COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NOS. 2008-SC-000037; 2008-SC-000044

ASSOCIATED INSURANCE SERVICE, INC.

and

AON RISK SERVICES, INC. OF OHIO **APPELLANTS**

v. **ON DISCRETIONARY REVIEW FROM COURT OF APPEALS CASE NO. 2006-CA-001737, AN APPEAL FROM JEFFERSON CIRCUIT COURT CASE NO. 02-CI-09027**

DANIEL GARCIA, M.D.

and

RITA GARCIA **APPELLEES**

REPLY BRIEF FOR APPELLANT, ASSOCIATED INSURANCE SERVICE, INC.

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CERTIFICATE OF SERVICE

This is to certify that a true and correct copy of this brief was served via regular mail this 29th day of January, 2009 upon the following persons: Hon. Samuel Givens, Jr., Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 40601-9230; Hon. Geoffrey P. Morris, Jeff. Cir. Ct., 700 West Jefferson St., Louisville, KY 40202; Lee E. Sitlinger, Esq., Sitlinger, McGlincy, Theiler & Karem, 370 Starks Building, 455 S. Fourth St., Louisville, KY 40202; Larry B. Franklin, Esq., Franklin Hance, PSC, 5050 W. Ormsby, Louisville, KY 40203; Mark S. Riddle, Esq. and P. Blaine Grant, Esq., 3500 National City Tower, 101 S. Fifth St., Louisville, KY 40202; and Gene Price, Esq., 400 W. Market, 32nd Floor, Louisville, KY 40202. I further certify that the record on appeal has not been checked out.

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STATEMENT OF POINTS AND AUTHORITIES

ARGUMENT 1

I. The Court of Appeals Erred in Failing to Follow Existing Kentucky Law 2

Coffey v. Jefferson Cty. Bd. of Educ., 756 S.W.2d 155 (Ky. App. 1988) 2, 3, 6, 7

II. The Case Law From Other Jurisdictions on Which the Court of Appeals Relied Does Not Provide Support for the Assignment at Issue 2

A. The Garcias had no claim to assign because they had suffered no damage. 3

Stateline Steel Erectors, Inc. v. Shields, 837 A.2d 285, 288 (N.H. 2003) 3

Oregon Mutual Ins. Co. v. Gibson, 746 P.2d 245 (1987) 3

Freeman v. Schmidt Real Estate & Ins., Inc., 755 F.2d 135 (8th Cir. 1985) 4, 5, 6

Red Giant Oil Co. v. Lawlor, 528 N.W.2d 524 (Iowa 1995) 6

B. The collusive circumstances of the assignment render it void as against public policy. 7

Campione v. Wilson, 661 N.E.2d 658, 661 (Mass. 1996) 8

Ayers v. C&D General Contractors, 269 F.Supp.2d 911, 915-916 (W.D. Ky. 2003) 8

III. The Garcias Fail to Even Address the Argument that Court of Appeals Erred by Invalidating a Portion of the Agreement Without Invalidating the Whole. 8

IV. The Garcias' Miscellaneous Other Arguments Are Unavailing. 9

CONCLUSION 10

ARGUMENT

For at least the following four reasons, the attempted assignment from the Star to the Garcias is prohibited by existing Kentucky law: (1) a professional negligence claim is not assignable because it sounds in tort; (2) the attempted assignment was legally ineffective because the Star suffered no damage and had no claim to assign; (3) an assignment coupled with a stipulated judgment and covenant not to execute is collusive as against public policy; (4) by invalidating part of the Agreement, the Court of Appeals was required to invalidate the whole.

Despite the existence of Kentucky law precluding the assignment, the Court of Appeals relied on cases from other jurisdictions and upheld the assignment as valid. The Garcias ask this Court to follow the same erroneous path. Respectfully, this Court should apply existing and applicable Kentucky law, not the law of other jurisdictions. Moreover, the foreign authorities advanced by the Garcias and followed by the Court of Appeals do not even support the assignment at issue in this case. The circumstances of the purported assignment from the Star to the Garcias are factually distinguishable from the circumstances of the assignments involved in those foreign decisions. Furthermore, the logic and reasoning of those decisions is questionable.

I. The Court of Appeals Erred in Failing to Follow Existing Kentucky Law.

The basis for the ruling by the Court of Appeals, and the Garcias' argument, is that other jurisdictions would permit the assignment from the Star to the Garcias of the alleged claims of professional negligence against the Star's insurance agent, Associated, and broker, AON. However, neither the Court of Appeals nor the

Garcias have sufficiently addressed whether ***existing Kentucky law*** allows the purported assignment. It does not.

The long-standing rule in Kentucky is that a tort claim is not assignable. This Court would have to overrule this precedent in order to uphold the assignment at issue in this case. (See Associated's Brief, pp. 7-8.) Additionally, a prior Court of Appeals decision, *Coffey v. Jefferson Cty. Bd. of Educ.*, 756 S.W.2d 155 (Ky. App. 1988), held that an assignment occurring under circumstances such as occurred here is legally ineffective for at least two reasons. ***First***, such a purported assignment can have no legal effect because the assignor has no claim to assign. The reason the assignor has no claim to assign is that, by virtue of the covenant not to execute, the assignor has suffered no damage. *Id.* at 156-157. ***Second***, the circumstances of such an assignment create a possibility of collusion that should not be accepted by Kentucky courts. *Id.*

II. The Case Law From Other Jurisdictions on Which the Court of Appeals Relied Does Not Provide Support for the Assignment at Issue.

Some of the foreign decisions on which the Court of Appeals relied did address the same concerns identified by the *Coffey* court – whether such an assignment should be deemed legally ineffective for lack of any damage to the assignor and whether the assignment is inherently collusive in violation of public policy. The particular cases cited by the Court of Appeals differed from *Coffey* in that they upheld the validity of such assignments despite the concerns identified by the *Coffey* court. In order to understand why those cases do not provide sound guidance to this Court, it helps to understand why those courts did not share the concerns of the *Coffey* court to the same degree.

A. The Garcias had no claim to assign because they had suffered no damage.

Other courts have addressed the argument that when an insured agrees to a stipulated judgment with a covenant not to execute on the judgment, the insured has effectively suffered no damage and, as such, has no claim to assign. Some courts have not been persuaded by this argument. They point out that where the assignor has received merely a covenant not to execute – rather than a complete ***release*** -- the assignor still remains legally liable for the stipulated judgment and thus has been damaged. *See, e.g., Stateline Steel Erectors, Inc. v. Shields*, 837 A.2d 285, 288 (N.H. 2003). Other courts disagree, stating that, as a practical matter, the existence of a covenant not to execute means that the assignor will not be exposed to any liability and thus has suffered no damage. *See, e.g, Oregon Mutual Ins. Co. v. Gibson*, 746 P.2d 245 (1987); *Coffey*, 756 S.W.2d at 157 . ("... the entire transaction involving the confession and acceptance of judgment, covenant not to execute and to indemnify, and assignment are not any indication of the actual damage, if any there was, as a result of legal malpractice.") Associated respectfully suggests that the Court should adopt the reasoning of the latter cases and hold the assignment at issue legally ineffective because, as a result of the Garcias' covenant not to execute against the Star, the Star suffered no damage and had no claim to assign to the Garcias.

Ultimately though, on the facts of this case the Court is not required to choose from these two competing lines of reasoning. That is because the former line of cases (on which the Court of Appeals relied) discusses only whether an insured remains legally liable for a judgment after receiving a covenant not to

execute. However, the question of whether an insured is ***liable*** for a judgment will not always determine whether the insured has suffered ***damage*** at the hands of an allegedly negligent insurance agent such that the insured would have a cognizable claim to assign. In a case of professional negligence against an insurance agent, an insured suffers damage not by virtue of becoming liable for a judgment but by virtue of becoming liable for a judgment ***for which an insurer also would have been liable under an insurance policy*** but for the insurance agent's negligence. The absence of a liable insurer is what creates the damage.

The cases cited by the Garcias and relied upon by the Court of Appeals did not discuss this issue, probably because the issue was not implicated by the facts of those cases. In a standard liability insurance policy, the liability of the insured will automatically trigger the liability of the insurer. *See Freeman v. Schmidt Real Estate & Ins., Inc.*, 755 F.2d 135 (8th Cir. 1985) ("under the typical liability insurance policy, an insurer must reimburse the insured only as to amounts which the insured 'shall become legally obligated to pay as damages.'") Thus, in a case involving a standard liability insurance policy, if the court decides that an insured with a covenant not to execute remains liable for a stipulated judgment, the court has no reason to question whether the insured has also suffered damage. The liability of the insured triggers the liability of the insurer. Since the insurer is unavailable due to the alleged negligence of the insurance agent, the insured has suffered cognizable damage giving rise to an assignable claim.

This case is different because of the Star's insurance contract with HIH. The Star agreed to an "indemnity," not a "liability," policy of insurance. Under that policy,

HIH's obligation would not arise until the Star ***actually paid*** the cost of any judgment against it. (TR 427, Insurance Policy, Apx. to Associated's Brief, Ex. 4) ("[HIH] hereby undertakes to pay up to the amount hereby insured ... such sums as [the Star] ... shall have become legally liable to pay ***and shall have paid*** ...") (emphasis supplied.) The Star had no right to insurance coverage unless and until it paid the cost of any judgment against it. Because the Star did not pay the judgment here, its right to indemnification under the policy was never triggered. Because the Star's right to indemnification never arose, the Star cannot claim it was damaged by the absence of an insurer. The Star never suffered cognizable damage giving rise to an assignable claim.

There does not appear to be a case squarely addressing the role of an indemnity policy of insurance in the context of an attempted assignment of a claim of professional negligence against an insurance agent. However, language from the Eighth Circuit's *Freeman* case highlights the significance of this issue. In *Freeman*, the Eighth Circuit examined whether Iowa would allow an assignment of claims against an insurance agent and insurance company in exchange for a stipulated judgment and covenant not to execute. 755 F.2d 135 (8th Cir. 1985). The court addressed the familiar issue of whether, in such circumstances, the assignor/insured has suffered damage such that he or she has a cognizable claim to assign. The court held (as in *Coffey*) that, as a "practical" matter, an "insured protected by a covenant not to execute has no compelling obligation to pay" and thus "will have suffered no damages." *Id.* at 138. Thus the claim is not assignable.[1]

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[1] The Iowa Supreme Court later held that Iowa would decide this particular issue differently in the context of a liability policy. *Red Giant Oil Co. v. Lawlor*, 528 N.W.2d 524 (Iowa 1995). Nothing

In analyzing this issue, the Eighth Circuit included an important brief reference – absent from other cases on this issue – to the differences in "liability" and "indemnity" policies and their different respective effects on whether an attempted assignment in these circumstances is effective.

> [U]nder the typical liability insurance policy, an insurer must reimburse the insured only as to amounts which the insured "shall become legally obligated to pay as damages." A covenant not to execute, some courts hold, is merely a contract, and not a release, such that the underlying tort liability remains and a breach of contract action lies if the injured party seeks to collect his judgment. Thus, the tortfeasor is still "legally obligated" to the injured party, and the insurer still must make good on its contractual promise to pay. An uninsured party would then be injured by the agent's negligence in failing to procure a policy because he would have the outstanding "liability" against which he sought to insure.[FN2]
>
> FN2. ***Liability*** **insurance, which is the most common form of automobile insurance and is apparently what [the insured] sought here, is to be distinguished from** ***indemnity*** **insurance, under which the insurer has no duty to reimburse until the insured has actually** ***paid out*** **money, rather than just when the insured becomes "obligated" to pay.**

Id. (italics in original; bold added) (internal citations omitted). This brief discussion strongly suggests that an attempted assignment of a claim of professional negligence against an insurance agent, in which the underlying insurance contract is an indemnity policy, would not be effective unless and until the insured actual ***paid out*** the cost of any judgment or settlement against it. Until the insured has actually

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in that subsequent decision, however, in any way diminishes the force or relevance of the *Freeman* court's brief discussion, cited *infra*, of the role of different types of insurance policies on this issue. *Freeman* involved a liability policy. The *Red Giant* case indicated that it would arrive at a different holding with respect to such a policy. The *Red Giant* holding does not attempt to suggest, nor could it credibly do so, that such an assignment would be effective in a case involving an indemnity policy such as the Star had with him.

paid the judgment out of pocket, he cannot claim to have been "damaged" or "injured."

Such is the case here. The Star had no expectation of or right to insurance coverage until it first paid out the cost of any judgment against it. Regardless of whether the Star technically remained ***liable*** to the Garcias after it received the covenant not to execute, the Star suffered no ***damage*** for purposes of its alleged professional negligence claim because it cannot complain about the lack of any available insurer. Under its indemnity contract of insurance, the Star had no right to coverage until it paid the judgment. This case is plainly distinguishable on its facts from the authorities relied upon by the Court of Appeals and the Garcias.

B. The collusive circumstances of the assignment render it void as against public policy.

As did the *Coffey* court, most other courts analyzing the assignability of a claim in these circumstances acknowledge the possibility of collusion between the assignor and the assignee. Not all of these courts have concluded, however, that the possibility of collusion in such assignments is sufficient to render them void as a matter of law. The reasoning of these decisions from foreign jurisdictions is unsound.

Courts upholding such assignments despite their potentially collusive nature have suggested that such assignments are "analogous" to assignments by insureds of claims against insurers (such as bad faith). *See Campione v. Wilson*, 661 N.E.2d 658, 661 (Mass. 1996). Similarly, the Court of Appeals in this case referred to the assignment in this context as merely an "obvious variation" on the recognized

practice of assigning bad faith claims against insurers. (Court of Appeals Opinion, p. 4.)

With all due respect to the Court of Appeals, however, the justifications for permitting an assignment such as the one at issue are far from "obvious," and the assignment of a claim against an ***insurance agent*** is not "analogous" to the assignment of a bad faith claim against an ***insurer***. There are special policy reasons that justify upholding assignments of claims against insurers in such circumstances, despite the possibility of collusion. See *Ayers v. C&D General Contractors*, 269 F.Supp.2d 911, 915-916 (W.D. Ky. 2003) (noting that courts have upheld such assignments on the grounds that when an insurer refuses to provide a defense, it runs the risk of incurring whatever judgment results, even if such a judgment results from a potentially collusive settlement).

No such policy reasons exist here. Neither the Court of Appeals nor the Garcias have identified policy reasons that would justify recognizing this broad new class of assignments, particularly where the circumstances under which they occur are fraught with the possibility for collusion.

III. The Garcias Fail to Even Address the Argument that Court of Appeals Erred by Invalidating a Portion of the Agreement Without Invalidating the Whole.

In its principal brief, Associated demonstrated that, having invalidated the arbitration component of the Agreement between the Star and the Garcias, the Court of Appeals should have voided the entire Agreement, including the purported assignment of claims. (Associated's Brief, p. 17-19.) The Garcias wholly fail to rebut this argument in their brief, although the argument provides a clear,

independent basis on which this Court should reverse the Court of Appeals and affirm the trial court's order granting summary judgment to Associated and AON.

IV. The Garcias' Miscellaneous Other Arguments Are Unavailing.

The Garcias remark that "[d]iscovery in this case has clearly demonstrated that both Associated and AON were negligent in placing the Star's insurance coverage with HIH Insurance." First, the merits of the Garcias' purported claim against Associated is not at issue. This appeal deals with whether the Garcias even have a right to pursue such a claim, not whether the claim has merit. Moreover, no discovery in the trial court proceedings supports the claim. The Garcias' theory of negligence is that Associated should have known in 1997 that HIH, an extremely large and well-established insurance provider, would become insolvent four years later. There can be no evidence to support such a far-fetched theory.

The Garcias also repeatedly suggest that Associated and AON have somehow questioned the integrity of the arbitrator, former Jefferson Circuit Court Judge Ken Corey, and have accused him of engaging in collusion. (Garcia Brief, pp. 25, 30.) No one has made any such suggestion. Associated has merely suggested, as the Kentucky Court of Appeals indicated in *Coffey*, that an assignment coupled with an admission of liability and a stipulated judgment (or, in this case, a stipulated range of damages and an arbitration proceeding) lends itself to collusion among the ***parties***. No one has impugned the integrity of the arbitrator.

The Garcias note that they chose to attempt to sue Associated and AON rather than the Star because they "were not desirous of putting the Star of Louisville out of business." (*Id.* at 35.) That is no basis to allow an assignment of a claim that

is otherwise non-assignable. Plaintiffs (the Garcias) have a right to be compensated by the person or entity (the Star) that purportedly caused their injuries, not by any other person or entity, such as Associated, with whom the Plaintiffs had no relationship and who caused no damage to the Plaintiffs. Moreover, there has been no indication that the Star of Louisville would have been unable to pay the cost of a judgment obtained by the Garcias.

The Garcias also state that "it should be noted that these proceedings are not an attempt to enforce an award against a necessary party to an arbitration proceeding ... [T]he arbitrator was not called upon to resolve any issue between the Star of Louisville and its agent (Associated) and Broker (AON)." These statements are disingenuous. The obvious purpose of the arbitration Agreement between the Garcias and the Star was to fix a sum of money (which they pleaded precisely in their complaint) that the Garcias would then seek to obtain from Associated and/or AON. This case is for all practical purposes an attempt to enforce an arbitration award against non-parties.

CONCLUSION

The Court should reverse the Court of Appeals and affirm the trial court's order granting summary judgment to Associated and to AON.

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