether the Harris family's claims were covered by his insurance policy and would "handle this matter under a reservation of rights." This letter was sent approximately two weeks after Geisinger acknowledged in an email to a co-worker that he was unsure whether there would be coverage for the Harris family's claims, while at the same time admitting "I don't know what claims are being made against the insured by the attorney."

Subsequently, Geisinger directed Indiana Insurance's Field Investigation Unit to interview Demetre and to conduct an investigation of the Campbell County property. This investigation included obtaining from Shield Environmental Associates—the contractor monitoring groundwater underneath the Campbell County property for the Commonwealth—all environmental records, information, data, and testing documents related to the Commonwealth's monitoring of the property. These efforts were directed to determining whether Demetre knew of the Harris family's claims *before* the Campbell County property was added to Demetre's insurance policy.

While Geisinger thoroughly investigated Demetre, his investigation of the Harris family's claims was practically non-existent. When asked what he had done to assist Demetre, Geisinger explained that he "undertook this investigation, responded to Mr. Dickman's letters, hired or assigned a Field Investigation Unit to do sitework." Geisinger acknowledged that while he had spoken to Dickman early in the case, the attorney knew very little about his

clients or their alleged injuries. When asked about following up on the Harris family's claims, Geisinger explained that he was waiting for the Harris family's attorney to respond to him. There was no effort to interview the Harris family members, request medical records, seek medical exams, inspect or sample the soil near the Harris residence or otherwise determine the validity and nature of the claims being asserted against Demetre.

Despite this inaction, Geisinger wrote a letter to Demetre on March 23, 2009 (more than six months after Indiana Insurance had received notice of the Harris family's claims), where he stated "[p]lease recall that we are investigating the claims being made by Ms. Harris and her family. Their attorney has not provided us with any information regarding those claims." Geisinger then proceeded to ask questions about the status of the storage tanks from the Campbell County property. In closing his letter, Geisinger reminded Demetre that "[Indiana Insurance] continues to handle this matter under a reservation of rights."[2]

On March 27, 2009, Demetre's case was reassigned from Geisinger to Karen Shields Glardon.[3] Despite the change in personnel, Indiana Insurance was consistent in its lack of progress in assessing the Harris family's claims. When questioned during the subsequent litigation, Glardon admitted to doing

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[2] On March 23, 2009, shortly before he was to leave the case, Geisinger acknowledged in an email "I have not determined a coverage position [as to the Harris claims]. I will need to obtain a coverage opinion from Claims Legal." When questioned, Geisinger testified that he never requested or obtained a coverage opinion.

[3] In this same month, the Harris family demanded alternative living arrangements to be paid for by Indiana Insurance. The insurer declined.

nothing to protect Demetre's interests during her handling of the case file. She did not seek information about the Harris family or their claims nor did she recall ever speaking with Demetre or Dickman.[4]

Despite Glardon's inaction, two significant developments occurred during her handling of the case. On June 29, 2009, Indiana Insurance renewed Demetre's insurance policy for another year. The second and more critical development came to pass on August 14, 2009, when the Harris family filed suit alleging trespass, nuisance and negligence claims against Demetre, and a third-party bad faith claim against Indiana Insurance. After consulting with the Special Claims Unit, Glardon engaged Tim Schenkel to represent Demetre and Don Lane to represent Indiana Insurance.[5] Although Glardon engaged Schenkel to represent Demetre, she admitted that she never spoke to him during her management of the case.

On September 25, 2009, Demetre's case was reassigned yet again to James Magi. Magi had significant experience handling toxic tort claims, to such an extent that he was considered the "go-to-guy" in the Special Claims Unit for this type of work. This reputation was likely in part derived from his success in closing 72% of his assigned insurance claims without paying any money to claimants. Further, on those cases where payment was made, 31%

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[4] Glardon did acknowledge sending an email inquiring about the existence of a coverage opinion.

[5] In August 2009, Demetre hired his own personal counsel to protect his interests given Indiana Insurance's seemingly adversarial position.

of them took an average of ten years to process (from the date a claim was made until the claim was closed and payment made). Magi was assigned Demetre's coverage claim and was also designated by Indiana Insurance to simultaneously handle the Harris family's liability claims.

Bruce Frederick, the unit leader of the Special Claims Unit and Magi's supervisor, explained that in Magi's role as insurance adjuster, he controlled and directed the activities of the attorneys involved in the case—Lane who represented Indiana Insurance and Schenkel who represented Demetre. As such Lane and Schenkel had to request permission from Magi to take necessary actions in representing their clients. To further demonstrate this, Magi testified that it was correct that, "[s]teps taken in litigation, whether to file a motion for summary judgment, whether to file a motion to bifurcate something, or take any other significant step in the conduct of litigation," had to be suggested by counsel to him, discussed with him, and approved by him, prior to the lawyer being permitted to take action.

In October 2009, Schenkel and Magi discussed hiring an expert to "determine the status" of the Campbell County property with the state environmental agency. With Magi's permission, Schenkel asked his associate Jason Morgan to find an expert to check the state regulatory records. On October 21, 2009, Morgan informed Schenkel that he had spoken to Bill Johnson, an environmental engineer in Louisville, who informed Morgan that the Campbell County property was "in Site Investigation NOT Corrective Action." In a memorandum to Schenkel, Morgan explained that "it seems to

me that if the site is in Site Investigation and not Corrective Action, it is unlikely that the [Harris family]'s claims are legitimate."

On November 4, 2009, Magi noted in an internal data management system that he "[s]poke to D/C, he is in the process of retaining an expert from Louisville. He will send me the CV and rates." Given the context of the diary and the date of the entry, it would appear that this message was referring to Schenkel, in his role as defense counsel, and Johnson, as the expert from Louisville. Additionally, in copies of email messages between Schenkel and Magi that were admitted as evidence in trial, Schenkel reiterates that Magi should "be assured that I will keep you informed of all future developments in this matter." Yet, in his trial testimony Magi denied having any knowledge of Morgan's memorandum about the questionable nature of the Harris family's claims.

Magi seemingly focused his full attention on attempting to deny coverage. On December 11, 2009, Magi sent a second Reservation of Rights letter to Demetre, in which he noted that defense counsel had been provided to Demetre and "Indiana [Insurance] shall continue such defense until a determination is made that no coverage exists for the [u]nderlying [c]laim. . . ."
Thus fifteen months after Demetre notified Indiana Insurance of the Harris family's claims, there was still no determination as to coverage.

Shortly after Magi sent this letter to Demetre, Indiana Insurance internally separated the Harris family's claims file, the bad faith file, and the coverage file. William Ambrose was assigned to handle the Harris family's

claims, while Magi retained control over the coverage and bad faith files. Despite the split in management of the files, Schenkel continued to update Magi about any developments he learned of in the handling of the Harris family's claims.

On January 22, 2010, Indiana Insurance answered the Harris family's amended complaint and filed a declaratory judgment cross-claim, under Kentucky Revised Statutes (KRS) 418.045, against its insured, Demetre. Indiana Insurance claimed that while Demetre contacted Indiana Insurance's agent to insure the Campbell County property, "the parties have been unable to identify an actual endorsement that was appended to the [p]olicy adding coverage for the [p]roperty to it." Second, Indiana Insurance alleged that '[a]t the time that Demetre sought to insure the [p]roperty, he was aware that investigations concerning possible contamination of the [p]roperty had been ongoing for several years and failed to inform the [a]gent or Indiana [Insurance] of contamination on the [p]roperty before seeking to insure it."

On May 4, 2010, Demetre filed an answer to Indiana Insurance's cross-claim and raised his own cross-claims alleging bad faith breach of contract, unfair claims settlement practices and violations of the Kentucky Consumer Protection Act. Demetre asserted that Indiana Insurance had wrongly asserted a reservation of rights, and he requested a declaration of his rights and duties under the liability policy.

On September 23, 2010, Indiana Insurance filed a motion for a declaratory judgment seeking a summary ruling that it had no duty to defend

or indemnify Demetre for the Harris family's claims under any insurance policies issued to Demetre by Indiana Insurance. Indiana Insurance argued that "[j]udgment is appropriate because the Harris claim results from a loss in progress under the relevant insurance coverage, and therefore, this 'loss' cannot be covered as a matter of law." The loss-in-progress doctrine relieves the insurer of a coverage obligation where the insured was aware of an ongoing progressive loss at the time the policy became effective. While the loss-in-progress doctrine has never been recognized by this Court or the Kentucky Court of Appeals, Indiana Insurance relied on a decision from the United States District Court for the Western District of Kentucky. *See Pizza Magia Int'l, LLC v. Assurance Co. of America*, 447 F. Supp. 2d 766, 776 (W.D. Ky. 2006). That Court opined that the Kentucky Supreme Court would adopt the loss-in-progress doctrine.[6]

On December 8, 2010, the trial court, after reviewing Indiana Insurance and Demetre's detailed pleadings, denied Indiana Insurance's motion for a

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[6] In support of the declaratory judgment motion, Indiana Insurance included an affidavit from Deborah Chikar, a senior underwriter with the Liberty Mutual Group, of which Indiana Insurance is a member company. She claimed that the insurer added the Campbell County property to Demetre's policy believing it was another residence occupied by the insured; that it was unaware that it was a "contaminated former gasoline station;" and that had it known the true status of the property it would never have insured it. This affidavit also provides some insight as to why Demetre's insurance policy was repeatedly renewed during this litigation. Chikar claimed that in September 2008, Indiana Insurance sought to discontinue its coverage. However, she claimed that Indiana Insurance could not cancel the coverage midterm for the 2008-2009 policy period. Second, she alleged that Dawn Dunham, a former employee of Liberty Mutual, had intended to send Demetre a notice cancelling the policy before its 2009-2010 renewal, but through clerical oversight failed to do so. Third, Chikar admitted that when it was time to renew the policy for 2010-2011, that she "was unable to timely complete [her own] due diligence" and as such renewed the policy for another year.

declaratory judgment. The trial court determined that a declaratory judgment would not be appropriate as "Indiana [Insurance] is essentially asking the [trial court] to adopt factual defenses in order to grant judgment in their favor." After noting that there was no controversy regarding whether the policy would cover the type of third-party loss that was the subject of the underlying *Harris* litigation or that Indiana Insurance had a duty to defend, the trial court explained:

> Indiana [Insurance] is asking this Court to declare that its *public policy based defense* under the known loss rule or loss in progress doctrine excludes them from having to indemnify Demetre should [the Harris family] succeed at trial. However, there is a controversy between Demetre and Indiana [Insurance] regarding whether Demetre knew of the loss at the time he sought coverage. Nonetheless, this is a fact-based question which goes directly to the proof of Indiana [Insurance]'s defense that cannot be disposed of through a declaratory judgment. The question is best reserved for the trier of fact and not appropriate for judicial determination as a matter of law unless the Known Loss Rule or the Loss in Progress Doctrine applies to the present case.

(emphasis in original).

Additionally, the trial court acknowledged the cited federal authority but concluded, "the Courts of the Commonwealth have [had] the opportunity to adopt the known loss rule and have not exercised that authority. Instead, the Kentucky appellate courts have recognized the fortuity doctrine." The trial court refused to recognize the known loss rule or the loss-in-progress doctrine and further noted that "even if [it] were to adopt the rule, Indiana [Insurance] has not provided sufficient facts to warrant summary judgment in its favor as a

matter of law under the known loss rule or the loss in progress doctrine or even the fortuity doctrine."[7]

On January 21, 2011, Demetre moved to discharge Schenkel as counsel.[8] Demetre sought an order "declaring that the lack of measureable progress by the attorney assigned to defend him in the tort action over the past 17 months and the conflict of interests between Indiana [Insurance] and Demetre in the tort action over-rides Demetre's duty to cooperate with Indiana [Insurance] found in his homeowner's policy." Accordingly, Demetre sought the discharge of the law firm assigned by Indiana Insurance and to proceed with independent counsel.

After Demetre's motion was filed, Indiana Insurance elected to abandon all insurance policy defenses, with the exception of the "time-on-loss" defense. In a February 10, 2011 response opposing Demetre's motion regarding counsel and seeking declaratory judgment in his favor regarding the coverage issue, Indiana Insurance stated that *"[a]fter investigation, Indiana [Insurance] waived [insurance policy defenses] because the investigation revealed that they may not apply*, and Indiana chose to resolve all doubts in favor of James Demetre."[9]

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[7] In the same order, the trial court expressed its displeasure with the failure of the parties to engage in discovery on the bad faith issue: "there has been no discovery on this issue despite this Court's order several months ago that the parties engage in discovery on all claims. The Court admonishes the parties to *immediately* commence discovery on the bad faith claim against Indiana (emphasis in original)."

[8] At trial, Demetre testified that he had met with Schenkel only on one occasion, during which they discussed his case for approximately fifteen minutes.

[9] Indiana Insurance apparently informed the trial court of its intent to waive its policy defenses at a January 28, 2011 hearing. When Indiana Insurance waived all

(Emphasis supplied). While the August 2010 Chikar affidavit supporting Indiana Insurance's motion for declaratory judgment had alleged that Demetre misled the insurer about the Campbell County property and its former use, in this response Indiana Insurance acknowledged it did not believe Demetre had ever intentionally obtained coverage on a false basis. The remaining insurance policy defense, "time-on-loss," was described by Indiana Insurance as "whether the [Harris family's] injuries, if any, occurred during the policy period, as opposed to occurring during a period in which Demetre chose not to insure the property."[10]

On March 7, 2011, while Demetre's motion for a declaratory judgment was still pending, Schenkel filed a motion requesting leave to withdraw as counsel. Schenkel explained that Demetre, "alleges that a conflict of interest has developed between and among the undersigned and himself which precludes further representation in this matter." The trial court granted Schenkel's motion to withdraw on March 22, 2011. Also, on the same day Schenkel moved to withdraw as counsel, three attorneys from Frost Brown Todd entered their appearance as Indiana Insurance's appointed counsel for Demetre.

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defenses to coverage with the exception of time-on-loss, it informed the trial court that it also "was voluntarily waiving its right of appeal on the 'loss in progress' issue."

[10] On June 29, 2011, Indiana Insurance in its answer to the Harris family's second amended complaint, formally adopted the time-on-loss defense in its cross-claim against Demetre. The time-on-loss defense was also maintained in Indiana Insurance's November 7, 2011 answer to the Harris family's third amended complaint. Under the time-on-loss theory, Indiana Insurance argued that Demetre would be liable for fifty percent of any personal injuries and two-thirds of any property damages awarded to the Harris family.

On September 28, 2011, more than three years after Indiana Insurance was first notified of the Harris family's claims and over two years after the family filed suit against Demetre, Mahannare Harris was finally deposed. All depositions which concerned the Harris family's claims were completed on December 19, 2011. In addition to the depositions, medical records of the Harris family were obtained, independent medical exams on the adult plaintiffs were conducted, and inspections of the Harris residence were performed. Based on this investigation (which took less than ninety days), Philip J. Schworer, an attorney with Frost Brown Todd, concluded in his December 16, 2011 pre-mediation statement for Demetre that the *Harris* case "is a *nuisance value case.*" The attorney concluded there was no evidence that the Harris family had suffered or would suffer harm from any substances associated with the Campbell County property. Schworer's conclusion about the merits of the Harris family's claims was similar to that reached by Morgan two years earlier in his October 2009 memorandum where he stated that, based on his consultation with an environmental engineer about the Campbell County property, "it is unlikely that the [Harris family]'s claims are legitimate." On January 23, 2012, Indiana Insurance elected to settle the Harris family's case for $165,000.[11]

With the resolution of the Harris family's claims, Demetre moved on February 7, 2012, to dismiss Indiana Insurance's cross-claim against him and

[11] The Harris family's earlier settlement demands had been for $10,000,000 and $3,000,000.

that cross-claim was dismissed with prejudice on February 17, 2012. By that point, Demetre had spent a significant amount of his own money litigating with Indiana Insurance. The sum total of Demetre's personal legal fees and expenses from August 27, 2009, to February 17, 2012, was approximately $397,541.04. However, the dismissal of Indiana Insurance's cross-claim against Demetre was not the end of the case, as Demetre continued to litigate his claims against Indiana Insurance.

On April 13, 2012, Indiana Insurance requested summary judgment on Demetre's bad faith claim, stating that it had "fully defend[ed] and indemnif[ied] [Demetre]," which included taking "reasonable and necessary steps to protect Mr. Demetre." Further, Indiana Insurance argued that Demetre was unable to prove that it acted in bad faith or breached a contractual obligation, "because he cannot show that Indiana [Insurance] failed to pay the claim; cannot deny that he has failed to prove any damages related to the improper manner in which he *alleges* that Indiana [Insurance] handled the claim; and cannot show that Indiana [Insurance] acted with malice or ill will toward him (emphasis in original)."

In denying Indiana Insurance's motion for summary judgment, the trial court noted that Indiana Insurance presented a legal argument, without specific evidentiary support, to establish that "the company did not act in bad faith and fulfilled all fiduciary duties owed Demetre." Further, the trial court interpreted Indiana Insurance's motion as a request 'to find as a matter of law that, because Indiana [Insurance] provided Demetre a defense and indemnity,

it fulfilled its obligations to Demetre.'" The trial court was unwilling to construe the Unfair Claims Settlement Practices Act ("the UCSPA") and Demetre's related causes of action so narrowly. Further, the trial court was persuaded that an insurer's unreasonable delay could be the basis of a claim under the UCSPA, if there was evidence to demonstrate that the delay was prompted to deceive the insured with respect to coverage or part of an attempt to extort a more favorable settlement.

In September 2012, the bad faith case went to trial. During Demetre's case-in-chief, he called Magi to testify. In his deposition prior to trial, Magi had claimed that there was a factual basis for Indiana Insurance to assert that Demetre knew about contamination on the Harris family's property prior to his obtaining insurance in April 2008. Specifically, Magi alleged the existence of a document, identifying soil vapors that existed on the Harris family's property and moreover that document was located in the claims file. After Magi was asked if that document had been provided to Demetre's counsel, Lane interjected saying "I'll just state for the record the entirety of the claim file has been produced." During that deposition, Demetre's counsel and Magi had the following exchange:

> Q - So, If I look at the claims file that's been produced by Indiana Insurance Company in this case, I'm going to find proof of soil contamination on Mrs. Harris's property prior to April 30th, 2008; correct?
> A – Correct.
> Q – That's the position of Indiana Insurance Company; correct?
> A – Correct.
> Q – I'm going to find a document confirming or verifying or identifying groundwater contamination underneath Mrs. Harris's

house or Mrs. Harris's property prior to April 30th, 2008, in the file correct?
A – Correct.
Q – That's the position of Indiana Insurance Company; correct?
A – Correct.
Q – I'm going to find in the file documentation identifying soil vapors on her property, on Mrs. Harris's property, existing prior to April 30th, 2008, in the file; correct?
A – Correct.
Q – And, again, that's the position of Indiana Insurance Company; correct?
A – Correct.
Q – And that is the factual basis for the allegation that this is a known loss; correct?
A – Correct.

When questioned at trial, Magi explained that three letters—and only those letters—constituted the basis for Indiana Insurance's position that Demetre knew prior to insuring his property about underground contamination on the Harris family's property. The first letter was sent to Demetre on March 28, 2007, from the Kentucky Department for Environmental Protection, Division of Waste Management's Underground Storage Tank Branch. The letter explained that review of information submitted in December 2004 by Shield Environmental Associates concerning the Campbell County property "indicate[s] the presence of BTEX constituents above allowable levels in the following areas: Entire Konens Site and possibly off-site to the East and West. This indicates the necessity for additional site investigation."[12] However, as later noted by the trial court, "[w]hat is noticeably absent from this notification is any indication of *actual* offsite migration or an indication of such and

[12] The "Konens Site" referenced in the letter is the Campbell County property at issue in this case.

whether any migration was in an amount rising to unallowable levels (emphasis in original)." Additionally, Magi admitted that Indiana Insurance never asked Demetre about this letter.

The second letter relied upon by Magi, dated January 7, 2008, was from the Department for Environmental Protection to Mahannare Harris. In that letter, the Department requested permission for Shield Environmental Associates to access the Harris family's property. The Department was interested in determining the extent of contamination, if any, caused by the Campbell County property. The letter explained that "[i]f contamination above allowable levels, is confirmed on your property, Mr. Jim Demetre—will be required to perform corrective action, pursuant to 401 KAR 42:060, as necessary to remediate the contamination." The third letter, dated August 28, 2007, was from Shield Environmental Associates to Harris. This letter informed Harris that they would be investigating soil and groundwater conditions at the Campbell County property. Shield Environmental Associates requested access to the Harris family's property because to complete its "investigation, the drilling and sampling of soils and possibly groundwater on your property will be necessary." Demetre was not copied on either of these letters to Harris and there was no evidence he was aware of the letters before insuring the Campbell County property in April 2008.

When questioned at trial about Indiana Insurance's time-on-loss defense, Magi admitted that it was rooted in speculation and conjecture. Specifically, Magi had speculated that any injury to the Harris family had occurred between

2004 when the Harris family obtained their property and April 2008 when Demetre contracted with Indiana Insurance to insure the Campbell County property. However, Magi admitted that there was no evidence available to support this defense.

Demetre testified at trial and acknowledged that he was in very good physical health for a seventy-two-year-old man, but he explained at length that the dispute with Indiana Insurance had taken a heavy toll on his mental health. When asked by his counsel about what his last four years had been like, Demetre said:

> Oh my God, it has been a total disaster. It has been a nightmare. What I've been through in these past four years because of that insurance company over there. They didn't honor their contract. I think it's wrong. I made a deal with them and they took my money and they fought me. And they just fought me for four years. To this day I'm still fighting.

Demetre described the stress of being sued for millions of dollars by the Harris family and worrying about what would happen to him and his wife if the Harris family succeeded on their claims and the insurance company refused to cover the damages. Demetre explained that he "[w]as scared to death. I was looking at all this money. Where was it going to come from? I didn't have that kind of coverage and I didn't have that kind of money and I'm looking at who knows what. I am looking at bankruptcy. I had no clue. Didn't know what was going to happen."

Demetre described to the jury the significant anxiety and worry he had experienced due to this case by saying, "[w]ell when you're about to lose whatever these figures come out, ten million, three million, it does cause a lot

of havoc. Past four years have been a total hell to me. Couldn't talk to my wife about it, just kept everything inside."[13] He revealed that it impacted all aspects of his life, including his marital life, his business relations, and his ability to sleep. While Demetre did not see a mental health professional for his stress, he sought spiritual comfort from his priest. Demetre labeled his treatment by Indiana Insurance a "persecution" that impacted his mental health dramatically for a considerable period of time. He also testified to the substantial financial and emotional stress caused by incurring almost $400,000 in attorney fees in order to secure the coverage he had purchased.

Demetre offered the expert testimony of Carl Grayson, who concluded that Indiana Insurance violated its common law and statutory duties of good faith and fair dealing, its fiduciary duties, and the Unfair Claims Settlement Practices Act. While Grayson acknowledged that Indiana Insurance could defend under a reservation of rights and that a declaratory judgment action is a proper means to resolve coverage issues, he was sharply critical of Indiana Insurance's conduct. Specifically, Grayson determined that Indiana Insurance: 1) misrepresented pertinent facts or insurance policy provisions relating to the coverage at issue; 2) failed to acknowledge and act reasonably promptly upon communications with respect to claims arising under the insurance policy; 3) failed to adopt and implement reasonable standards for the prompt

[13] Demetre's wife later learned of the litigation through a notice sent to their residence by the sheriffs' office. Demetre had not revealed the dispute to her, for three and one-half years, due to concerns for her failing health.

investigation of insurance claims; 4) refused to pay claims without having conducted a reasonable investigation based upon all available information; and 5) failed to affirm or deny coverage of claims within a reasonable time after receiving notice.

At the close of Demetre's case, Indiana Insurance moved for a directed verdict on all claims, contending that the evidence showed that they had provided Demetre a defense and indemnification. Further, Indiana Insurance argued that there was insufficient evidence of Demetre's alleged emotional distress. The motion was denied. Subsequently, Indiana Insurance called Peter Hildebrand, an expert witness, as its first and only witness. Hildebrand testified that Indiana Insurance did not deny Demetre coverage and that it conducted a reasonable investigation and defended Demetre from the Harris family's claims. Although Indiana Insurance had abandoned the defense, he explained the known loss rule in describing and defending the insurer's original position regarding the lack of coverage. He also opined that environmental claims are difficult to handle and that generally it takes two to four years to resolve claims involving leaky underground storage tanks. At the conclusion of Hildebrand's testimony, Indiana Insurance renewed its motion for directed verdict, which was again denied.

The case was submitted to the jury with instructions setting forth three causes of action: 1) violation of the Unfair Claims Settlement Practices Act; 2) violation of the Consumer Protection Act; and 3) breach of contract. The jury

found for Demetre on all three theories and awarded him $925,000 in emotional distress damages and $2,500,000 in punitive damages.[14]

Shortly thereafter, Indiana Insurance filed a motion for judgment notwithstanding the verdict or for a new trial. While that motion was pending, Indiana Insurance alerted the trial court to this Court's recently rendered opinion in *Osborne v. Keeney* regarding expert testimony. After considering Indiana Insurance's arguments and pleadings, the trial court overruled the motion for judgment notwithstanding the verdict or for a new trial.[15] Indiana Insurance then appealed the trial court's judgment to the Court of Appeals, which, as noted above, affirmed the judgment in its entirety.

ANALYSIS

I. The Trial Court Properly Denied Indiana Insurance's Motions for Directed Verdict and Judgment Notwithstanding the Verdict.

Indiana Insurance argues that the trial court erred by not granting its motions for directed verdict and judgment notwithstanding the verdict. The standard of review of a trial court's denial of a motion for directed verdict is explained in detail in *Lewis v. Bledsoe Surface Mining Co.*, 798 S.W.2d 459 (Ky. 1990):

> Upon review of the evidence supporting a judgment entered upon a jury verdict, the role of an appellate court is limited to determining

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[14] The jury instructions included a "not to exceed" number of $2.5 million for emotional distress and $10 million for punitive damages.

[15] Subsequently, Demetre sought an award of attorneys' fees in the amount of $1,006,991. The trial court denied the motion, except that in the event that the verdict under the Consumer Protection Act was affirmed but the overall verdict in favor of Demetre was reduced below the amount claimed by Demetre as fees, in that case Demetre would be adjudged entitled to an award of fees necessary to reach a total award of $1,006,991.

> whether the trial court erred in failing to grant the motion for directed verdict. All evidence which favors the prevailing party must be taken as true and the reviewing court is not at liberty to determine credibility or the weight which should be given to the evidence, these being functions reserved to the trier of fact.

Id. at 461 (citing *Kentucky & Indiana Terminal R. Co. v. Cantrell*, 184 S.W.2d 111 (Ky. 1944); *Cochran v. Downing*, 247 S.W.2d 228 (Ky. 1952)). Additionally, the nonmoving party "is entitled to all reasonable inferences which may be drawn from the evidence." *Lewis*, 798 S.W.2d at 461. The decision of the trial court will stand unless it is determined that "the verdict rendered is 'palpably or flagrantly' against the evidence so as 'to indicate that it was reached as a result of passion or prejudice.'" *Id.* at 461-62 (quoting *NCAA v. Hornung*, 754 S.W.2d 855, 860 (Ky. 1988)). Further, "the considerations governing a proper decision on a motion for judgment notwithstanding the verdict are exactly the same as those . . . on a motion for a directed verdict." *Cassinelli v. Begley*, 433 S.W.2d 651-52 (Ky. 1968).

Before turning to Indiana Insurance's specific arguments in support of a directed verdict or judgment notwithstanding the verdict, it is necessary to revisit briefly Kentucky law regarding bad faith. As this Court recognized in *Davidson v. American Freightways, Inc.*, 25 S.W.3d 94 (Ky. 2000), bad faith claims against an insurer can be premised on common law as developed in cases such as *Manchester Ins. & Indem. Co. v. Grundy*, 531 S.W.2d 493 (Ky. 1975) (bad faith claim premised on insurer's refusal to settle a third-party liability claim, resulting in a verdict in excess of policy limits) and *Curry v. Fireman's Fund Ins. Co.*, 784 S.W.2d 176 (Ky. 1989) (bad faith claim for failure

to settle claim made by insured under his own policy). Common law bad faith claims flow from the insurer's breach of the covenant of good faith and fair dealing.

A bad faith claim can also be based on either or both of two Kentucky statutes: the Kentucky Consumer Protection Act, KRS 367.170, and the UCSPA, KRS 304.12-230. See *Davidson*, 25 S.W.3d at 96-100. The Consumer Protection Act prohibits "unfair, false, misleading, or deceptive acts or practices in the conduct of any trade or business" and grants a right of recovery to persons who have purchased or leased goods or services for personal, family or household purposes and in conjunction therewith have been injured by a prohibited act or practice. KRS 367.170; KRS 367.220. *See, e.g., Stevens v. Motorists Mut. Ins. Co.*, 759 S.W.2d 819 (Ky. 1988) (homeowner's policy was purchase of "service" and homeowner had Consumer Protection Act claim where insurer intentionally misrepresented experts' report and arbitrarily refused to negotiate blasting damage claim).

The UCSPA prohibits a number of different "acts or omissions" including, but not limited to, misrepresenting pertinent facts or policy provisions relating to coverage; failing to promptly acknowledge and respond to claims; failing to adopt and implement standards for prompt investigation of claims; refusing to pay claims without first conducting a reasonable investigation; failing to affirm or deny coverage within a reasonable period of time; and not attempting in good faith to reach a prompt, fair and equitable settlement of claims on which liability is reasonably clear. KRS 304.12-230. "The gravamen of the UCSPA is

that an insurance company is required to deal in good faith with a claimant, whether an insured or a third-party, with respect to a claim which the insurance company is contractually obligated to pay." *Davidson*, 25 S.W.3d at 100. Although the UCSPA does not include a private right of action provision, KRS 446.070 allows a person injured by a violation of any Kentucky statute to recover damages from the offender. Thus, "KRS 446.070 and KRS 304.12-230 read together create a statutory bad faith cause of action." *State Farm Mut. Auto Ins. Co. v. Reeder*, 763 S.W.2d 116, 118 (Ky. 1988).

As the *Davidson* court noted, Justice Leibson, writing for a unanimous court in *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993), "gathered all of the bad faith liability theories under one roof and established a test applicable to all bad faith actions," whether first-party or third-party claims and whether based on common law or statute. 25 S.W.3d at 100. The three required elements are:

> (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.

Id. quoting *Wittmer*, 864 S.W.2d at 890.

Indiana Insurance argues, rather half-heartedly, that the *Wittmer* elements do not actually apply to this case because Demetre is neither a first-party claimant seeking to recover personally on his own policy nor a third-party claimant seeking recovery from a tortfeasor's liability policy. While this is true,

we reject the insurer's proposition that Demetre is not a claimant at all. The essence of liability insurance is that the insured is indemnified in the event of a third-party claim and, if necessary, has counsel to represent his or her interest in litigation. A liability insured who seeks these benefits owed under a policy of insurance is most assuredly making his or her own claim. As this Court noted in *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 516 (Ky. 2006), "'claim' is subject to multiple, subtly different definitions. . . . But at its most basic, the word means an assertion of a right, with the contours and specific nature of the right depending on context."[16] When Demetre notified Indiana Insurance of the Harris family's claims in September 2008, he himself made a "claim" for the benefits he had purchased under the liability policy.[17] With this overview of bad faith claims in mind, we turn to Indiana Insurance's argument that it was entitled to judgment as a matter of law.

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[16] *Knotts* also quotes the following Black's Law Dictionary of the word "claim:"

> 1. The aggregate of operative facts giving rise to a right enforceable by a court <the plaintiff's short, plain statement about the crash established the claim>.—Also termed *claim for relief*. 2. The assertion of an existing right; any right to payment or to an equitable remedy, even if contingent or provisional <the spouse's claim to half the lottery winnings>. 3. A demand for money, property, or a legal remedy to which one asserts a right; esp., the part of a complaint in a civil action specifying what relief the plaintiff asks for.... 4. An interest or remedy recognized at law; the means by which a person can obtain a privilege, possession, or enjoyment of a right or thing; CAUSE OF ACTION (1) <claim against the employer for wrongful termination>."

[17] The jury instructions in this case appropriately defined "claim" as "The assertion of a right or a demand for something that is believed to be rightfully due under an insurance policy."