By Justin Sanders

No Ordinary Bad Faith Case: The Repercussions of *Indiana Insurance Co. v. Demetre* on Kentucky Tort Law

On October 1, 2012, a jury in Campbell County, long considered one of the most conservative venues in the commonwealth, returned a $3.425 million dollar insurance bad faith verdict in favor of James Demetre against Indiana Insurance Company, a subsidiary of Liberty Mutual. Mr. Demetre's trial team consisted of Jeffrey and Bob Sanders, Matt Nakajima, and me. The Court of Appeals affirmed the judgment in 2015.

On August 24, 2017, the case was affirmed by the Kentucky Supreme Court, in a 58-page, 6-1, to-be-published opinion, *Indiana Insurance Co. v. James Demetre*, -- S.W.3d --, 2017 Ky. LEXIS 364 (No. 2015-SC-000107). The opinion, by Justice Hughes, was the culmination of approximately eight years of difficult, hard-fought litigation. At each stage of the case, the judges and judicial staff did yeoman's work to digest a complex, nuanced factual record, thoroughly and thoughtfully analyze the applicable statutes and case law, and issue well-reasoned rulings and decisions. The result is greatly enhanced protections for insurance policyholders under Kentucky law.

As significant as the *Demetre* decision is in the realm of bad faith, the impact the decision has on the practice of Kentucky tort law, generally, is equally important. For instance, *Demetre* clearly (and favorably, from a plaintiffs' attorney's perspective) defines what one must prove to collect damages for emotional distress in tort cases. The court also strongly condemned over-aggressive insurance claims handlers who attempt to manipulate and control attorneys hired to defend policyholders or represent the carrier in coverage disputes.

The factual record in *Demetre* is immense. Thus, an extensive recitation of the record is not attempted in this article. A brief overview of the facts, however, is helpful for context. In 2000, James Demetre acquired a vacant lot that, several decades before, had been the site of a Texaco service station. The station closed in 1962. The building was razed, and the underground storage tanks (UST) were removed around 1998. At his insurance agent's suggestion, Demetre added the parcel to his Indiana Insurance (Indiana) homeowner's policy in 2008. The application for insurance fully disclosed the prior use of the property. Indiana issued the coverage with no environmental or other relevant exclusions.

Later that year, a lawyer for residents of the house next door to the lot, the Harris family, sent Mr. Demetre a letter claiming that petroleum contaminants had migrated through the soil from Mr. Demetre's property into the Harris home. The letter claimed that contaminants caused the Harris family to suffer "significant medical damages" and a loss of fair market value of their home.

Mr. Demetre timely notified Indiana of the claim. For several years, Indiana did virtually nothing to investigate the Harris family's claims. Instead, Indiana devoted its attention and resources to contesting and attempting to defeat coverage under the policy it sold Mr. Demetre. Had Indiana succeeded, Mr. Demetre would have been abandoned to face the multi-million-dollar liability claim on his own. His life savings and the security of his impending retirement years were put in grave jeopardy. Indiana engaged a lawyer to defend Demetre under a reservation of rights and, simultaneously, filed suit against Demetre seeking a declaratory judgment that there was no coverage under the Indiana policy for the Harris claim. At trial, Indiana's adjuster admitted its coverage defenses claims were based, not on facts or evidence, but only on the adjuster's "speculation and conjecture."

At the same time Indiana was pursuing speculative and conjectural coverage defenses against Mr. Demetre, the carrier ignored and concealed evidence showing that the Harris family's claims against Demetre were likely meritless. When attorneys retained by Indiana to defend Mr. Demetre informed the insurer that evidence in their possession showed "… it is unlikely the plaintiff's claims (against Demetre) are legitimate," Indiana suppressed that evidence and continued its aggressive efforts to defeat coverage.

Mr. Demetre eventually hired Jeffrey M. Sanders as his personal counsel and filed a claim against Indiana for bad faith. Jeff brought the rest of the *Demetre* team together and, for nearly two more years, fought Indiana's scorched-earth

litigation tactics. Ultimately, nearly all of Indiana's bogus policy defenses were disproven, and the case was distilled down to a single and questionable "time on loss" defense asserted by Indiana.

Motions were filed to remove the hired by Indiana to "defend" Demetre. Before the Court could rule on the motions to remove the insurance defense lawyers, the lawyers removed themselves. In an apparent effort to extract itself from a serious bad faith posture of its own creation, Indiana engaged an attorney who seriously investigated the Harris family's case against Demetre. The new attorney quickly dismantled the Harris family's case. Proof was gathered to show there was no harmful chemical contamination on the Harris property and no one in the family had been injured. Despite the fact that the new lawyer opined that the Harris claims were without merit and could be disposed of for "nuisance value," Indiana agreed to pay the Harrises $165,000. Indiana then defended Mr. Demetre's bad faith claim by arguing it fulfilled its obligations under Demetre's policy: it provided Demetre with a defense throughout (by always having an insurance *defense* lawyer of record for him) and *indemnified* him by paying the Harrises.

Indiana's arguments fell flat with the Campbell County jury. The jury found in favor of Mr. Demetre and against Indiana Insurance on every theory of liability in the case. Specifically, the jury found Indiana breached its contract with Mr. Demetre by violating the implied covenant of good faith and fair dealing; violated the Kentucky Consumer Protection Act (KCPA, K.R.S. §367.170); violated the Kentucky Unfair Claims Settlement Practices Act (KUCSPA, K.R.S. §304.12-230); and engaged in common law bad faith. The jury awarded Demetre $925,000 for "emotional pain and suffering, stress, worry, anxiety, or mental anguish," and $2,500,000 in punitive damages. No expert testimony was presented to support the emotional distress claims. The jury assessed emotional distress damages based on testimony from Mr. Demetre himself, along with consideration of the global evidence of what Indiana Insurance put him through over the several preceding years.

The verdict was affirmed by the Court of Appeals in a 2015 opinion by

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Judge Kelly Thompson, and by Justice Hughes' 6-1 opinion for the Supreme Court. Both opinions were extremely well written and are recommended reading for anyone considering a bad faith claim or dealing with issues concerning emotional distress damages.

Dispelling Insurance Industry Myths

The Supreme Court's decision definitively laid to rest a number of myths perpetuated by the insurance industry and attorneys who represent carriers in coverage disputes. The first such myth is that a policyholder in Mr. Demetre's position, *i.e.*, an insured against whom a tort claim is asserted, as opposed to one seeking payment of money damages from his insurance company, has no protection under Kentucky bad faith law against insurers who unfairly attempt to avoid coverage without a valid legal or factual basis for doing so.

In *Wittmer v. Jones*, 864 S.W.2d 885 (Ky. 1993), the Kentucky Supreme Court established a three-part test for any bad faith action, whether the claim is based on common law bad faith or violations of the KCPA or KUCSPA. A plaintiff alleging bad faith must prove that: 1) the insurer was obligated to pay a claim under the terms of the policy; 2) the insurer lacks a reasonable basis in law or fact for denying the claim; and 3) the insurer knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.[1]

Indiana contended that James Demetre had no cause of action for bad faith, because he was not seeking payment of money under his insurance policy.[2] While Justice Hughes was dismissive of Indiana's argument on this issue, suggesting that it was asserted "rather half-heartedly," it was, from our perspective as Mr. Demetre's trial attorneys, a hotly contested issue that Indiana fought at every stage of the litigation. Indiana argued that this case fell under neither the KUCSPA nor the bad faith elements set forth in *Wittmer*, because Mr. Demetre should not have been considered a 'claimant.'

The Supreme Court's decision to address this issue as directly as it did was excellent for Kentucky policyholders. Citing *Knotts v. Zurich Ins. Co.*, 197 S.W.3d 512, 516 (Ky. 2006), the Court held a "claim" is the "assertion of a right, with the contours and specific nature of the right depending on context."[3] As applied to Mr. Demetre, the Court held that his "claim" for the benefits of his liability policy was sufficient to put his case squarely within the confines of Kentucky bad faith law. This clear, unequivocal holding provides significant protection to policyholders against abuse or abandonment by their insurance companies and helps ensure they get the peace of mind they bargain and pay for.

Another myth dispelled by the *Demetre* opinion is that insurers are deprived of their right to raise legitimate coverage defenses because they risk bad faith liability for doing so. Indiana took the position in both the Court of Appeals and the Supreme Court that it was found to have acted in bad faith solely on the basis of filing a declaratory judgment action on the coverage issue. The Supreme Court recognized Indiana's position as the "straw man" argument that it was. Mr. Demetre never alleged bad faith on the basis of Indiana's filing of a declaratory judgment action; the bad faith claim was premised on the fact that the coverage action, against which Mr. Demetre was forced to defend himself at great personal expense, was baseless. Justice Hughes accurately observed that Mr. Demetre's "bad faith allegations were about more than the fact that the insurer sought a judicial determination regarding coverage."[4]

At trial, Indiana's principal claims representative admitted that Indiana's suit against Demetre was based on no evidence, but merely "speculation and conjecture." The Court took great care to distinguish this case from *Guaranty National Ins. Co. v. George*, 953 S.W.2d 946 (Ky. 1997), which involved a "mutual mistake" by the insurer and insured with regard to whether a particular vehicle should have been listed on the policy, and *Philadelphia Indem. Ins. Co. v. Youth Alive, Inc.*, 732 F.3d 645 (6th Cir. 2013), where coverage turned on the interpretation of a specific policy exclusion.

The Court held that Indiana's insistence on fighting coverage long after it could have and should have determined that coverage applied, and its failure to take any meaningful steps in defending Mr. Demetre against the Harris family's claims for nearly three years, supported the jury's verdict.[5] An insurer, in general, certainly has the right to challenge coverage under its policy and, if appropriate, seek declaratory relief. But without sufficient factual support, the insurer does so at its own peril.

A third myth laid to rest by the *Demetre* opinion is that the insurer can, by any means necessary and at whatever cost to the policyholder, attempt to avoid coverage without exposing itself to bad faith liability, so long as it ultimately fulfills its written obligations under the policy. By Indiana's reasoning, the fact that it had no evidentiary or legal support for its coverage positions was irrelevant, as was the fact that Indiana put its insured to more than four hundred thousand dollars in litigation expense to fight its efforts to avoid

coverage. Indiana contended it was absolved of all wrongdoing and should have been granted judgment as a matter of law, because it provided a defense by hiring insurance defense lawyers the carrier controlled; and "indemnifying" Demetre by paying the Harris family $165,000 for a worthless claim.

The Supreme Court rejected Indiana's argument. Instead, the Court applied the same standard it developed in first party bad faith cases where the claimant is seeking payment of money benefits: "whether there is sufficient evidence from which reasonable jurors could conclude that in the investigation, evaluation and processing of the claim, the insurer acted unreasonably and either knew or was conscious of the fact that its conduct was unreasonable."[6] The Court's holding makes clear that an insurer's fulfillment of its written obligations of an insurance contract will not automatically preclude a finding of bad faith. If, in the process of meeting its written obligations, the insurer violates KUCSPA or the KCPA, breaches its fiduciary duties, or violates its covenant of good faith and fair dealing, bad faith will still lie.[7]

Clarification of Evidentiary Requirements for Emotional Distress Damages

Demetre's significance is not limited to insurance bad faith cases. The opinion also provides clear and definitive

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answers to important questions regarding how emotional distress damages are proven that impact nearly every tort case in Kentucky. In *Osborne v. Keeney*, 399 S.W.3d 1 (Ky. 2012) the Supreme Court, laudably, eliminated Kentucky's longstanding "contact rule," which had, for decades, precluded even obviously meritorious claims[8] for negligent infliction of emotional distress in the absence of some physical impact or contact between the thing causing the distress and the person who suffered it. Out of concern that abolition of the contact rule could lead to specious or contrived claims for emotional distress damages, the *Osborne* opinion stated, "… recovery should be provided only for 'severe' or 'serious' emotional injury." However, the *Osborne* court also held "a plaintiff claiming emotional distress damages must present expert medical or scientific proof to support the claimed injury or impairment."[9]

Although *Osborne* was a Negligent Infliction of Emotional Distress (NIED) case, it was, unfortunately but predictably, interpreted by many defense attorneys and some trial courts (particularly in the federal system) as setting a new evidentiary requirement of expert medical or scientific proof in *all* cases where emotional distress damages are alleged, regardless of the underlying cause of action or whether the case involved a physical impact or injury.[10] The justification for such an overbroad interpretation of *Osborne* was that the opinion "gave no indication that the expert-testimony requirement is limited to impact-free cases."[11] [12]

The *Osborne* decision was released during the post-trial motion briefing phase of *Demetre*. *Osborne* was immediately submitted by Indiana in support of its motion for judgment notwithstanding the verdict (JNOV). Indiana argued that the heightened evidentiary standards for emotional distress claims should apply to *all* emotional distress damages claims, including those arising from bad faith. Suddenly, in the wake of *Osborne*, the question of whether Mr. Demetre presented sufficient evidence to support the award of emotional distress damages, or whether his lack of expert testimony was fatal to his claim, went from being a peripheral issue to being a central battle in the post-trial motions and appeals. Campbell Circuit Judge Fred Stine denied Indiana's JNOV motion. The Court of Appeals affirmed and the issue was perceived as an important reason why the Supreme Court granted discretionary review.

Before *Osborne,* emotional distress damages in bad faith cases were already subject to a heightened proof standard of "clear and satisfactory" evidence.[13] The evidence at trial in support of James Demetre's emotional distress claim consisted of Mr. Demetre's testimony within the context of all the evidence of the spiteful and aggressive campaign waged by Indiana Insurance to wrongfully deny coverage for the Harris family's multi-million dollar claims. Mr. Demetre testified that being forced to fight his own insurance company while his whole financial future and retirement security were put at risk was a "nightmare." After a long career of hard work and considerable financial success, Mr. Demetre described how it felt facing the possibility of losing his entire life savings in this litigation. He described being unable to share the stress of the dispute with his wife for fear her fragile medical condition could be worsened by the added stress. Although he did not see a mental health professional for his stress, the Court noted that he *had* sought spiritual comfort from his priest.[14] Mr. Demetre eloquently and thoroughly testified about the disastrous impact the case had on all aspects of his life. Within the context of the evidence of the insurance company's misbehavior towards him, the Court held that Mr. Demetre's description of the experience and its effects on him was sufficient to uphold the jury's award of $925,000 in emotional distress damages.

The Court's holding could not have been clearer: "[W]e hold that *Osborne*'s requirement of expert medical or scientific proof is limited to claims of intentional or negligent infliction of emotional distress."[15] Justice Hughes reasoned that:

> [T]he imposition of the stringent proof requirements adopted by this Court in *Osborne* for all claims for emotional damages would dramatically limit the otherwise compensable claims that arise in bad faith cases as well as a variety of other actions.[16]

Claims for emotional distress damages in bad faith cases are "less likely to be fraudulent than those advanced under a free-standing claim of [IIED] or [NIED]."[17] The Court expressed its faith and trust in juries to decide whether a particular plaintiff has presented sufficient evidence of emotional distress.

Loosening the Chokehold Insurance Carriers Have on Litigation

While the effect the *Demetre* decision has on bad faith and other tort claims is, overall, certainly more beneficial to plaintiffs than defendants, defense *attorneys* should find comfort in the opinion, too. As noted, Mr. Demetre's bad faith action was premised, in part, on an unjustifiable lack of progress in the defense of the Harris family's

personal injury allegations, while Indiana focused its attention and resources on the contrived dispute over coverage. Indiana argued that, as a matter of law, Mr. Demetre could not convert complaints of poor performance by his attorney into a bad faith claim against the insurer. Indiana suggested that the more appropriate mechanism for seeking redress for the attorney's "litigation conduct" is a legal malpractice claim or sanctions under Rule 11.

The evidence at trial showed, however, that Indiana Insurance exercised very tight control and direction over the actions of Mr. Demetre's assigned defense counsel, as well as Indiana's coverage counsel. Indiana's adjuster testified that he had to approve all significant decisions made in the litigation—whether to file a summary judgment motion, whether to hire a particular expert, or whether to move for bifurcation of claims. The picture painted by Indiana's own witnesses presented insurance defense lawyers as nothing more than puppets who dance to whatever tune the claims handlers whistle. The reason so little was done for so long to defend Mr. Demetre from the Harris family's claims was because Indiana's claims handlers were pouring the company's efforts and resources into the fight to escape its responsibilities under the policy.

The Court rejected Indiana's argument that this case was about attorney malpractice or misconduct. Although the Court's analysis of the issue is set-forth in a footnote, it is clear that the justices understood this case was about the insurance company's misconduct, not any shortcomings of the attorneys involved.[18]

Hopefully, insurance defense attorneys see the *Demetre* opinion as support for the proposition that they should always act in conformity with their own judgment about what is best for the insurance policyholders. Insurance defense counsel's ethical duties are to the individual citizens they represent, not to the insurance company that pays their fees. Carriers who manipulate and control the attorneys they assign to defend cases would be wise to change their ways. *Demetre* makes clear that insurance companies are not shielded from bad faith liability by pointing a finger of blame at the attorneys they hire. When adjusters and insurance company executives make key decisions about how cases are defended, Kentucky courts will hold them—not the puppets dancing to the company's tune—accountable in actions for bad faith, KUCSPA violations, KCPA violations, and breach of contract. As in *Demetre*, all four of those legal theories are highly viable to hold insurers accountable for misdeeds that are set up, controlled and carried out by the insurer.

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1 *Wittmer*, 864 S.W.2d at 890.
2 *See* Brief of Appellant filed in the Supreme Court at p. 12 ("Mr. Demetre was not a claimant at all. Instead, Mr. Demetre was an insured against whom a claim was asserted.").
3 *Indiana Insurance Co. v. Demetre*, -- S.W.3d --, 2017 Ky. LEXIS 364 (No. 2015-SC-000107) at *33.
4 *Id.* at *35.
5 *Id.* at *44.
6 *Id.* at *48 (quoting *Farmland Mutual Ins. Co. v. Johnson*, 36 S.W.3d 368, 376 (Ky. 2000)).
7 *Id.* at *50-51.
8 For example, see Robert E. Sanders & Julie Duncan, *Bystander's Right to Bring a Cause of Action for Negligent Infliction of Emotional Distress in Kentucky: An Analysis of Major v. General Motors Corp. & Deutsch v. Shein,* 24 N. Ky. L. Rev. 253 (Spring 1997), cited in *Osborne v. Keeney* at endnote 38, as part of the "large body of scholarly work (that) has disparaged the impact rule" that the Court noted as an "article of particular interest to Kentucky."
9 *Osborne*, 399 S.W.3d at 17-18.
10 *See, e.g.*, *Powell v. Tosh*, Civil Action No. 5:09-CV-00121-TBR, 2013 WL 1878934 at * 3 fn. 6 (W.D. Ky. May 3, 2013); *Ellis v. Arrowood Indemnity Co.*, Civil Action No. 7:12-cv-00140-ART-CJS at *2 (E.D. Ky. Sept. 23, 2014)(holding that *Osborne* requires "all Kentucky tort plaintiffs to present expert testimony of emotional injury" and citing *Sergent v. ICG Knott Cnty., LLC*, Civ. No. 12-118-ART, 2013 WL 6451210 (E.D. Ky. Dec. 9, 2013) ("*Osborne* repeatedly referred to the rule it was establishing as a rule about emotional damages, period."); *Adkins v. Shelter Mut. Ins. Co.*, Civil Action No. 5:12-cv-00173-KKC, 2015 WL 4548728 (E.D. Ky. 2015)(ruling that *Osborne* applies to all negligence actions and that plaintiff's own testimony was insufficient to support her emotional distress claim).
11 *Demetre*, 2017 Ky. LEXIS 364 at *57 (quoting *Sergent*, 2013 WL 6451210 at *7).
12 A thorough discussion of the potential for misinterpretation of the unfortunately broad wording employed by the Kentucky Supreme Court in *Osborne* can be found in a previous *Advocate* article: Robert E. Sanders & W. Matthew Nakajima, "Abolition of the Impact Rule and the Unintended Consequences of the Supreme Court's Decision in *Osborne v. Keeney*, 2012 WL 6634129 (Ky. Dec. 20, 2012)," *The Advocate*, Vol 41, Number 4 (July/August 2013).
13 *See Motorists Mut. Ins. Co.*, 996 S.W.2d 437, 454 (Ky. 1999).
14 *See Demetre*, 2017 Ky. LEXIS 364 at *26.
15 *Id.* at *63.
16 Id.
17 *Id.* at *64.
18 *See Id.* at *51 fn. 22.