COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2012-SC-317-D

JAMES D. NICHOLS — APPELLANT

v. On Discretionary Review from the Kentucky Court of Appeals
Case No. 2010-CA-1393-MR

Appeal from Jefferson Circuit Court
Honorable Irvin G. Maze, Presiding
Case No. 05-CI-8961

ZURICH AMERICAN INSURANCE COMPANY — APPELLEE

BRIEF ON BEHALF OF APPELLANT JAMES D. NICHOLS

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CERTIFICATE OF SERVICE

I hereby certify that on this 11th day of February, 2013, ten (10) originals of this brief were served via Federal Express upon Hon. Susan Stokley Clary, Clerk of the Supreme Court, Room 209, 700 Capital Ave., Frankfort, KY 40601 with one (1) copy served by regular mail on the following: Robert E. Stopher, Robert D. Bobrow, Boehl Stopher & Graves, LLP, Aegon Center, Suite 2300, 400 W. Market St., Louisville, KY 40202; Hon. Angela Bisig, Judge, Jefferson Circuit Court, Division Ten, 700 W. Jefferson St., Louisville, KY 40202; and Sam Givens, Clerk, Kentucky Court of Appeals, 360 Democrat Dr., Frankfort, KY 40601.

KEVIN C. BURKE

INTRODUCTION

The defense of mutual mistake does not retroactively annul underinsured motorist (UIM) coverage and deny automobile accident victims UIM benefits where:

- There is no clear and convincing evidence of mistake by the insurer;
- The insurer raises the affirmative defense only after discovery and dispositive motion; and
- Statutes regulating insurance prohibit its application.

The Court of Appeals erred in affirming summary judgment in favor of Zurich American Insurance Company, and this Court should therefore reverse and remand.

STATEMENT CONCERNING ORAL ARGUMENT

Pursuant to CR 76.12(4)(c)(ii) of the Kentucky Rules of Civil Procedure, Appellant, James Nichols, requests the opportunity to present oral argument. The issues can be explained and the error of the Court of Appeals demonstrated if Mr. Nichols is allowed the opportunity to present oral argument.

STATEMENT OF POINTS AND AUTHORITIES

Exhibit 4:	Zurich correspondence dated December 2, 2003; November 2, 2004; and February 3, 2005
Exhibit 5:	Rejection forms sent June 20, 2002
Exhibit 6:	Order denying summary judgment (entered: 11/28/2006)
Exhibit 7:	Order granting summary judgment to Zurich, and denying Nichols' motion for partial summary judgment on the issue of coverage (entered: 3/11/2010)
Exhibit 8:	Order denying Nichols motion to vacate (entered: 6/29/2010)
Exhibit 9:	Common Policy Change Endorsement

STATEMENT OF THE CASE

SUMMARY

This case involves the defense of mutual mistake. Specifically, does an alleged "mutual mistake" retroactively annul underinsured motorist (UIM) benefits otherwise due a third-party insured accident victim?

Here, Appellee Zurich—*the party who claims to have been "mistaken" from the outset of this case*—raised mutual mistake for the first time four years into this litigation but failed to offer any evidence that it was mistaken. The Court of Appeals affirmed summary judgment and invalidated UIM coverage based on mutual mistake—despite lack of proof, untimeliness, and statutes designed to prevent such a result.[1] The Court of Appeals denied a timely petition for rehearing.[2] This Court accepted discretionary review.

THE ACCIDENT AND INSURANCE COVERAGE (2002-2005)

On June 4, 2002, James Nichols suffered serious injuries in an automobile wreck in Jefferson County, Kentucky. At the time of the accident, he was driving a truck for his employer, Miller Pipeline. Nichols received workers compensation benefits and asserted a liability claim against the at-fault driver's liability insurer, Direct General.[3]

Nichols also asserted a UIM claim against Miller Pipeline's commercial carrier, Zurich American Insurance Company (Zurich).[4] Nichols was an "insured" under two

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[1] Exhibit 1: Court of Appeals Opinion.
[2] Exhibit 2: Order denying petition for rehearing.
[3] R. at 1.
[4] *Id.*

policy endorsements of a 2002-2003 Zurich commercial fleet policy.[5] The first was a state-specific Kentucky UIM endorsement with limits of $1,000,000 (Endorsement CA 21 79). Alternatively, Nichols could recover under an "Uninsured Motorist" endorsement, applicable in every state, which by its terms combined UIM with UM benefits in the same amount (Endorsement CA 21 17).[6] Nichols had secondary UIM coverage, excess over Zurich's limits, in the amount of $25,000 through Founders Insurance.[7]

On September 13, 2003, the at-fault driver's insurer, Direct General, tendered its $25,000 liability limits.[8] Given the UIM limits in the Zurich Policy, Nichols agreed to accept the liability proceeds and sent the appropriate notice to Zurich pursuant to KRS 304.39-320(3) and *Coots v. Allstate Ins. Co.*, 853 S.W.2d 895 (Ky. 1993).[9] The *Coots* procedure operated to release the at-fault driver of further liability. *See True v. Raines*, 99 S.W.3d 439 (Ky. 2003). At about the same time, Zurich offered to resolve its workers compensation lien if Nichols agreed to reimburse Zurich one-third ($8,333.33) of the liability proceeds.[10] Given the generous UIM limits under Zurich's commercial fleet policy, Nichols agreed.

On February 3, 2005—more than a year after Nichols released the at-fault driver and satisfied the workers compensation lien—Zurich notified Nichols that "Miller

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[5] Exhibit 3: Zurich Policy BAP 3473032-00 declarations sheet and relevant policy endorsements for policy period April 1, 2002 through April 1, 2003.
[6] *Id.*
[7] R. at 1
[8] *Id.*
[9] *Id.*
[10] Zurich was also Miller Pipeline's workers compensation carrier. See Exhibit 4: Zurich Correspondence of December 2, 2003, November 2, 2004, and February 3, 2005 (incorrectly dated "November 2, 2004").

Pipeline rejected the [UIM] coverage both in the states of Kentucky and Indiana, as well as in the majority of other states where they conduct business."[11] The Zurich claims adjuster noted: "I apologize for having to bring this to your attention now." Zurich denied Nichols' UIM claim.

THE CIRCUIT COURT PROCEEDINGS (2005-2010)

Nichols filed suit in Jefferson Circuit Court.[12] Zurich filed its answer, claiming Zurich *timely cancelled* UIM coverage before the accident.[13] Importantly, in its responsive pleading, Zurich did not allege *mutual mistake* as an affirmative defense as required by CR 8.03, or identify any mistake with particularity as required by CR 9.02.

On August 11, 2006, Zurich filed a motion for summary judgment alleging timely cancellation of UIM coverage before the accident.[14] Although Zurich produced a "Common Policy Change Endorsement" form that provided written notice that the policy had been amended to cancel the coverage, it was unclear *when* the change was made.[15] Indeed, other documents showed that the forms for rejecting UM/UIM coverage were not signed and mailed out until June 20, 2002 – *sixteen days after the accident.*[16] Again, Zurich did not amend its answer to assert mutual mistake as an affirmative defense or identify, with particularity, any mistake that might invalidate coverage.

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[11] See Exhibit 4. Although dated November 2, 2004, a fax header confirms that this letter was actually sent on February 3, 2005. Zurich sent a letter on November 2, 2004 - but it requested further documentation of Nichols' injuries to evaluate his UIM claim for "some type of settlement, prior to year end."

[12] R. at 1. Nichols also filed suit against the secondary UIM insurer, Founders Insurance. Founders joined Nichols in all arguments regarding the Zurich policy.

[13] R. at 23.

[14] R. at 196.

[15] *Id.*

[16] Exhibit 5: Rejection forms sent June 20, 2002.

On November 28, 2006, the Jefferson Circuit Court issued an order denying Zurich's motion for summary judgment.[17] The Court found that it could not conclusively determine "when the alleged cancellation of the underinsured benefits occurred." The Court went on to observe, pursuant to KRS 304.20-030: "*Clearly, cancellation after the time of the accident would not void the policy as to Plaintiff's claim.*" (Emphasis added).

The parties conducted discovery on the cancellation issue as directed by the circuit court. In response to Requests for Admissions propounded by Nichols, Zurich states as follows:

> "***Zurich American, by counsel, admits that, at one time, the subject policy included a schedule of forms and endorsements reflecting uninsured and underinsured motorists coverage in various states, including Kentucky***. However, Miller Pipeline Corporation, by and through its risk manager, rejected uninsured and underinsured motorists coverage in writing in various states, including Kentucky. Zurich American issued Endorsement Number 002, ***amending the policy and cancelling*** uninsured and underinsured motorists coverage in various states, including Kentucky, effective April 1, 2002. To the extent, if at all, the plaintiff requests any further admission, the request is denied at this time."[18]

However, Zurich failed to respond to interrogatories requesting the date its commercial fleet policy was issued with combined UM and UIM coverage, the date the coverage was rejected, and the date the endorsement was issued purportedly "cancelling" coverage. In response to Nichols' motion to compel, Zurich represented to the Court that it was no longer in possession of, and did not have access to, documentation responsive to the requested information—but that employees of the insured, Miller Pipeline, and Miller's insurance broker-agent, M.J. Insurance (M.J.), had various relevant records that would be responsive. On February 2, 2009, the Court entered an order compelling Zurich

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[17] Exhibit 6: Order denying summary judgment (11/28/06).
[18] R. at 297.

to complete all discovery with the insurance representatives within ninety days and for the parties to "submit an agreed order regarding the deposition which needs to be taken."[19] Two depositions were then taken on June 11, 2009: one of Jeanne Fuqua, Miller Pipeline's risk manager, and the other of Kathy Kebo, a former employee of Miller Pipeline's insurance broker, M.J.

Since its primary place of business is in Indianapolis, Indiana, Miller Pipeline chose M.J., an Indiana insurance broker-agent, to help Miller Pipeline find commercial insurance. In 2002, Kebo was a licensed insurance "producer" for M.J. and obtained commercial auto insurance for Miller Pipeline through Zurich. Prior to 2002, other broker-agents obtained insurance for Miller Pipeline—but never from Zurich.[20] Importantly, as a licensed insurance "producer", Kebo could only act as an agent for her "client," Miller Pipeline.[21] Kebo was prohibited by Indiana law from acting as an agent for Zurich or any other insurance carrier.[22]

When her deposition was taken in 2009, Kebo was no longer employed by M.J. and had no knowledge of what, if any, information was communicated between M.J. and Zurich.[23] Kebo did not negotiate any coverage terms with Zurich.[24] In fact, ***Kebo never***

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[19] R. at 359.
[20] Fuqua confirmed that in 2001-2002 AON was Miller Pipeline's broker-agent and obtained commercial coverage through AIG Insurance. The 2002-2003 policy year was the first year commercial coverage was provided by Zurich. Fuqua depo., pp. 11, 14.
[21] Kebo refers to Miller Pipeline as M.J.'s "client" throughout her deposition.
[22] "Producers" are specifically defined by Indiana statute as "a person required to be licensed under the laws of Indiana to sell, solicit, or negotiate insurance." IC 27-1-15.6-2(7). In this capacity, *Ms. Kebo was expressly prohibited by Indiana law to act as Zurich's agent.* IC 27-1-15.6-14.
[23] Kebo depo., pp. 6, 74, 91-92.
[24] Kebo depo., p. 92.

communicated with Zurich about Miller Pipeline's coverage. As stated in her deposition:

> Q: Have you ever had any conversations with anyone from Zurich regarding the coverage for Miller Pipeline for 2002-2003 with regard to this particular claim? Did anyone from Zurich ever talk to you?
>
> A: No, sir.[25]

Fuqua, for her part, confirmed in her 2009 deposition that she "signed [the rejection forms] and sent them back to M.J. [not Zurich] ***on June 20th, '02***."[26] A "post-it" note on the rejection form, initialed "JMF" (Jeanne M. Fuqua), confirms that Miller Pipeline sent the rejection to M.J. on or after June 20, 2002 — at least 16 days after the accident— even though Fuqua admitted to back dating the forms.[27] ***Like Kebo, Fuqua had no dealings with Zurich regarding the coverage provided to Miller Pipeline***. She only dealt with Kebo and M.J.:

> Q: Now did you have any particular dealings with Zurich American Insurance Company regarding canceling or deleting that underinsured motorists coverage, or did you rely on M.J. to do that?
>
> A: I did not have any dealings directly with Zurich. All of my dealings and communications were with M.J. Insurance.[28]

Not surprisingly, given the lack of communication with Zurich, ***neither Kebo nor Fuqua could say what Zurich knew before the accident***—specifically whether Zurich

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[25] Kebo depo., p. 91.
[26] Fuqua depo., p. 64(Emphasis added); see also Fuqua depo., p. 70. see also Exhibit 7: Rejection forms.
[27] Fuqua depo., p. 70; see also Exhibit 5: Rejection forms.
[28] Fuqua depo., pp. 18-19. See also Fuqua depo., pp. 52, 67.

knew Miller Pipeline did not want UIM coverage before the accident. Zurich failed to submit any proof on this issue.[29]

On May 20, 2009 and June 18, 2009, Nichols filed two separate motions for sanctions due to Zurich's refusal to provide discovery.[30] Nichols also filed a motion for partial summary judgment, alleging that Zurich's UIM coverage was valid and in force on the date of the accident because it was not timely cancelled according to the testimony of Fuqua and Kebo.[31] Moreover, while the "Common Policy Change Endorsement" lists no amendment date cancelling UM and UIM coverage, it specifically states that the amendment is based on Miller Pipeline's ***rejection of the coverage***, which only occurred ***after Nichols' accident***.[32]

On July 27, 2009, Zurich filed a renewed motion for summary judgment claiming, for the first time, that the policy should be "reformed" to invalidate UIM coverage based on "mutual mistake."[33] Nichols objected on several grounds, including Zurich's failure to plead mutual mistake.[34] Zurich then filed a motion to amend its answer to plead mutual mistake in compliance with CR 8.03 and CR 9.02. To satisfy CR 9.02's mandate that the "circumstances constituting mistake shall be stated with particularity" Zurich simply "incorporate[d] by reference its summary-judgment memoranda."[35] The circuit court granted Zurich's motion.[36]

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[29] Indeed, Zurich failed to comply with a discovery order to produce its business records.
[30] R. at 360; R. at 366.
[31] R. at 433.
[32] See Exhibit 9.
[33] R. at 530.
[34] R. at 571; see also R. at 559.
[35] R. at 266.
[36] *Id.*

On March 11, 2010, after a change in judges, the Jefferson Circuit Court granted Zurich's motion for summary judgment and denied Nichols' pending motions.[37] The Court found that the deposition testimony of Fuqua and Kebo – taken pursuant to an order compelling discovery on the issue of cancellation – instead proved mutual mistake. Of course, Nichols never had notice of mutual mistake as an affirmative defense before the Fuqua and Kebo depositions—and Nichols never received necessary document discovery from Zurich in any event. But, most importantly, Zurich failed to produce any evidence showing that Zurich inadvertently included the UM and UIM coverage ***after*** Zurich was advised to exclude it.

Because Founders Insurance remained a defendant for excess UIM coverage, over Zurich's $1,000,000 policy, the order granting summary judgment in favor of Zurich was made "final and appealable with no just cause for delay" pursuant to CR 54.02(1). Nichols then filed a motion to amend the complaint to allege violations of the Unfair Claims Settlement Practices Act given Zurich's deceptive claims practices and the now-obvious prejudice to Nichols.[38] Nichols also filed a timely CR 59.05 motion.[39] The circuit court denied both motions and, again, included the CR 54.02(1) dual recitation.[40]

THE APPEAL (2010-PRESENT)

Nichols appealed.[41] On November 18, 2011, the Court of Appeals affirmed. In addressing the issue of mutual mistake, the Court relied solely on *Campbellsville Lumber Co. v. Winfrey*, 303 S.W.2d 284 (Ky. 1957)—a case that did not involve insurance

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[37] Exhibit 7: Order granting summary judgment for Zurich; denying Nichols' motion for partial summary judgment on the coverage issue. (3/11/2010).
[38] R. at 759.
[39] R. at 721.
[40] Exhibit 8: Order denying motion to vacate (6/29/2010).
[41] R. at 869.

coverage, and a case where the High Court actually found *insufficient* evidence of mutual mistake despite some evidence of mistake by both parties to the contract.[42] The Court of Appeals did not cite to any proof in the record of Zurich's alleged mistake (because there is no proof Zurich included the UM and UIM coverage after being advised to exclude it), a fact that makes this case substantially weaker from an evidentiary standpoint than even *Campbellsville Lumber*. The Court of Appeals also affirmed the order denying Nichols' motion to amend the complaint to allege unfair claims practices against Zurich.

The Court of Appeals did not consider other arguments raised by Nichols: (1) whether mutual mistake was inappropriate in light of statutes regulating insurance; (2) whether Zurich improperly raised issue of mutual mistake so late in the case and after discovery; and (3) whether Nichols was entitled to partial summary judgment on the coverage issue.

Nichols filed a timely petition for rehearing. The Court of Appeals denied the petition for rehearing on April 25, 2012.[43] Nichols then filed a motion for discretionary review. This Court granted the motion on December 12, 2012.

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[42] Exhibit 1: Opinion of the Court of Appeals. On page 5 of the Opinion states that "[t]he written instrument to which Nichols cites as indicating that UIM coverage existed is actually the *proposed* policy that was presented to Miller by M.J. in March of 2002)." (Emphasis added). This is not accurate. The policy referred to is the *actual* policy. Indeed, Zurich attached a full copy of the same policy to its brief. In any event, to the extent any confusion remains, Zurich conceded: "We admit that BAP 3473032-00 [the commercial policy issued to Miller Pipeline for policy period 4/1/02 to 4/1/03], as originally issued, unambiguously showed that Miller Pipeline had UIM coverage in Kentucky." R. at 681: Zurich Reply.

[43] Exhibit 2: Order denying petition for rehearing.

ARGUMENT

I. Mutual mistake requires clear and convincing evidence—and there is no proof Zurich mistakenly issued UIM coverage.[44]

"A mutual mistake is one in which ***both parties*** participate by each laboring under the same misconception." *Kane v. Hopkins*, 309 Ky. 488, 218 S.W.2d 37, 39 (1949) (internal citations omitted; emphasis added). Evidence of a unilateral mistake will not suffice unless there is fraud. *Id.*[45] Moreover, evidence of mutual mistake must be shown by clear and convincing evidence. *Abney v. Nationwide Mut. Ins. Co.*, 215 S.W.3d 699, 704 (Ky. 2006). Clear and convincing evidence means evidence more persuasive than a mere preponderance, but proof which need not rise to the level of beyond a reasonable doubt. *Fitch v. Burns*, 782 S.W.2d 618 (Ky. 1989).

The Court of Appeals relied on *Campbellsville Lumber Co. v. Winfrey*, 303 S.W.2d 284 (Ky. 1957). In *Campbellsville Lumber Co.*, the High Court described the nature of proof necessary for mutual mistake:

> In the first place, it must show the mistake to be mutual, not unilateral....The mutual mistake must be proven beyond a reasonable controversy by *clear and convincing evidence*....In addition, it must be shown that the parties had actually agreed upon terms different from those expressed in the written instrument.

Id. at 286 (emphasis in the original). In *Campbellsville Lumber Co.*, the Court found some evidence of mutual mistake by the parties, mostly circumstantial, but could not conclude that the evidence was "substantial." *Id.* The Court further noted that it was "far

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[44] This issue was addressed by Appellant in his response to Zurich's motion for summary judgment in the circuit court (R. at 657), in his briefs in the Court of Appeals, and in his motion for discretionary review.

[45] Zurich has not alleged fraud.

from being convinced," given the "character of the evidence," that both parties mutually agreed on something different from the written agreement. *Id.*

Although citing *Campbellsville Lumber Co.*, the Court of Appeals, and the circuit court before that, ***failed to identify any proof that Zurich knew Miller Pipeline did not want UIM coverage and Zurich mistakenly included it anyway***. According to the proof, it may have been the intention of the policy purchaser, Miller Pipeline, and its broker-agent, M.J., not to have the coverage.[46] But there is no proof that the *other* party to the contract—the insurer, Zurich—issued UIM coverage knowing Miller Pipeline did not want it. Indeed, the 2002-2003 commercial fleet policy was the first policy Zurich had ever issued to Miller Pipeline. The proof conclusively shows that there was ***no communication to Zurich*** by Miller Pipeline (through Jeanne Fuqua) or M.J. Insurance (through Kathy Kebo) declining UIM coverage before the June 4, 2002 accident.

When her deposition was taken in 2009, Kebo was no longer employed by M.J. and had no knowledge of what, if any, information was communicated between M.J. and Zurich.[47] Kebo did not negotiate any coverage terms with Zurich.[48] Kebo in fact did not communicate with Zurich about Miller Pipeline's coverage.[49]

Fuqua, for her part, confirmed in her 2009 deposition that she only "signed [the rejection forms] and sent them back to M.J. [not Zurich] ***on June 20th, '02***."[50] A "post-it" note on the rejection form, initialed "JMF" (Jeanne M. Fuqua), confirms that Miller

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[46] Fuqua was a representative of Miller Pipeline; and Kebo was a "producer" for Miller Pipeline's insurance agent/broker, M.J. Insurance.
[47] Kebo depo., pp. 6, 74, 91-92.
[48] Kebo depo., p. 92
[49] Fuqua depo., pp. 18-19. See also Fuqua depo. pp. 52, 67.
[50] Fuqua depo., p. 64(Emphasis added); see also Fuqua depo., p. 70. See also Exhibit 7: Rejection forms.

Pipeline sent the rejection to M.J. on or after June 20, 2002 — at least 16 days after the accident— even though Fuqua admitted to back dating the forms.[51] Like Kebo, Fuqua never had any dealings with Zurich regarding the coverage. She only dealt with Kebo and her insurance agent, M.J. Insurance.[52]

Not surprisingly, given the lack of communication with Zurich, neither Kebo nor Fuqua could say what Zurich knew regarding the changes in coverage that Miller Pipeline wanted —specifically, whether Zurich knew that Miller Pipeline did not want UIM coverage—or that they knew it at any time before Mr. Nichols' claim had already accrued. Zurich failed to submit any proof on this issue.[53]

Furthermore, there is no evidence M.J. somehow acted as Zurich's agent. In 2002, Miller Pipeline's primary place of business was in Indianapolis, Indiana. Miller Pipeline hired M.J., an Indiana insurance broker-agent, to help Miller Pipeline find commercial insurance for their fleet of nearly 1000 vehicles located throughout a dozen states. Importantly, as a licensed insurance "producer," Kebo could only act as agent for her "client," Miller Pipeline.[54] Indiana law expressly prohibited Kebo from acting as an agent for Zurich or any other insurance carrier.[55] Given the relationship between Miller Pipeline and M.J. on the one hand, and Zurich on the other, the following diagram visually represents the proof in this case:

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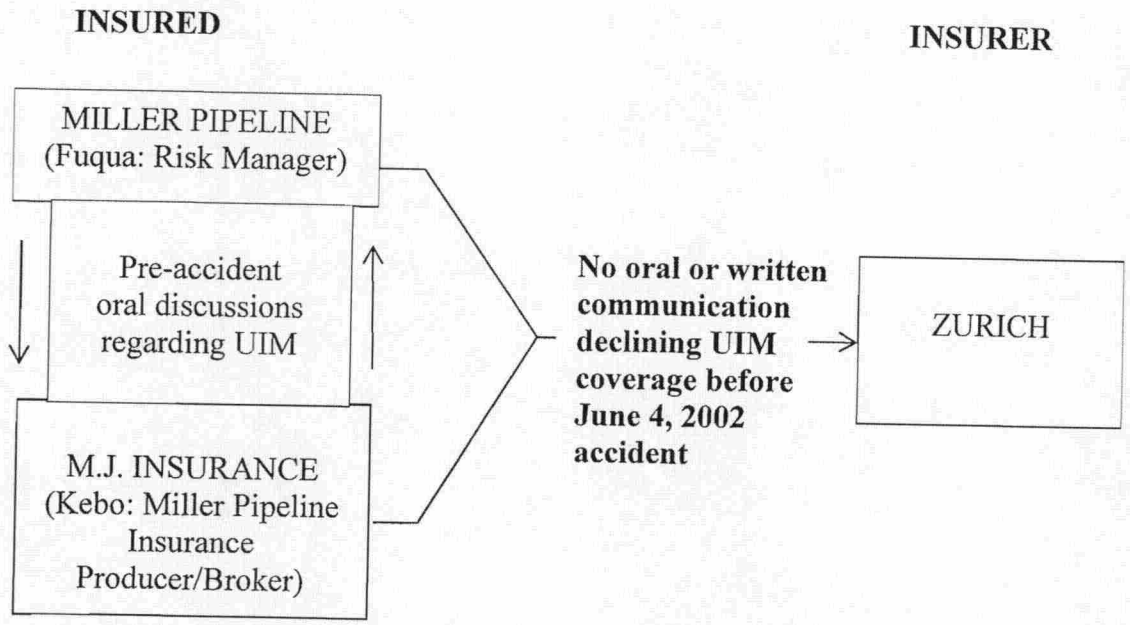
[51] Fuqua depo., p. 70; see also Exhibit 5: Rejection forms.
[52] Fuqua depo., pp. 18-19. See also Fuqua depo., pp. 52, 67.
[53] Indeed, Zurich failed to comply with a discovery order to produce its business records.
[54] Kebo refers to Miller Pipeline as M.J.'s "client" throughout her deposition.
[55] "Producers" are specifically defined by Indiana statute as "a person required to be licensed under the laws of Indiana to sell, solicit, or negotiate insurance." IC 27-1-15.6-2(7). *Ms. Kebo was expressly prohibited by Indiana law to act as Zurich's agent.* IC 27-1-15.6-14.



There is simply no proof that Zurich "mistakenly" issued UIM coverage, because there is no proof Zurich knew Miller Pipeline did not want UIM coverage before the accident.

Even assuming M.J. could be considered a dual agent of Miller Pipeline and Zurich—and there is no evidence of dual agency in this case—that is still insufficient to establish a mistake by Zurich. In *Investors Heritage Life Insurance Co. v. Farmers Bank,* 749 S.W.2d 688 (Ky. App.1987), an insurance policy was procured to protect a loan taken out by the insured, Mr. Shafer, who died prior to paying off the loan. The Bank and the insurance company were principals and the Bank's employees acted as dual agents for the Bank (in procuring the loan) and for Investors Heritage (in procuring insurance). The Bank argued that its employee did not fully insure the loan because the employee mistakenly stated on the loan application that it was for a monthly reducing loan. The co-signers testified that they signed the loan because the Bank assured them the loan was

insured. The Kentucky Court of Appeals found that the Bank's mistake in obtaining the wrong coverage was unilateral because Investors Heritage merely "issued the policy ordered and paid for" by the insured. *Id.* at 689-90. The Court noted the "general rule that one principal is not liable to the other for the acts of their dual agents" and that "[t]he Bank was the only one able to protect itself under these circumstances." *Id.* Accordingly, the dual agency role of the Bank employees did not convert a unilateral mistake by the Bank into a mutual mistake by both the Bank and Investors Heritage sufficient to change the terms of the insurance coverage.

Likewise, in the present case, Zurich issued the policy ordered and paid for. Zurich had never insured Miller Pipeline. Before 2002, Zurich had no knowledge whether Miller Pipeline wished to deviate from commercial coverage routinely provided for similar companies with a fleet of nearly 1000 vehicles. Furthermore, these vehicles were located throughout a dozen states, each with various legal requirements for coverage. Therefore, Zurich provided broad coverage and charged a premium based primarily on the number of vehicles insured. Zurich automatically included UM and UIM coverage. Indeed, the evidence in this case shows that ***Zurich refunded no portion of the premium charged to Miller Pipeline—even after cancellation of UM and UIM coverage.***[56]

Neither Miller Pipeline nor M.J. informed Zurich that Miller Pipeline did not want UIM coverage—at least not before the June 4, 2002 accident. Accordingly, any mistake in this case was unilateral, not mutual, given Miller Pipeline's failure to inform Zurich

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[56] Exhibit 9: Common Policy Change Endorsement, which notes that policy premiums were unchanged by the UM/UIM rejection. Although the "effective date" of this document is listed as April 1, 2002, the proof of record reveals the rejection was not sent until at least June 2002. Compare Fuqua deposition, verifying that rejection forms were not sent until June 20, 2002, and Exhibit 7: Rejection forms (handwritten notation). See also Fuqua depo, p. 58 (confirming no change in premium).

that Miller Pipeline wanted to deviate from routine coverage. The Court of Appeals erred in affirming summary judgment in favor of Zurich based on mutual mistake. If the lower courts' rulings stand, it would dramatically lessen the evidentiary burden of a party alleging mutual mistake. Indeed, it would effectively blur the line between unilateral and mutual mistake.

II. Zurich waived the defense of mutual mistake by failing to plead affirmatively and with particularity.[57]

Assuming Zurich mistakenly issued UIM coverage in 2002, before the accident, with knowledge of Miller Pipeline's wishes—why did Zurich not plead mutual mistake as an affirmative defense in its first responsive pleading?

Zurich filed its answer in 2005 and claimed that UIM coverage was "cancelled" before the accident.[58] In 2005, Zurich failed to allege *mutual mistake* as an affirmative defense as required by CR 8.03, or state the grounds for mistake with particularity as required by CR 9.02. Zurich also failed to suggest there had been a mutual mistake when they filed their first motion for summary judgment in 2006. Zurich again failed to mention that inclusion of UIM coverage was a mistake even after Zurich's defense counsel spoke with Fuqua about this case ***the year before her deposition***.[59] Zurich waited to allege mutual mistake for the first time ***after the depositions of Fuqua and Kebo***—depositions taken because Zurich's counsel represented to both Nichols and the circuit court that Fuqua and Kebo had custody of "various relevant records"[60] showing (1) the

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[57] This issue was addressed by Appellant in his response to Zurich's motion for summary judgment in the circuit court (R. at 657), in his briefs in the Court of Appeals, and in his motion for discretionary review.
[58] R. at 23.
[59] Fuqua depo., p. 68.
[60] Records which, conveniently, Zurich claimed it did not have.

date the commercial fleet policy was issued with combined UM and UIM coverage, (2) the date the coverage was rejected in writing by Miller Pipeline, and (3) the date the "Common Policy Change Endorsement" cancelled UIM coverage.

CR 8.03 states: "[i]n pleading to a preceding pleading, a party *shall* set forth affirmatively...[any] matter constituting an avoidance or affirmative defense." (Emphasis added). If any of the affirmative defenses are to be raised, a defendant must allege them in the first defensive move, either by motion or responsive pleading. *See Independent Order of Foresters v. Chauvin*, 175 S.W.3d 610 (Ky. 2005); *Old Line Life Ins. Co. of America v. Garcia*, 418 F.3d 546 (6th Cir. 2005). It is well-established that failure to raise an affirmative defense in a responsive pleading constitutes waiver thereof. *See, e.g., Vogler v. Salem Primitive Baptist Church,* 415 S.W.2d 72 (Ky.1967). The defense of mutual mistake is a contractual "avoidance" under CR 8.03 which must be affirmatively pled. Moreover, CR 9.02 expressly requires that the circumstances for an averment of mistake "shall be stated with particularity." This rule is also mandatory. *See Dulworth v. Hyman*, 246 S.W.2d 993 (Ky. 1952).

Zurich first gave notice of its mutual mistake defense *four years into the litigation*—in 2009—after discovery was concluded on the coverage issue, and after Zurich filed a second motion for summary judgment based on a defense that had not yet been properly pled, all in plain violation of the pleading requirements of CR 8.03 and CR 9.02. Zurich moved to amend its answer to plead mutual mistake only after filing its second summary judgment motion, and then simply incorporated by reference arguments in its second motion for summary judgment to comply with the pleading requirements.

However, the "particularity" pleading requirements of CR 9.02 are not satisfied by simply referring to summary judgment arguments after the close of proof.

Pleading an affirmative defense like mutual mistake with particularity is not a mere technicality. The purpose is to put the adverse party on notice for the purpose of discovery. *Smith v. Sushka*, 117 F.3d 965, 969 (6th Cir. 1997). Here, Nichols had no notice of Zurich's mutual mistake defense before the Fuqua and Kebo depositions. Those depositions were taken because the circuit court compelled Zurich to produce evidence *when* the UIM coverage had been *cancelled* – not for any other reason. Nichols was prejudiced because he did not receive required notice. Notice would have allowed Nichols to fully develop testimony from Kebo and Fuqua necessary to rebut the affirmative defense—mutual mistake—which Zurich failed to raise. Indeed, given Fuqua's conversations with Zurich's counsel about UIM coverage issue the year before her deposition, withholding notice of the mutual mistake defense until after the depositions is a particularly sharp practice.

Given the circumstances, especially the prejudice to Nichols and the lack of any justification for the four-year delay, the failure of Zurich to timely allege mutual mistake as an affirmative defense (and plead it with particularity) must be considered waiver.

III. Reformation based on mutual mistake is equitable relief and, in this case, incompatible with statutes regulating insurance.[61]

Contract reformation for mutual mistake is "equitable relief" at common law. *See Kane v. Hopkins*, 309 Ky. 488, 218 S.W.2d 37 (1949). This Court last examined the

[61] This issue was addressed by Appellant in his response to Zurich's motion for summary judgment in the circuit court (R. at 657), in his briefs in the Court of Appeals, and in his motion for discretionary review.

defense in *Abney v. Nationwide Mut. Ins. Co.*, 215 S.W.3d 699 (Ky. 2006). *Abney* identified three general requirements for mutual mistake:

> To vary the terms of a writing on the ground of mistake, the proof must establish three elements. *See Campbellsville Lumber Co. v. Winfrey,* 303 S.W.2d 284, 286 (Ky.1957). First, it must show that the mistake was mutual, not unilateral. *See id.* Second, "[t]he mutual mistake must be proven beyond a reasonable controversy by *clear and convincing evidence.*" *Id.* (emphasis in original). Third, "it must be shown that the parties had actually agreed upon terms different from those expressed in the written instrument." *Id.*

Abney at 704. *Abney* involved an ordinary contract, not a heavily regulated insurance policy. Nonetheless, despite the harsh result, this Court refused to reform the document in *Abney*.

Unlike Nationwide's position in *Abney*, which sought to enforce a normal contract against a defense of mutual mistake, Zurich uses mutual mistake as a sword to set aside *insurance coverage* after a claim accrues despite the provisions of the Kentucky Insurance Code, KRS Chapter 304, and its various subtitles. This is prohibited. Indeed, as this Court has pointed out, "[t]he Insurance Code regulates the insurance industry, and an insurance company derives its right to do business in Kentucky by virtue of the Code." *Farmland Mut. Ins. Co. v. Johnson*, 36 S.W.3d 368, 380 (Ky. 2000). Moreover, the Insurance Code is designed to protect insureds who are not parties to the insurance contract (like Nichols), but whose rights may be affected. *See State Farm Mut. Auto Ins. Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988) (finding that the Insurance Code, and specifically Subtitle 12 in that case, protected third-party claimants). The Insurance Code is remedial legislation and accident victims and consumers, who are its intended beneficiaries, are entitled to a liberal construction of its provisions. *Kentucky Ins. Guar.*

Ass'n v. Jeffers ex rel. Jeffers, 13 S.W.3d 606, 611 (Ky. 2000) (quoting 73 Am.Jur2d Statutes, §278 (1974)).

Kentucky law is clear that one who seeks equity—whether through contract reformation or otherwise—must do equity. *Louisville Asphalt Co. v. Cobb*, 310 Ky. 126, 220 S.W.2d 110 (1949). But one cannot do equity *and* do violence to remedial legislation designed to police the insurance industry and protect accident victims like Nichols. If the "equitable" doctrine of mutual mistake is at odds with any provision of the Insurance Code, it cannot be applied. Zurich's attempted reformation violates several provisions.

First, KRS 304.14-180(1) requires that "[n]o agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy." The Zurich Policy (BAP 3473032-00) specifically included a Kentucky UIM endorsement with limits of $1,000,000 (Endorsement CA 21 79). The policy also contained alternate "Uninsured Motorist" coverage in the same amount, applicable in every state, which by its terms included UIM (Endorsement CA 21 17). Under Kentucky and Indiana law, it was mandatory for Zurich to include the coverage unless rejected in writing.[62] Therefore, even if Miller Pipeline's desire to exclude UM and UIM coverage was orally communicated to Zurich (and it clearly was not), Zurich was still required to include UM (and by its terms, UIM) until the written rejection forms were executed. The depositions and other evidence in this case conclusively reveal that Miller Pipeline rejected UM/UIM coverage in writing no earlier than June 20, 2002—

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[62] Under Kentucky law, pursuant to KRS 304.20-020(1), Zurich was *required* to provide UM coverage in Miller Pipeline's commercial auto policy until such time as Miller expressly communicated, *in writing*, its desire to reject such coverage. Under Indiana law, pursuant to IC 27-7-5-2, every policy of insurance, *absent a written rejection*, automatically includes both UM and UIM coverage in limits at least equal to the limits of liability specified in the bodily injury liability provisions of an insured's policy.

sixteen days *after* Nichols' wreck. Since the policy had initially included the coverage, the policy was not amended to cancel the coverage until this modification was put in writing and made a part of the policy.

Second, KRS 304.14-110 states that "[m]isrepresentations, omissions, and incorrect statements shall not prevent a recovery under the policy or contract" unless fraudulent, material to the risk insured, or the insurer in good faith would not have issued the policy based on *inter alia* the premium rate. Zurich contends that UM/UIM coverage was included by error. However, Zurich offered no proof (and there is none) that any of the exceptions in KRS 304.14-110 apply. Indeed, the proof reveals that *Zurich charged the same premium with or without UM/UIM coverage.*[63] In any event, Kentucky law enforces policy provisions for the benefit of third-party insureds who are not involved in contract formation (like Nichols), even if the statutory exceptions apply. *See e.g. National Ins. Ass'n v. Peach*, 926 S.W.2d 859 (Ky. App. 1996).

Third, KRS 304.20-030 provides:

> "No insurance contract insuring against loss or damage through legal liability for the bodily injury or death by accident of any individual, or for damage to the property of any person, shall be retroactively annulled by any agreement between the insurer and insured after the occurrence of any such injury, death, or damage for which the insured may be liable, and any such annulment attempted shall be void."

Zurich argues that the defense of mutual mistake invalidates the UM/UIM endorsements, yet concedes that the policy and endorsements were in force on the date of Nichols'

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[63] Exhibit 9: Common Policy Change Endorsement, which notes that policy premiums were unchanged by the UM/UIM rejection. Although the "effective date" of this document is listed as April 1, 2002, the proof of record reveals the rejection was not sent until at least June 2002. Compare Fuqua deposition, verifying that rejection forms were not sent until June 20, 2002, and Exhibit 7: Rejection forms (handwritten notation). See also Fuqua depo, p. 58 (confirming no change in premium).

wreck. KRS 304.20-030 not only prohibits retroactive annulment of coverage but, at the same time, recognizes that the circumstances giving rise to such an annulment could be the product of collusion between the insurer and insured. Allowing Miller Pipeline and Zurich to "agree," post-accident, to invalidate otherwise valid policy endorsements that provide benefits to a third party insured accident victims violates KRS 304.20-030. Indeed, the circuit court, in its November 28, 2006 order denying summary judgment, ***agreed that such a retroactive annulment violates KRS 304.20-030.***[64]

Fourth, KRS 304.20-020(1) mandates that "Uninsured Motorist" Coverage is automatically included in all motor vehicle liability policies unless the named insured "reject[s] in writing such coverage." *See also Meridian Mut. Ins. Co. v. Siddons*, 451 S.W.2d 831 (Ky. 1970). Here, the Zurich Policy had alternate "Uninsured Motorist" coverage in the amount of $1,000,000, applicable in every state, which by its terms included UIM (Endorsement CA 21 17). While the terms of the policy were subject to the laws of each of a dozen jurisdictions where Miller Pipeline vehicles were garaged, KRS 304.20-020(1) compelled Zurich to include UIM coverage until Miller Pipeline rejected it in writing. In fact, Miller Pipeline's desire to deviate from coverage Zurich customarily provided in fleet commercial motor vehicle policies was inconsequential until Zurich specifically rejected the UM coverage provided by Endorsement CA 21 17 in writing. That UM coverage, by its definition, included UIM.[65] Therefore, at the time of the wreck, Endorsement CA 21 17 was in force and Nichols is entitled to the benefits thereunder.

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[64] Exhibit 6: Order denying summary judgment (11/28/06).

[65] Several of the jurisdictions in which the policy was intended to provide coverage specifically required that UIM, as well as UM, be provided unless expressly rejected in writing. Indiana, where the policy was issued, requires insurance companies to provide both UM *and* UIM coverage in all existing or newly issued policies in amounts that are, at a minimum, equal to the liability limits afforded by the policy. See IC 27-7-5-2.

See also Howard v. INA County Mut. Ins. Co., 933 S.W.2d 212 (Tex. App. 1996) (court refused to invalidate an "uninsured motorist" policy endorsement, which included underinsured motorist benefits, based on mutual mistake where the coverage was not rejected in writing before an injury claim accrued).

Fifth, KRS 304.39-320 addresses UIM coverage. While stand-alone UIM coverage is optional in Kentucky, the statute has a mandatory mechanism for collecting UIM benefits. Before recovering UIM, an accident victim must first "agree to settle" with the at-fault party then send notice to the UIM carrier. See KRS 304.39-320(3); *Malone v. Kentucky Farm Bureau Mut. Ins. Co.*, 287 S.W.3d 656 (Ky. 2009) The *Coots* procedure operates to release the tortfeasor. *See True v. Raines*, 99 S.W.3d 439 (Ky. 2003). Therefore, the existence and amount of UIM benefits plays a significant role when an accident victim is deciding whether to elect the *Coots* procedure. Here, Nichols elected to follow KRS 304.39-320(3) and release the tortfeasor based, in part, on substantial UIM benefits available under the Zurich Policy. Nichols likewise relied on the existence of the coverage when he chose to reimburse Zurich one third of the liability proceeds to cover Zurich's subrogation claim for workers compensation payments.

When a contract (in this case the Zurich Policy with UM/UIM endorsements) is for the benefit of a third party (here Nichols), "...the parties to the contract cannot rescind it so as to deprive him of its benefits, after he has accepted, adopted or acted upon the contract." *Rhodes v. Rhodes*, 266 S.W. 2d 790, 792 (Ky. 1953). "Reformation or rescission of a contract is inappropriate where third parties have relied on the written agreement." *Whitson v. Parks*, 291 Ky. 141, 163 S.W. 2d 298, 299 (1942). Accordingly, reformation based on mutual mistake is inappropriate given KRS 304.39-320(3) and

Nichols' reliance on ostensibly valid UIM coverage—coverage which Zurich itself represented to Nichols was available, at least from 2002 until 2005.

For these reasons, even if the defense of mutual mistake is otherwise applicable (and it is not), reformation of the insurance policy based on mutual mistake would be inconsistent with legislatively expressed public policy through statutes governing insurance. The defense of mutual mistake is therefore inapplicable as a matter of law.

IV. In the absence of mutual mistake, Nichols is entitled to partial summary judgment on the issue of UIM coverage.[66]

Given the facts of this case, UIM coverage was clearly included in the Zurich Policy on the date of the accident, and Nichols was therefore entitled to partial summary judgment on the coverage issue. As the circuit court explained in its November 28, 2006 order denying summary judgment, any retroactive annulment would violate KRS 304.20-030.[67] Since Jeanne Fuqua could not "annul" the UIM coverage by rejecting it in writing after the accident, Zurich concedes that, without mutual mistake, UIM coverage is "a straightforward, read-the-policy question."[68]

Nichols filed a motion for partial summary judgment, alleging that Zurich's UIM coverage was valid and in force on the date of the accident as a matter of law because it was not timely cancelled.[69] Nichols explained that he was entitled to UIM coverage regardless of whether Kentucky or Indiana law applied.

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[66] This issue was addressed by Appellant in his motion for partial summary judgment in the circuit court (R. at 435), in his briefs in the Court of Appeals, and in the motion for discretionary review.
[67] Exhibit 6: Order denying summary judgment (11/28/06).
[68] Response to Motion for Discretionary Review, p. 2.
[69] R. at 433.

Under Kentucky law, Nichols was entitled to UIM coverage because the Zurich Policy provided UIM as part of general UM coverage and because the policy included a separate and specific UIM endorsement under Kentucky law. The Zurich Policy included an "Uninsured Motorist" endorsement, applicable in every state, which by its terms included both UM and UIM benefits in the same amount (Endorsement CA 21 17).[70] Pursuant to KRS 304.20-020(1), Zurich was *required* to provide UM coverage in Miller Pipeline's commercial auto policy until such time as Miller expressly communicated, *in writing*, its desire to reject such coverage. For several years, in fact, Zurich's grounds for denying the UM or UIM was that the coverage had been rejected by Miller Pipeline. Since the coverage was not rejected until after the injury claim accrued, Nichols is entitled to the coverage.

The Zurich Policy also included a state-specific Kentucky UIM endorsement with limits of $1,000,000 (Endorsement CA 21 79).[71] Since the policy had already been issued before Zurich was informed of Miller Pipeline's desire not to have the coverage, then pursuant to KRS 304.14-180(1), Zurich could not modify the policy to exclude the coverage until the "Common Policy Change Endorsement" modified the policy in writing and that was made a part of the policy. Here, it is undisputed that Zurich cancelled UIM coverage only after UM and UIM coverage was rejected in writing. Regardless of the date that the Change Endorsement was made part of the insurance contract, this clearly occurred sometime after the accident.

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[70] Exhibit 3: Zurich Policy BAP 3473032-00 declarations sheet and relevant policy endorsements for policy period April 1, 2002 through April 1, 2003.
[71] *Id.*

Under Indiana law, every policy of insurance, absent a written rejection, automatically includes both UM and UIM coverage in limits at least equal to the limits of liability specified in the bodily injury liability provisions of an insured's policy. IC 27-7-5-2. Since the policy was obtained by M.J., an Indiana insurance broker-agent, on behalf of Miller Pipeline, an Indiana Corporation, *Zurich was required by Indiana law to include the UM/UIM* when the policy was issued and delivered unless Miller rejected both in writing. The proof shows, once again, that Miller did not reject UIM coverage until after the accident. Furthermore, since the bodily injury liability coverage had limits of $1,000,000, then the "minimum UM/UIM" Zurich could write required limits of $1,000,000.

In light of the Zurich Policy and endorsements in force on June 4, 2002, Nichols was entitled to partial summary judgment on the issue of coverage under the Zurich Policy.

V. On remand, Nichols should be allowed leave to amend his complaint to include a claim for statutory bad faith.[72]

The circuit court denied Nichols' motion to amend his complaint for statutory bad faith against Zurich. However, the circuit court did so based on its ruling that Zurich's UIM coverage was invalid for mutual mistake. In any event, the circuit court designated its orders with regard to Zurich "final and appealable" with "no just cause for delay" pursuant to CR 54.02(1). The circuit court action is still pending. Accordingly, upon remand, Nichols should be allowed to amend his complaint based on Zurich's conduct

[72] This issue was raised by Appellant in the circuit court by motion (R. at 759), in his briefing before the Court of Appeals, and in his motion for discretionary review.

leading up to and including its late allegation of "mutual mistake" raised for the first time in its second motion for summary judgment.

Kentucky's Unfair Claims Settlement Practices Act (UCSPA) imposes a duty of good faith and fair dealing by an insurer to an insured. The UCSPA was enacted to protect the public from unfair trade practices and fraud in the manner that insurance carriers handle claims for benefits and coverage questions. The statute should be liberally construed to effectuate its purpose. *Hamilton Mutual Insurance Company of Cincinnati v. Buttery*, 220 S.W.3d 287 (Ky. App. 2007).

The Act is set out in KRS 304.12-230 and defines and imposes a comprehensive, detailed list of duties upon an insurer by designating specific acts and omissions as unfair claims settlement practices, including:

> (1) Misrepresenting pertinent facts or insurance policy provision relating to coverages at issue;
>
> (2) Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
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> ****
>
> (4) Refusing to pay claims without conducting a reasonable investigation based upon all available information;
>
> (5) Failing to affirm or deny coverage of claims within a reasonable time after proof of loss statements have been completed;
>
> (6) Not attempting in good faith to effectuate prompt, fair and equitable settlements of claims in which liability has become reasonably clear;
>
> (7) Compelling insureds to institute litigation to recover amounts due under an insurance policy by offering substantially less than the amounts ultimately recovered in actions brought by such insureds;
>
> ****

> (14) Failing to promptly provide a reasonable explanation of the basis in the insurance policy in relation to the facts or applicable law for denial of a claim or for the offer of a compromise settlement.

If Zurich had conducted a reasonable investigation based on all available facts, Zurich would have known that Miller Pipeline rejected UM/UIM coverage *only after* the accident on June 4, 2002. However, after breaching its duty to respond within a reasonable period of time, Zurich represented to Nichols that the policy was "cancelled" before the accident—and did so only after first representing to Nichols that UIM coverage was available. Years later, and only after failing in their first attempt to obtain a summary judgment, Zurich abandoned the defense of cancellation in favor of attempting to reform the contract based on an alleged mutual mistake. However, Zurich did not raise mutual mistake as a defense until 2009—after proof was concluded on the coverage issue, after Zurich filed a second motion for summary judgment, and even though Jeanne Fuqua discussed Miller Pipeline's rejection of UIM coverage with Zurich's defense counsel the year before her deposition was taken.[73] Moreover, Zurich knew it had no representative or agent that could testify that Zurich issued UIM coverage knowing that Miller Pipeline did not want it.

In *Knotts v. Zurich Ins. Co.,* 197 S.W.3d 512 (Ky. 2006) this Court found that "[n]othing in KRS 304.12-230 limits its applicability to pre-litigation conduct" and held that the duties imposed on Zurich Insurance Company by the UCSPA "[apply] both before and during litigation. The UCSPA "is intended to protect the public from unfair and deceptive acts and practices in the business of insurance." *State Farm Mutual Auto Insurance Co. v. Reeder*, 763 S.W.2d 116 (Ky. 1988). In *Knotts*, this Court determined

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[73] Fuqua depo., p. 68.

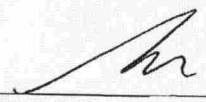
that the need for protection did not end with the filing of a claim and that the duties set forth in KRS 304.12-230 are owed by insurers, even through the litigation process.

Leave to amend a complaint "shall be freely given when justice so requires." CR 15.01. Here, the circuit court necessarily abused its discretion in denying Nichols motion to amend the complaint to allege bad faith—because the circuit court erred in invalidating UIM coverage based on a non-existent "mutual mistake." Because reformation based on mutual mistake is inapplicable, Nichols should be allowed to amend his complaint on remand. Zurich committed numerous violations of KRS 304.12-230, both before and during this litigation—indeed throughout the ten years Zurich has wrongfully denied UIM benefits to Nichols—and Nichols should at least have an opportunity to assert such a claim in light of *Knotts, supra.*

CONCLUSION

WHEREFORE, Appellant, James Nichols, respectfully requests that this Court reverse the Opinion of the Court of Appeals and remand to the Jefferson Circuit Court with directions to (1) enter partial summary judgment on the issue of Nichols' entitlement to UIM coverage under the Zurich Policy; and (2) allow Nichols to amend his complaint for statutory bad faith.

Respectfully submitted,



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