KENTUCKY SURVEY ISSUE

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A Survey of Kentucky Employment Law

by Joseph S. Burns* and Carrie E. Fischesser†

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I. INTRODUCTION

The purpose of this survey article is to provide a useful tool for those practicing employment law in the Commonwealth of Kentucky. The focus of this survey is on the adjudication of cases involving the employment-at-will doctrine. Each section of the survey includes a summary of relevant cases from Kentucky decided during the past three years. Section II of the survey is broken down into two subsections. Subsection A discusses common law claims involving the employment-at-will doctrine, while Subsection B discusses statutory claims. The specific topics covered in subsection A include the following: (1) public policy exception to the employment-at-will doctrine; (2) contractual modifications of the employment-at-will doctrine, including both written and oral modifications of the employment-at-will doctrine; (3) fraud, misrepresentation and estoppel; (4) obligations of good faith and fair dealing; (5) negligent hiring, retention, and supervision of employees; (6) intentional infliction of emotional distress; (7) defamation; and (8) drug testing. Topics discussed in Subsection B include statutory claims based upon (1) workers' compensation retaliation and (2) The Kentucky Civil Rights Act.

II. EMPLOYMENT-AT-WILL DOCTRINE

The basis of all employment relationships, whether oral or written, is a contract. Under Kentucky law, an employment contract for an indefinite period of time is considered to be an employment-at-will contract. As the name

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1 This survey serves as an update of 28 N. Ky. L. Rev. 219 (2001) written by Richard A. Bales and Joseph S. Burns.
2 For a discussion of Kentucky cases decided between 1999 and 2001, see id.
4 See Miller v. N.W. Ritter Lumber Co., 110 S.W. 869, 869 (Ky. 1908) (holding evidence was insufficient to show that contract of employment was for a definite period of time).
5 See Prod. Oil Co. v. Johnson, 313 S.W.2d 411, 413 (Ky. 1958) (holding that where an employment contract is not for a definite period of time, it is terminable at will by either party). See also Scroghan v. Kraftco Corp., 551 S.W.2d 811, 812 (Ky. Ct. App. 1977).
implies, an employment-at-will contract may be terminated at will by either the employer or the employee.⁶ Kentucky has generally recognized the right of an employer to discharge an at-will employee for good cause, for no cause, or for a cause that may be viewed by many as "morally indefensible."⁷ There are, however, certain exceptions to the at-will doctrine permitting an employee to maintain a cause of action based upon both statutory and common law principles.⁸ The remainder of this article addresses these exceptions.

A. Common Law Claims

1. Public Policy Exception to the Employment-at-Will Doctrine

The Kentucky Supreme Court recognizes an exception to the rule that an employee may be discharged without cause when the employee's discharge violates a strong public policy.⁹ Such a cause of action, which is typically referred to as "wrongful discharge in violation of public policy," is available when the employee's discharge violates a fundamental and well-defined public policy.¹⁰ This exception, however, has generally been narrowly construed in its application.¹¹ In order for the exception to apply, the public policy must be "clearly defined by statute and directed at providing a statutory protection to the [employee] in his employment situation."¹² Whether there has been a violation of public policy is a question of law for the court to decide.¹³ Kentucky courts

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⁶ Scroghan, 551 S.W.2d at 812 (holding that a contract for employment for an indefinite period of time may be terminated at will by either party and therefore, employer did not unlawfully discharge the employee after the employee decided to attend law school at night).
⁸ See id. at 733-34 (recognizing that where a cause of action is predicated upon retaliatory discharge, "it is a question of law for the court to decide whether the reason for discharge is unlawful because of a constitutionally protected right or a right implicit in a statute"). See also Grzyb v. Evans, 700 S.W.2d 399, 401-02 (Ky. 1985) (holding that a constitutionally protected right to freedom of association did not limit the employer's right to discharge an at-will employee).
¹⁰ See EMPLOYMENT DISCRIMINATION COORDINATOR ¶ 112, 650 (2003).
¹¹ See Grzyb, 700 S.W.2d at 400-01. The supreme court noted the existence of adequate statutory remedies and refused to recognize a common law cause of action where the employee's discharge was motivated by sex discrimination. Id. The court emphasized the narrowness of Kentucky's version of the common law doctrine, holding that it applies only in situations involving discharge in retaliation for refusal to violate the law, or in retaliation for exercising a statutory right. Id.
¹² Id.
¹³ See EMPLOYMENT DISCRIMINATION COORDINATOR ¶ 112, 650 (2003).
generally view causes of action for wrongful discharge in violation of public policy as based on tort law.\textsuperscript{14}

The most recent decision involving a cause of action premised on the public policy exception to the employment-at-will doctrine is \textit{Dauley v. Hops of Bowling Green, Ltd.}\textsuperscript{15} In \textit{Dauley}, the trial court entered summary judgment in favor of the employer, Hops of Bowling Green, Ltd. ("Hops") and its manager, Todd Alexander ("Alexander").\textsuperscript{16} The court concluded that Patricia Dauley ("Dauley"), a part-time server at Hops, was an employee-at-will, and that she did not have a cause of action for wrongful discharge in violation of the public policy exception to the terminable-at-will doctrine.\textsuperscript{17} Dauley appealed the trial court’s decision.\textsuperscript{18}

The claim arose when Alexander terminated Dauley after receiving complaints from several female employees indicating that Dauley had acted in a sexually offensive manner towards them.\textsuperscript{19} Hops had a zero-tolerance sexual harassment policy.\textsuperscript{20} On the same day that Alexander terminated Dauley, he called to offer her an opportunity to return to work pending an investigation of the allegations.\textsuperscript{21} Dauley, however, rejected the offer, and instead filed a claim against Hops alleging breach of fiduciary duty and retaliatory discharge.\textsuperscript{22} The Warren Circuit Court granted summary judgment in favor of Hops and Alexander.\textsuperscript{23}

On appeal, Dauley maintained that she had been terminated in violation of K.R.S. § 344.280.\textsuperscript{24} While the court of appeals acknowledged that there are indeed exceptions to the general rule allowing for the largely unfettered

\textsuperscript{14} \textit{Id.} See also \textit{Firestone Textile Co. Div.}, 666 S.W.2d at 733 (likening the public policy violation cause of action to tort actions for outrageous conduct, invasion of privacy, and interference with prospective advantage).


\textsuperscript{16} \textit{Id.}

\textsuperscript{17} \textit{Id.}

\textsuperscript{18} \textit{Id.}

\textsuperscript{19} \textit{Id.}

\textsuperscript{20} \textit{Id.}

\textsuperscript{21} \textit{Dauley}, 2003 WL 1340013, at *1.

\textsuperscript{22} \textit{Id.}

\textsuperscript{23} \textit{Id.}

\textsuperscript{24} KY. REV. STAT. ANN. § 344.280 (Banks-Baldwin 2003). This section provides, in pertinent part:

\begin{quote}
It shall be an unlawful practice for a person, or for two (2) or more persons to conspire: (1) To retaliate or discriminate in any manner against a person because he has opposed a practice declared unlawful by this chapter, or because he has made a charge, filed a complaint, testified, assisted, or participated in any manner in any investigation, proceeding or hearing under this chapter ....
\end{quote}

\textit{Id.}
termination of at-will employees, such exceptions having their origin in the
Kentucky Supreme Court’s decisions of Firestone Textile Co. Division v. Meadows,25 and Grzyb v. Evans,26 the court held that Dauley failed to state a claim under these exceptions.27 The court determined that K.R.S. § 344.280(1) was intended to protect individuals who file charges of sexual harassment; it was not intended to protect individuals accused of committing sexual harassment offenses.28

In reaching its decision, the court of appeals also relied on the holding in Firestone.29 In Firestone, the Kentucky Supreme Court held that an employee has a cause of action when the discharge violates a “fundamental and well-defined public policy” set forth in a constitutional or statutory provision.30 Further, the court of appeals asserted that the “protection of the employee should not extend beyond ‘constitutionally protected activity’ or ‘public policy’ as established by ‘legislative determination.’”31 Additionally, the court of appeals stated that, in Grzyb,32 the Kentucky Supreme Court qualified the decision it set forth in Firestone by adopting the position of the Michigan Supreme Court in Suchodolski v. Michigan Consolidated Gas Co.33 In the Suchodolski opinion, the Michigan Supreme Court held that only two situations create an actionable cause for discharge of an at-will employee in violation of public policy.34 The first exception is “where the alleged reason for the discharge of the employee was the failure or refusal to violate a law in the course of employment.”35 The second exception arises “when the reason for a discharge was the employee’s exercise of a right conferred by well-established legislative enactment.”36 Therefore, because Dauley was an employee-at-will, and because she failed to state a claim for wrongful discharge under the public policy exception to the terminable-at-will doctrine, the court affirmed the trial court’s grant of summary judgment in favor of the employer.37

While the court in Dauley held that the employee’s discharge did not fall within the public policy exception to the terminable-at-will doctrine, the court in

25 666 S.W.2d 730 (Ky. 1984).
26 700 S.W.2d 399 (Ky. 1985).
28 Id. at *2.
29 Id. at *3.
30 Firestone, 666 S.W.2d at 731.
31 Id. at 732-33 (quoting Scroghan v. Kraftco Corp., 551 S.W.2d 811, 812 (Ky. Ct. App. 1977)).
34 Suchodolski, 316 N.W. 2d at 711.
35 Id.
36 Id. at 712.
Northeast Health Management Inc. v. Cotton\textsuperscript{38} found that the employees did have a cause of action for discharge within the public policy exception to the terminable-at-will doctrine.\textsuperscript{39}

In \textit{Cotton}, the Kentucky Court of Appeals held that the hospital administrator's alleged action of asking employees to perjure themselves in the administrator's criminal trial qualified as an exception to the terminable-at-will doctrine.\textsuperscript{40} In the McLean Circuit Court, the jury awarded both compensatory and punitive damages to two employees for wrongful termination.\textsuperscript{41} The trial court denied the hospital's motion to set aside the verdict or to grant a new trial.\textsuperscript{42} In turn, the hospital appealed.\textsuperscript{43}

Kimberly Cotton ("Cotton") and Pamela Howell ("Howell") were employees at the McLean County General Hospital ("the Hospital") at a time when Mynette Dennis ("Dennis") was employed as the Hospital's administrator.\textsuperscript{44} As administrator, Dennis had significant input into the decisions relating to hospital personnel, including participation in both the hiring and terminating of employees.\textsuperscript{45} Both Cotton and Howell had good working relationships with Dennis; however, their relationships began to deteriorate sometime after March 1995 when Dennis was convicted of shoplifting.\textsuperscript{46}

Prior to her conviction, Dennis called both employees into her office to discuss the circumstances surrounding the shoplifting charges.\textsuperscript{47} The employees claimed that Dennis wanted them to falsify testimony during her trial for shoplifting.\textsuperscript{48} Both employees claimed that, after they refused to perjure their testimony, there were drastic changes in their working conditions, as well as their working relationship with Dennis.\textsuperscript{49} Additionally, Howell claimed that, during an investigation of the hospital by the Commonwealth of Kentucky, Dennis asked her to alter business documents in order to prove that the nurses


\textsuperscript{39} \textit{Cotton}, 56 S.W.3d at 441.

\textsuperscript{40} Id.

\textsuperscript{41} Id. at 442.

\textsuperscript{42} Id. at 445.

\textsuperscript{43} Id.

\textsuperscript{44} Id. at 443.

\textsuperscript{45} \textit{Cotton}, 56 S.W.3d at 443.

\textsuperscript{46} Id.

\textsuperscript{47} Id. Dennis denied that she asked the employees to falsely testify. Id.

\textsuperscript{48} Id. at 444. Dennis completely cut off verbal communication with the employees. Id.

\textsuperscript{49} Id. at 444. Additionally, Dennis constantly watched over them, required them to meet strict lunch and break times and did not permit the two employees to communicate with each other. Id.

\textsuperscript{50} Moreover, the employees were asked to return their office keys and were no longer invited to attend staff meetings. Id. at 444-45. Other employees confirmed that there were changes in the work environment after Dennis was convicted on the shoplifting charges. Id. at 444.
had proper training, and to prove that certain policies were in place at the time of the incident for which the hospital was being investigated. Howell, however, refused to falsify any documents.

After the jury ruled in favor of Howell and Cotton on their claim of wrongful discharge in violation of public policy, the Hospital appealed. On appeal, the Hospital argued that the employees' discharge did not fall into one of the exceptions to the terminable-at-will doctrine. The Hospital premised its argument on the fact that the employees remained employed for more than a year after Dennis asked them to perjure their testimony and, therefore, the claims of retaliation were unlikely. However, the court of appeals found that the employees satisfied the first prong of the Grzyb test that is necessary for a discharge to fall within the exception of the terminable-at-will doctrine. The court specifically found that Dennis asked the employees to violate a law by requesting that they perjure their testimony in her shoplifting trial.

The Hospital also argued that Dennis' act of asking the employees to perjure their testimony failed to satisfy the necessary employment-related nexus as set forth in both Firestone and Grzyb. The court of appeals, however, was not persuaded by the Hospital's argument. The court found that although the shoplifting charge was personal to Dennis, the request and retaliation by Dennis satisfied the employment-related nexus because these actions were an abuse of her authority as the employees' supervisor.

Additionally, the Hospital claimed that the jury's finding that Howell was constructively discharged for failing to alter business documents, was erroneous because Howell failed to produce evidence that this type of request violated any type of legislative enactment. Again, the court of appeals was not persuaded

50 Id. at 444.
51 Cotton, 56 S.W.3d at 444.
52 Id. at 445.
53 Id. Cotton and Howell resigned in October 1996. Id. However, both the trial court and the Court of Appeals determined that the evidence supported a finding that Dennis' actions constituted a constructive discharge. Id. at 446. Due to the limited scope of this survey, the authors limit their discussion to that part of this case relating to termination of an at-will employee in violation of public policy.
54 Id. at 447.
55 See Grzyb v. Evans, 700 S.W.2d 399, 402 (Ky. 1985). In Grzyb it was stated that there are only two situations "where grounds for discharging an employee are so contrary to public policy as to be actionable" absent "explicit legislative statements prohibiting the discharge." Id. at 402 (quoting Suchodolski v. Michigan Consol. Gas Co., 316 N.W.2d 710, 711 (Mich. 1982)). The first situation is "where the alleged reason for the discharge of the employee was the failure or refusal to violate a law in the course of employment." Suchodolski, 316 N.W.2d at 711.
56 Cotton, 56 S.W.3d at 447.
57 Id.
58 Id.
59 Id.
60 Id.
61 Id.
by the Hospital's argument. In the trial court it was suggested that the altering of business documents violated K.R.S. § 517.050. The trial court concluded that, based upon Howell's testimony, it was not unreasonable for the jury to determine that Howell had been asked to unlawfully alter business records. Accordingly, the court of appeals held that there was sufficient evidence to support the jury's finding that Dennis' actions violated K.R.S. § 517.050.

Lastly, the Hospital argued that the award of punitive damages was not warranted. In affirming the award of punitive damages, the court relied on the holding in Simpson County Steeplechase Ass'n v. Roberts in which the court recognized that an employee may be awarded punitive damages on a wrongful discharge claim. Also with regard to the punitive damages award, the Hospital argued that, under K.R.S. § 411.184(3), it should not be liable for Dennis'...
However, the court of appeals found that since Dennis had sole discretion over decisions relating to hospital personnel, and was provided with minimal direct supervision by the hospital, the evidence was sufficient to warrant punitive damages to the employees. Accordingly, the court of appeals affirmed the decision of the McLean Circuit Court awarding both compensatory and punitive damages to the two employees for wrongful termination in violation of public policy. Accordingly, the court of appeals affirmed the decision of the McLean Circuit Court awarding both compensatory and punitive damages to the two employees for wrongful termination in violation of public policy.

As both Dauley and Cotton suggest, Kentucky courts have continued to construe and apply the public policy exception very narrowly, sustaining causes of action only when an employee's discharge is contrary to a "fundamental and well-defined" public policy as evidenced by a constitutional or statutory provision, or when an employee's discharge results from his or her refusal to violate a law in the course of employment. While Cotton is a quintessential example of an employee being discharged for refusing to comply with an employer's request to violate a law, Dauley represents a sensibly reasoned opinion in which the court refused to accept a strained interpretation of a legislative enactment that clearly was not designed to protect those accused of sexual harassment.

2. Contractual Modifications of Employment-at-Will Doctrine

As explained above, when an employee is employed under a contract for an indefinite term, the general rule is that either the employer or the employee may terminate the contract without cause. But even when there is an indefinite length of employment, it is nonetheless possible for an employer's termination rights to be restricted by an oral or written contractual modification to the employment-at-will doctrine. In order for this exception to apply, Kentucky
decisions indicate that the employer and the employee must clearly manifest their intent—either orally or in writing—to modify the employee's status as an at-will employee.\textsuperscript{78} While contractual modifications occur most often through the use of employee handbooks or manuals, the mere existence of an employee handbook or manual does not automatically create a "just cause" relationship.\textsuperscript{79} Rather, as noted in \textit{Shah v. American Synthetic Rubber Corp.},\textsuperscript{80} the modifying language must expressly indicate that the employment relationship is not simply at will:

\begin{quote}
Parties may enter into a contract of employment terminable only pursuant to its express terms—as "for cause"—by clearly stating their intention to do so, even though no other considerations than services to be performed or promised, is expected by the employer, or performed or promised by the employee.\textsuperscript{81}
\end{quote}

In other words, an employer and employee may remove their relationship from application of the at-will doctrine only by expressly stating the terms and conditions upon which either party may terminate the employment.\textsuperscript{82}

As demonstrated by the cases in the following two subsections, Kentucky courts have carefully scrutinized attempts to modify an employee's at-will status, requiring that such modifications clearly and unambiguously express the parties' intent to create a "just cause" relationship or a contract for a definite term.\textsuperscript{83} Thus, if an employer and employee wish to create a "just cause" relationship, the parties should obviously be sure to manifest their intentions in writing.\textsuperscript{84} It should also be noted, however, that while most courts require contractual modifications to be clearly manifested, several decisions have inferred the existence of a "just cause" relationship based on the language of employee handbooks that were arguably unclear.\textsuperscript{85} As such, employers must be cautious not to inadvertently create a "just cause" relationship through the use of employee handbooks containing ambiguous language.\textsuperscript{86} A simple disclaimer—stating that nothing in the employee handbook creates a "just cause" relationship, and that employment is at will—is the most effective way to

\textsuperscript{78} Id.
\textsuperscript{79} Id.
\textsuperscript{80} 655 S.W.2d 489 (Ky. 1983).
\textsuperscript{81} Id. at 492.
\textsuperscript{82} Id.
\textsuperscript{83} Id.
\textsuperscript{84} Id.
\textsuperscript{86} See \textit{Shah}, 655 S.W.2d at 492.
preclude an employee handbook from unintentionally creating a "just cause" relationship.87

a. Written Modifications of the Employment-at-Will Doctrine

In *Baker v. Kentucky State University*88 a former employee sued Kentucky State University and various officials in state court alleging that his discharge deprived him of property in violation of his rights to due process. The officials removed the action to federal court.89 The United States District Court for the Eastern District of Kentucky entered summary judgment in favor of the officials.90 The former employee appealed, and the court of appeals held that the employee's employment manual did not provide him with a property interest in his job.91

The employee was hired as a police officer with the University.92 Under the provisions of his contract, he was to be reappointed each year for a one-year term of employment.93 Shortly after he began his employment, the University implemented a Staff Personnel Policy and Procedure Manual ("Employment Manual"), which contained a grievance procedure for all employees.94 As a result of an on-campus incident, the University suspended the employee pending an internal investigation.95 The employee, however, never returned to work, as the University chose not to renew his employment at the end of the contract year.96 Subsequently, the employee brought suit alleging that his termination was in violation of the procedures set forth in the Employment Manual.97 In particular, the employee alleged that the University violated his due process and equal protection rights under 42 U.S.C. § 1983,98 along with Section 2 of the Kentucky Constitution.99

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88 45 Fed. Appx. 328 (6th Cir. 2002).
89 Id. at 329.
90 Id.
91 Id. at 331.
92 Id. at 329.
93 Id.
95 Id.
96 Id.
97 Id.

Every person who, under color of any statute, ordinance, regulation, custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person with the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the
The proceedings were removed to district court where the court held that the employee's claims under the United States Constitution were barred by the Eleventh Amendment. The employee's state law claims were also dismissed, as the court found that they were barred by state immunity. Subsequently, the individual defendants moved for summary judgment on the remaining claims, arguing that the employee did not have a protected property interest in his employment. The district court granted summary judgment, holding that the employee's claims were now barred by the statute of limitations and, in the alternative, that the employee did not have a protected property interest in his employment. The employee filed, and was granted, a motion to reconsider; however, the district court dismissed the § 1983 claim because the employee did not have a property interest protected by the United States Constitution.

On appeal, the employee asserted that he had a protected property interest in his employment, which was secured by an implied contract, and that the implied contract was breached when the University terminated him in a procedure that was inconsistent with those presented in the Employment Manual. Further, the employee claimed that the Employment Manual was the basis of his property interest, and, therefore, consistent with the procedure in the manual, he was entitled to a hearing before being terminated by the University.

The court of appeals found that, in order for the employee's argument to succeed, it would be necessary for him to prove that he had a "legitimate expectation of continued employment." Because there is no statutory provision granting the employee a protected property interest in reappointment to his position, it was necessary for the court to turn to Kentucky contract law to determine whether the employee had a cause of action against the University. The court relied on the Kentucky Supreme Court's decision in Shah v. American Synthetic Rubber Corp., in which the court held that "parties may enter into a... Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress..."

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Id. Baker, 45 Fed. Appx. at 329. See also KY. CONST. § 2. That section provides, "[a]bsolute and arbitrary power over the lives, liberty and property of freemen exists nowhere in a republic, not even in the largest majority." Id. Baker, 45 Fed. Appx. at 329. Id. Id. Id. Id. at 329-30. Id. at 330. Id. at 330. Baker, 45 Fed. Appx. at 330. Id. (quoting Johnston-Taylor v. Gannon, 907 F.2d 1577, 1581 (6th Cir. 1990)). Id. Id. 655 S.W.2d 489 (Ky. 1983).
contract of employment terminable only pursuant to its express terms as ‘for cause’ by clearly stating their intention to do so.” While the general rule is that employment contracts are at-will, the Kentucky Supreme Court’s decision presented a caveat by allowing an exception for contractual obligations where the parties manifested an intent to be bound by another standard.

The court found that the evidence presented by the employee was not sufficient to support an implied contract between the employee and the University. Further, the court found that the Employment Manual did not have any significance as a contract between the employee and the University because it did not require the University to automatically reappoint one-year contract employees. Moreover, the employee did not present any evidence that the University had made an oral promise to reappoint the employee except for cause: “Each of [the employee’s] contracts was for a single year, and [the employee] has pointed to no evidence that ‘the parties specifically manifest[ed] their intention to condition’ the renewal of [the employee’s] contract on some standard other than the parties’ discretion.” The court ultimately found that the Employment Manual did not place any conditions on the University’s ability to decline to extend the employee’s contract for another year, and that the language in the contract did not take the employee out of the realm of terminable-at-will employment. Accordingly, the court of appeals affirmed the decision of the district court.

In Kimmel v. Progress Paint Manufacturing Co., Stanley Kimmel (“Kimmel”) filed a complaint against Progress Paint Manufacturing Company (“Progress” or “the employer”) alleging breach of an employment contract. The Jefferson Circuit Court granted summary judgment in favor of the employer, and Kimmel appealed. Kimmel had been employed with Progress for twenty-five years. At the time of his termination, the terms of Kimmel’s employment were set forth in a letter dated January 12, 1994, pursuant to which Kimmel received his

As under the previous agreement, Mr. Kimmel will represent Progress [ ] as a straight commission sales agent selling to Kentucky Manufacturing . . . Progress [ ] will pay
commissions on a monthly basis, with a small portion paid on an annual basis.\textsuperscript{122} Kimmel's contention on appeal was that the provisions in the letter created a yearly employment contract between him and Progress.\textsuperscript{123} To support this contention, he relied on the Kentucky Court of Appeals' decision in \textit{Putnam v. Producer's Livestock Marketing Ass'n}.\textsuperscript{124}

The court of appeals, however, distinguished the provisions set forth in Kimmel's letter of employment from the provisions involved in the \textit{Putnam} decision.\textsuperscript{125} Unlike the written agreement in \textit{Putnam},\textsuperscript{126} Kimmel's letter of employment did not provide that he would be compensated on a yearly basis; under the 1994 agreement, Kimmel was to receive compensation, in the form of a sales commission, on a monthly basis.\textsuperscript{127} Furthermore, the court reasoned that since the agreement was silent as to the duration of Kimmel's length of employment, and since there was nothing in the agreement that specifically stated the parties' intention that Kimmel's employment was anything other than an at-will relationship, the letter could not be considered a contract for yearly employment.\textsuperscript{128}

Ultimately, the court held that, even though Kimmel received a small portion of his commissions on a yearly basis, there was nonetheless insufficient evidence to support Kimmel's contention that the letter had created a yearly employment contract between him and Progress.\textsuperscript{129} Therefore, according to the court, Progress could properly terminate him at any time under the provisions of the employment-at-will doctrine.\textsuperscript{130}

\begin{flushleft}
8\% commission in full, on the 22nd of each month, for the previous months [sic] sales. Mr. Kimmel will pay his own expenses and is entitled to all company benefits . . . Mr. Kimmel will represent no other coatings supplier while working under this agreement."
\end{flushleft}

\textit{Id.}\textsuperscript{122} \textit{Id.} The annual commissions were "attributable to 'cash sales' of a de minimis nature." \textit{Id.}\textsuperscript{123} \textit{Kimmel, 2003 WL 1226837, at *1.}\textsuperscript{124} \textit{Putnam, 75 S.W.2d 1075 (Ky. 1934).} In \textit{Kimmel}, the Kentucky Court of Appeals recognized that "employment for an indefinite period of time may be terminated by either party at-will, but that employment for a definite period of time creates a contract of employment terminable only for cause within such period." \textit{Kimmel, 2003 WL 1226837, at *1.} The court in \textit{Putnam} held that "the circumstances of agreeing on weekly, monthly, quarterly, or semiannual payments of wages is sufficient of itself to establish the presumption of hiring for the period covered by each payment . . . the specification in the contract of an annual salary creates the inference of annual employment."

\textit{Putnam, 75 S.W.2d} at 1076-77.\textsuperscript{125} \textit{Kimmel, 2003 WL 1226837, at *2.}\textsuperscript{126} \textit{Putnam's written offer of employment stated that employment was at a salary of $3300 per year. Id.}\textsuperscript{127} \textit{Kimmel, 2003 WL 1226837, at *2.}\textsuperscript{128} \textit{Id.}\textsuperscript{129} \textit{Id.}\textsuperscript{130} \textit{Id.}
b. Oral Modifications of the Employment-at-Will Doctrine

In *Wells v. Huish Detergents, Inc.*, Ivan Wells ("Wells") sued his former employer, Huish Detergents, Inc. ("Huish"), alleging that Huish violated an oral contract. Following removal to federal court, the United States District Court for the Western District of Kentucky granted Huish's motion for summary judgment, and denied Wells' motion to alter or amend the judgment. Wells appealed this decision, and the court of appeals affirmed.

Wells began his employment with Huish in 1995, and reported directly to John Hillenger ("Hillenger"), who, in turn, reported to Amir Mahdavi ("Mahdavi"). Prior to beginning his employment, Wells received a handbook that contained Huish's employment policies. Sections 1.00 and 6.007 of the handbook summarized Huish's at-will policy. Additionally, of particular relevance, Section 6.016 of the handbook provided policies with respect to self-dealing transactions. There was no dispute that Wells received a copy of the handbook, and that he understood the terms of the handbook, having had agreed in writing to its terms.

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132 *Id.* at 171.
133 *Id.*
134 *Id.*
135 *Id.*
136 *Id.* at 171-72.
138 *Id.* In pertinent part, Section 1.00 provides:

This Handbook is not intended to be a contract of employment . . . . No supervisor, manager or other representative of [the Company] – other than the President – has the authority to make any agreement or promise of employment for any specified period, or to change the at-will status of employment. The President of [the Company], is authorized to make an employment agreement only if it is in writing.

*Id.*
139 *Id.* at 172-73. In pertinent part, Section 6.016 provides:

Employees are prohibited from having any personal financial dealing with any individual or business organization that furnishes merchandise, supplies, property or service to the Company. Employees are not permitted to conduct Company business with companies that have relatives of the Huish employee, if the employee has approval authority over that area of business for Huish.

*Id.*
140 *Id.* at 173. Wells signed an Acknowledgement which stated:
"In February of 1998, Hillenger learned that Wells owned an independent business that was selling items to Huish in violation of company policies on self-dealing. These facts came to light after a supervisor, John Holder, informed Hillenger that the address on a purchase order signed by Wells’ fiancée looked familiar. Holder subsequently informed Hillenger that this address was the home address of Wells and his fiancée. Hillenger in turn notified Mahdavi of the situation.

When Wells’ fiancée was confronted with this issue, she asserted that she had received permission from Ron Anglin (“Anglin”), the powder packaging manager, before initiating any transactions with Wells’ company. She also claimed that Anglin was aware that Wells was involved with the company because she had previously informed him about Wells’ involvement. When Wells was confronted by his supervisors, he openly admitted that he owned the company that was supplying items to Huish. Wells told his supervisors that his fiancée had informed him that Huish needed items that his company could supply. Furthermore, Wells asserted that Anglin approved his company’s dealings with Huish and told him that this was “common practice” at Huish.

I have received my copy of the [Company Handbook] which outlines the policies, practices and benefits of Huish Detergents, Inc. I accept responsibility for informing myself about these policies, either by reading them or by asking that they be explained to me. All employees of the Company are employees “at-will” and, as such, are free to resign at any time without reason. The Company, likewise, retains the right to terminate an employee’s employment at any time or without reason. Nothing contained in the [Handbook] (or any other document provided to the employee) is intended to be, nor should it be, construed as a guarantee that employment or any benefit will be continued for any period of time. I understand and agree that no one in this Company has offered me employment or terms different from what is stated on this page; and I understand and agree that no one in the Company is authorized by the Company to promise me in the future that the terms of employment will be different from what is stated on this page.

Id.
141 Id.
142 Id. at 173.
144 Id.
145 Id.
146 Id.
147 Id. at 174.
148 Id.
During the meeting, however, Mahdavi informed Wells that an employee's self-dealing with the company was in direct violation of the provisions in the handbook, explaining that even if Wells had requested permission from Mahdavi before becoming involved in the transactions, they still would have been impermissible according to the provisions of Section 6.016 of the handbook.\textsuperscript{150} After the meeting, Mahdavi spoke to Hillenger and Anglin, both of whom said they were not aware that Wells was involved in self-dealings with the Company.\textsuperscript{151} Anglin also denied giving Wells permission to become involved in this practice.\textsuperscript{152} As a result, both Wells and his fiancée were terminated from Huish on February 13, 1998.\textsuperscript{153}

On appeal, Wells contended that the permission he received from Anglin—to participate in self-dealings with Huish—created an oral contract, modifying his status as an employee at-will.\textsuperscript{154} Accordingly, Wells contended that his termination for engaging in self-dealing transactions constituted a breach of contract.\textsuperscript{155} In support of his argument, Wells relied on \textit{Hammond v. Heritage Communications, Inc.}\textsuperscript{156} in which the Kentucky Court of Appeals held that an issue of fact existed, precluding summary judgment, as to whether an employee’s at-will status had been modified by an oral promise by the employer.\textsuperscript{157} Wells contended that like the employee in \textit{Hammond}, he should have been allowed to proceed to a jury on his claim for breach of contract.\textsuperscript{158}

The court of appeals, however, found that Wells’ assertions were distinguishable from those in \textit{Hammond}.\textsuperscript{159} First, the Huish handbook clearly stated that Huish would not be bound by unauthorized statements made by its employees; in \textit{Hammond}, there was no evidence of such a policy.\textsuperscript{160} Second, unlike the provisions in Huish’s handbook, there was no evidence in \textit{Hammond} that the company specifically limited modifications of the employment relationship to written statements from the company president.\textsuperscript{161} Finally, the court of appeals found that Wells’ reliance on \textit{Hammond} was misplaced because he personally attested to the terms in the handbook when he signed the acknowledgement form.\textsuperscript{162} Thus, Wells was fully aware that his at-will status with Huish could only be modified by a written agreement executed by the

\textsuperscript{150} Id.
\textsuperscript{151} Id.
\textsuperscript{152} Id.
\textsuperscript{153} Id.
\textsuperscript{154} Id. at 175.
\textsuperscript{155} \textit{Wells}, 19 Fed. Appx. at 175.
\textsuperscript{156} 756 S.W.2d 152 (Ky. Ct. App. 1988).
\textsuperscript{157} \textit{Wells}, 19 Fed. Appx. at 175.
\textsuperscript{158} Id.
\textsuperscript{159} Id.
\textsuperscript{160} Id.
\textsuperscript{161} Id.
\textsuperscript{162} Id.
president of the company; neither Anglin nor any other manager had the authority to modify Wells’ employment relationship with Huish. Accordingly, because Wells’ status as an at-will employee had not been contractually modified, the court of appeals held that the district court did not err in granting summary judgment on the breach of contract claim.

3. Fraud, Misrepresentation, and Estoppel

Under Kentucky law, in an action for fraud, six elements must be established by clear and convincing evidence: “[1] material representation [2] which is false [3] known to be false or made recklessly [4] made with inducement to be acted upon [5] acted in reliance thereon and [6] causing injury.” In an action predicated on fraud, detrimental reliance may be established when a party acts or fails to act due to fraudulent misrepresentations. However, there will be no redress for a representation that the party knew to be false or for a failure by the party to disclose facts which he knew existed. Additionally, the party must establish that they were justified in relying upon the representations in the exercise of common prudence and diligence. Promissory estoppel involves “a promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee and . . . which does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise.” On several occasions oral promises have been enforced on this basis. Promises of employers with regard to fringe benefits are generally found to be supported by consideration, but will at least give rise to elements of promissory estoppel where the employer can reasonably foresee that the continuation of employment has been induced by a promise and injustice can be avoided only by giving effect to the promise.

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163 Wells, 19 Fed. Appx. at 175-76.
164 Id.
165 See United Parcel Serv. Co. v. Rickert, 996 S.W.2d 464, 468 (Ky. 1999) (stating that in an action for fraud, the complainant “must establish six elements of fraud by clear and convincing evidence”).
166 Id. at 469.
167 See, e.g., Lincoln-Income Life Ins. Co. v. Kraus, 132 S.W.2d 318, 322 (Ky. 1939) (holding that evidence was insufficient to present a jury question of fraud, where plaintiff, knowing statements to be false, considered an offer of compromise agreement for a period of time and subsequently accepted it).
168 See, e.g., Selke v. Stewart, 86 S.W.2d 83, 87 (Ky. 1935) (finding that a buyer of an established business did not exercise ordinary diligence where he failed to make inquiries concerning creditors or amounts of their accounts before accepting a proposal to purchase the business; therefore, the buyer could not recover any losses he sustained through his reliance upon false representations made by the seller as to the status of the creditors’ accounts).
171 Id. § 109.
In *Wells v. Huish Detergents, Inc.*, Wells also asserted a claim for fraudulent misrepresentation against Huish since he relied on Anglin's material representation that he could engage in self-dealing without any adverse employment consequences. The district court did not address Wells' fraudulent misrepresentation claim in its summary judgment order. Rather, this issue was addressed for the first time in the district court's order denying Wells' motion to alter or amend judgment, pursuant to which the district court concluded that the action against Huish was not proper because the handbook stated that no statement by an employee should be interpreted as altering the employment agreement.

On appeal, the court of appeals found that there were several factors that indicated that Wells was not justified in relying on Anglin's permission in the exercise of common prudence and diligence. First, Huish's policies made it clear that they would not be bound by unauthorized statements by any of its employees. Thus, Wells knew that Anglin did not have the authority to make the representation. Second, under the provisions of the handbook, Wells was aware that unauthorized representations, such as Anglin's, were to be considered "nothing more than ill-advised and unauthorized act[s]." Third, according to his acknowledgment of the handbook, Wells was aware that only the president of Huish could modify the at-will status of an employee, and that "no statement by any employee should be interpreted as altering the employment agreement." Thus, the court of appeals held that Wells was not justified in relying upon Anglin's statements, and that the district court did not err in granting Huish's motion for summary judgment on the fraudulent misrepresentation claim.

In *Dickson v. Comair, Inc.*, former employee, Nancy Dickson ("Dickson"), asserted a claim for promissory estoppel. The Boone Circuit Court dismissed her claims against Comair and two Comair employees. However, the court of appeals held that summary judgment was improperly granted on Dickson's promissory estoppel claim because evidence and testimony presented a genuine issue of material fact.

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173 *Id.*
174 *Id.*
175 *Id.* at 177.
176 *Id.*
177 *Id.*
179 *Id.*
180 *Id.*
181 *Id.*
183 *Id.* at *1.
184 *Id.*
185 *Id.*
In 1997, Comair informed all of its employees that they were considering a policy change to require employees to relinquish their seniority earned as flight attendants when the employees took positions as in-flight supervisors.\footnote{id.} In other words, if a flight attendant took a position as an in-flight supervisor, all seniority would be lost if they decided to return to a flight attendant position.\footnote{id.} At the time that Comair was considering the proposed policy changes, Dickson was an in-flight supervisor who was told that she would have to agree to the new policy in order to remain a supervisor.\footnote{id.}

Dickson, concerned about the possibility of forfeiting her twelve years of seniority, had various meetings and conversations with her supervisors.\footnote{id.} Dickson claimed that she was informed by Comair that she would not lose her seniority if she had to return to a flight attendant position due to Comair eliminating her supervisory position.\footnote{id.} In 1999, Comair reorganized its in-flight department.\footnote{id.} Dickson alleged that after the reorganization, there were drastic changes in her work duties that effectively eliminated her position as a supervisor.\footnote{id.}

In turn, Dickson applied for a position as a flight attendant instructor, based upon assurances from Linda Noble ("Noble") and Lorain DeLottell ("DeLottell") that her seniority would be reinstated under these circumstances.\footnote{id.} After accepting the new position, however, Dickson was informed that it might not be possible to reinstate her seniority.\footnote{id.} Dickson took the new position under protest and with the understanding that the seniority issue would remain under consideration.\footnote{id.} Eventually, the decision was made that Dickson would lose all of her seniority, and as a result Dickson stated that she was "forced to leave" Comair because "she could no longer bear to work under those circumstances."\footnote{id.}

Comair argued that Dickson could not prevail on her promissory estoppel claim because she had failed to establish a sufficiently clear and definite promise and detrimental reliance upon that promise.\footnote{id.} Furthermore, Comair asserted that the changes in Dickson’s job were not so drastic as to have effectively eliminated her position.\footnote{id.} Comair characterized "the changes in Dickson’s
supervisory position as 'missing two meetings, the computerization of some paperwork, a new office location, and other minor adjustments.' 

The testimony of the in-flight supervisor, DeLotell, was taken from her deposition. Part of her testimony involved documents from a personnel meeting regarding the policy changes Comair was considering in late 1997. During this meeting, DeLotell represented these changes as policy and not as policy considerations. DeLotell stated that although the policy had not yet been adopted, it was Comair's intent to put the policy in place with regard to supervisors and likely with regard to flight attendants as well. During her testimony, DeLotell also recalled meeting with Dickson, who had expressed concerns about the possibility of giving up her seniority. Dickson believed, following this meeting, that if her job status changed to the extent that her job was, in effect, eliminated, she would be able to regain her seniority.

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199 Id.
200 Dickson, 2003 WL 21471979, at *2.
201 Id. DeLotell read the following:

We removed supervisors from the in-flight service seniority list to ensure their commitment to the position. There is, however, one exception and that is should we ever reduce the number of supervisors or eliminate a particular position, they will be returned to their original position on the list in order that they may maintain their employment with Comair as a flight attendant.

202 Id.
203 Id.
204 Id. at *3.
205 Id.
206 Dickson, 2003 WL 21471979, at *3.
Noble, the senior vice president of human resources, also recalled attending a meeting between Dickson and DeLotell in which Dickson said that she would give up her seniority.\textsuperscript{207} Noble did not recall any other statements by Dickson during that meeting; however, she did recall that Dickson was told that if her supervisory job was eliminated as a result of downsizing then her seniority would be re-established.\textsuperscript{208} Noble further testified that she did recall Dickson complaining about the changes in her responsibilities.\textsuperscript{209}

In light of the evidence and testimony provided by DeLotell and Noble, the court of appeals held that genuine issues of material fact existed in Dickson’s claim of promissory estoppel.\textsuperscript{210} Accordingly, the court of appeals found that the trial court’s entry of summary judgment on Dickson’s promissory estoppel claim was improper and reversed the trial court’s decision.\textsuperscript{211}

4. Obligation of Good Faith and Fair Dealing

In \textit{Nationwide Mutual Insurance Co. v. Ramey},\textsuperscript{212} Joyce Ramey ("Ramey") filed, amongst other claims, a breach of contract claim against Nationwide in response to Nationwide’s suit against her for breach of a non-compete clause following the termination of her employment.\textsuperscript{213} "The district court granted Ramey’s motion for summary judgment dismissing Nationwide’s claim,” and granted partial summary judgment on Ramey’s counterclaims.\textsuperscript{214} Ramey appealed the decision alleging that genuine issues of material fact existed with regard to her breach of contract claim.\textsuperscript{215} However, the court of appeals affirmed the district court’s dismissal of the claims.\textsuperscript{216}

Ramey and her husband established the Ramey Insurance Company in 1979.\textsuperscript{217} Subsequently, her husband became a Nationwide agent and entered into an "Agent Agreement to become the principal and exclusive Nationwide agent for Floyd County."\textsuperscript{218} Thereafter, Ramey agreed to serve as an associate agent for Nationwide.\textsuperscript{219} As Ramey approached retirement, the couple decided to switch positions; Ramey would become the principal agent and her husband

\textsuperscript{207} \textit{Id.} at *4.
\textsuperscript{208} \textit{Id.}
\textsuperscript{209} \textit{Id.}
\textsuperscript{210} \textit{Id.} at *5.
\textsuperscript{211} \textit{Id.}
\textsuperscript{212} No. 99-5669, 2000 WL 1478385 (6th Cir. Sept. 29, 2000).
\textsuperscript{213} \textit{Id.} at *3.
\textsuperscript{214} \textit{Id.}
\textsuperscript{215} \textit{Id.}
\textsuperscript{216} \textit{Id.}
\textsuperscript{217} Ramey, 2000 WL 1478385, at *1.
\textsuperscript{218} \textit{Id.}
would act as an associate agent. This plan was discussed with Nationwide agents, and although there was a disagreement as to the percentage of commission Ramey would receive as a result of the agreement, the agents assured Ramey that their intention was to give her the agency.

Shortly after this meeting occurred, however, Ramey’s husband died unexpectedly. As a result, Nationwide held another meeting with Ramey to arrange a short-term agency agreement so that the business could continue to operate until another agency agreement was established. Nationwide and Ramey thereupon entered into an “Agency Service Agreement,” whereby they agreed that either party could cancel the agreement with seven days written notice.

In addition to the “Agency Service Agreement,” Ramey received a copy of Nationwide’s PASPORT agreement. In order for Ramey to receive a permanent assignment of her husband’s policies, it was necessary for her to agree to all of the terms of the PASPORT agreement. Ramey reviewed this agreement in detail with the Nationwide agents but never signed the agreement. Although she had not signed the agreement, Ramey believed that she had verbally agreed to all of the terms of the PASPORT agreement, and that the agreement would be signed at a later date.

Before the parties had an opportunity to sign the PASPORT agreement, Nationwide decided to terminate their employment relationship with Ramey. Shortly thereafter, Nationwide filed suit against Ramey for violating a non-compete clause that was contained in the associate agent agreement that she had entered into prior to her husband’s death. In turn, Ramey filed a counterclaim for breach of contract based upon her oral agreement with Nationwide to sign and implement the PASPORT Agreement. In arguing her breach of contract claim, Ramey asserted that Nationwide had breached an implied covenant of good faith and fair dealing.

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220 Id.
221 Id.
222 Id.
223 Id.
224 Ramey, 2000 WL 1478385, at *1.
225 Id. at *2. “PASPORT is a program to provide new agents with a portfolio of [ ] Nationwide policies” in order to provide a foundation for their businesses. Id. PASPORT consists of two parts: “a memorandum of the expected standards to be met by the new agent [ ] and a Nationwide Agent Agreement.” Id. The agent must agree to the expected standards before entering into the Nationwide Agent Agreement. Id.
226 Id.
227 Id.
228 Id.
229 Id.
230 Ramey, 2000 WL 1478385, at *3.
231 Id.
232 Id. at *7.
The court of appeals found that the only agreement that Ramey and Nationwide had entered into was an Agency Service Agreement, which was an at-will employment agreement.\textsuperscript{233} The agreement expressly stated that either party could cancel the agreement upon seven days' notice.\textsuperscript{234} Therefore, Nationwide could terminate Ramey's employment for good cause, for no cause, or even if Nationwide had acted in bad faith.\textsuperscript{235} This was, of course, unless Nationwide's actions fell within one of the narrow public policy exceptions to the terminable at-will doctrine set forth by the Kentucky Supreme Court.\textsuperscript{236} In its decision the court of appeals stated that, "an employee's tenure with an employer does not impose an implied duty of good faith and fair dealing upon the employer [such as] to create an exception to this doctrine."\textsuperscript{237} Therefore, the court of appeals held that Nationwide did not breach an implied duty of good faith and fair dealing in terminating Ramey's employment.\textsuperscript{238}

The court's decision in \textit{Ramey} is consistent with the Kentucky Court of Appeals decision in \textit{Wyant v. SCM Corp.},\textsuperscript{239} in which the court also declined to imply a duty of good faith and fair dealing into the at-will employment relationship, reasoning that "terminable at-will employment in Kentucky may be ended at any time, with or without cause."\textsuperscript{240} From a purely legal perspective, an obligation of good faith and fair dealing is patently inconsistent with the employment at-will doctrine, under which the Kentucky Supreme Court has held that an employer may discharge an employee "for good cause, for no cause, or for a cause that some might view as morally indefensible."\textsuperscript{241} While the employment at-will doctrine is far from indelible, having been scythed by a number of exceptions, the courts' decisions refusing to imply a duty of good faith and fair dealing have had the effect of at least temporarily preserving the employment at-will doctrine from inanity.

\textsuperscript{233} \textit{Id.} This was the agreement entered into immediately after her husband's death. \textit{Id.}

\textsuperscript{234} \textit{Id.}

\textsuperscript{235} See \textit{Firestone Textile Co. Div. v. Meadows}, 666 S.W.2d 730, 731 (Ky. 1983) (explaining that ordinarily an employer may discharge his at-will employee for good cause, for no cause, or for a cause that some might view as morally indefensible).

\textsuperscript{236} \textit{Ramey}, 2000 WL 1478385, at *7. In order for the exception to apply, the public policy must be "clearly defined by statute and directed at providing a statutory protection to the [employee] in his employment situation." Grzyb v. Evans, 700 S.W.2d 399, 400 (Ky. 1985). Since Ramey's actions were not statutorily protected, the termination did not fall within the narrow public policy exception to the terminable-at-will doctrine. \textit{Ramey}, 2000 WL 1478385, at *7.

\textsuperscript{237} \textit{Ramey}, 2000 WL 1478385, at *7.

\textsuperscript{238} \textit{Id.}

\textsuperscript{239} 692 S.W.2d 814 (Ky. Ct. App. 1985).

\textsuperscript{240} \textit{Id.} at 816.

\textsuperscript{241} \textit{Firestone Textile Co. Div. v. Meadows}, 666 S.W.2d 730, 731 (Ky. 1983).
5. Negligent Hiring, Retention, and Supervision of Employees

Tort liability may be imposed upon an employer for the negligent hiring, retention, or supervision of an employee.\textsuperscript{242} The basis of the tort is the employer's negligence in hiring, retaining, or supervising an incompetent employee who the employer either knew, or should have known, was incompetent, unfit, and likely to create an unreasonable risk of harm to a third party.\textsuperscript{243} Often, the terms negligent hiring, negligent supervision, and negligent retention are used interchangeably.\textsuperscript{244} The factual difference between the three negligent employment claims is based upon the time at which the employer became aware of the employee's incompetence or unfitness for the position for which they were employed.\textsuperscript{245} Whereas negligent hiring actions are premised upon negligence in the pre-employment investigation into the employee's background, negligent retention and supervision actions are premised upon omissions or actions by the employer once the employer becomes chargeable with knowledge surrounding an employee during the employee's course of employment.\textsuperscript{246} Under Kentucky law, the elements of a suit predicated on negligent hiring, supervision and retention are "that (1) the employer knew or reasonably should have known that the employee was unfit for the job for which he was employed, and (2) the employee's placement or retention at that job created an unreasonable risk of harm" to a third party.\textsuperscript{247}

In *Grego v. Meijer, Inc.*,\textsuperscript{248} the plaintiff, Stephanie Grego ("Grego"), filed a suit premised upon a theory that her former employer, Meijer, negligently supervised two employees who sexually harassed her during her employment.\textsuperscript{249} Meijer moved for summary judgment on the negligent supervision claim, and the court granted the motion, holding that the Workers' Compensation Act provided the exclusive remedy where an employee is injured by an employer's negligence.\textsuperscript{250}

Grego was employed with Meijer for only a short period—February to April of 1998.\textsuperscript{251} During this short period of employment, Grego encountered two co-

\textsuperscript{242} 30 C.J.S. *Employer – Employee* § 186 (2003).
\textsuperscript{243} Id.
\textsuperscript{244} 6 *CAUSES OF ACTION* 2d 745 (2003).
\textsuperscript{245} Id.
\textsuperscript{246} Id.
\textsuperscript{247} See Stalbosky v. Belew, 205 F.3d 890, 894 (6th Cir. 2000) (holding that in order for the plaintiff to succeed on a claim for negligent hiring and retention it was necessary to satisfy this two-part test and because the plaintiff failed to establish that the employee's employment as a long-haul truck driver posed unreasonable risk of harm to the victim, the elements of the test were not sufficiently satisfied).
\textsuperscript{248} 239 F. Supp. 2d 676 (W.D. Ky. 2002).
\textsuperscript{249} Id. at 678.
\textsuperscript{250} Id. at 683.
\textsuperscript{251} Id. at 679.
workers who regularly and consistently made offensive and demeaning comments and gestures toward her.\textsuperscript{252} Grego not only indicated to her co-workers that this behavior was offensive, but she also reported the harassing conduct to her supervisor on at least two separate occasions.\textsuperscript{253} However, the conduct continued and after an incident where one of the co-workers approached her in a walk-in freezer, Grego decided not to return to work.\textsuperscript{254} Grego’s claim of negligent supervision against her former employer was premised on the alleged harassment by her two former co-workers.\textsuperscript{255}

Meijer put forth two separate arguments against Grego’s claim for negligent supervision: (1) Grego failed to produce evidence suggesting that Meijer knew or should have known that her co-workers posed an unreasonable risk of harm; and (2) that the exclusivity provision of the Kentucky Workers’ Compensation Act, K.R.S. § 342.690(1), barred the negligent employment action.\textsuperscript{256} The court rejected Meijer’s first argument because Grego presented clear evidence from which a jury could determine that Meijer either knew or should have known that the two employees were harassing other women and therefore, might also harass Grego.\textsuperscript{257}

The court agreed, however, with Meijer’s second argument, and further determined that Grego’s claim was barred under the provisions of K.R.S. § 342.690(1).\textsuperscript{258} The court stated that, “[t]he statute and Kentucky case law interpreting the statute make it clear that the Workers’ Compensation Act provides the exclusive remedy where a covered employee is injured by [an]...
employer's negligent actions." Accordingly, the court sustained Meijer's motion for summary judgment on the negligent supervision claim.

While the Grego decision is consistent with the underlying policy of Kentucky's Workers' Compensation Act, it is arguably contrary to several older decisions from Kentucky. For instance, in Ballard's Administratrix v. Louisville & Nashville Railroad Co., a case involving the issue of an employer's liability for the death of an employee who was killed by another employee's "prank," the court held as follows:

The master must exercise ordinary care in the selection of his servants and if he fails to exercise such care, and one of the servants is injured by the incapacity of another servant, the master is liable, but the incapacity of the fellow servant must relate to the duties required of him by the master.

Therefore, an employer can be held liable for the acts of an employee which are injurious to a fellow employee if the employer failed to exercise reasonable care in hiring that employee; however, the employee's injurious conduct must be within the scope of the employment.

In Ballard's Administratrix, Ballard was killed when, as described by the court, "Hodge slipped up behind him with a compressed air hose, and turned the high pressure of air from the hose into Ballard's rectum, the air entering his bowels and rupturing them in such a way that he died shortly afterwards." Noting that Hodge had been using the air hose in a "playful manner" for some time prior to Ballard's death, the court pointed out that "Hodge was a careless, 

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[M]akes it clear that the worker's compensation act provides the exclusive remedy for [the] death even if Kentucky does recognize the tort of negligent hiring and retention and even if [the plaintiff] can prove that [the defendant] was negligent in its hiring or retention of [the plaintiff's co-worker and murderer].


261 See, e.g., Ballard's Adm'x v. Louisville & Nashville R.R. Co., 110 S.W. 296 (Ky. 1908).

262 Id.

263 Id. at 297. See also Central Truckaway System, Inc. v. Moore, 201 S.W.2d 725, 728 (Ky. Ct. App. 1947) (quoting the above language with approval).

264 Ballard's Adm'x, 110 S.W. at 297.

265 Id. at 296.
reckless, and stupid boy, and utterly unfit to be working around or handling this
dangerous air hose."\textsuperscript{266} The court also made the following additional
observations:

The defendant, knowing of the careless, reckless, and dangerous disposition of Hodge,
and knowing of his conduct in connection with the use of the dangerous compressed air,
negligently retained him in its employ, and negligently failed to exercise proper and
reasonable supervision over his acts and conduct while in defendant’s services, and negligently
exposed [ ] Ballard to the dangers and hazard of working with this reckless, unsafe, and unfit
servant.\textsuperscript{267}

Here, because the employer was negligent in its hiring and retention of Hodge,
who had a “dangerous disposition” which was known by the employer, the
employer was liable for the injuries Ballard sustained as a result of Hodge’s
conduct.\textsuperscript{268}

Although Ballard’s Administratrix was obviously decided prior to the
enactment of Kentucky’s current Workers’ Compensation Act, it is peculiar that
the Grego court did not discuss Ballard’s Administratrix, particularly in light of
the Grego court’s comment that “[t]he parties have not cited, and the court has
been unable to locate, any Kentucky case law dealing with this precise point of
law.”\textsuperscript{269} Nonetheless, Ballard’s Administratrix - which clearly allowed an
injured employee to pursue a negligent supervision claim against her employer -
has apparently been overruled by Grego.\textsuperscript{270}

Although it was not specifically addressed in Grego, it is also worth noting
that the Grego decision prohibits only employees from pursuing negligent
supervision claim against employers. A third person (not employed by the
employer at issue) who is injured by an employee may still pursue a negligent
supervision claim against the employee’s employer.\textsuperscript{271}

\textsuperscript{266} Id.
\textsuperscript{267} Id.
\textsuperscript{268} Id.
\textsuperscript{269} Grego v. Meijer, Inc., 239 F. Supp. 2d 676, 682 (W.D. Ky. 2002).
\textsuperscript{270} See id.
\textsuperscript{271} See, e.g., Oakley v. Flor-Shin, Inc., 964 S.W.2d 438 (Ky. Ct. App. 1998); Roman Catholic
Diocese of Covington v. Secter, 966 S.W.2d 286 (Ky. Ct. App. 1998); Stalbosky v. Belew, 205
F.3d 890 (6th Cir. 2000).
While the issue of negligent hiring and retention of an employee was not disputed in the following case, *Westfield Insurance Co. v. Tech Dry, Inc.*, the case presented an interesting matter of first impression: "whether negligent hiring and retention of an employee can constitute an 'occurrence' in the context of a general liability policy." *Westfield* brought a declaratory judgment action, seeking a determination that it was not obligated to defend or indemnify its insured, Tech Dry, in a wrongful death action brought by the daughter of the victim, who was murdered by a former Tech Dry employee. The United States District Court for the Eastern District of Kentucky granted summary judgment in favor of Tech Dry and Westfield appealed. The court of appeals held that Tech Dry's alleged negligent hiring and retaining of Fred Furnish ("Furnish") was a qualifying "occurrence" under the Commercial General Liability insurance policy.

In 1998, while employed with Tech Dry, Furnish performed work in the home of Ramona Williamson ("Williamson"). Shortly after his termination, Furnish entered the home of Williamson and murdered her. As a result, Williamson's daughter filed a wrongful death action against Tech Dry, alleging Tech Dry was negligent in hiring and retaining Furnish as an employee. In evidence was the fact that Tech Dry's owner did not complete a criminal background check on Furnish before hiring him and more importantly, that Tech Dry retained Furnish even after receiving complaints of theft from several of its customers.

As a result of Williamson's murder, Tech Dry asked Westfield to provide defense and indemnity in the wrongful death action. In response to Tech Dry's request, Westfield filed an action seeking a declaratory judgment that Tech Dry's policy did not require Westfield to defend Tech Dry or to satisfy any judgment that Williamson's daughter might receive in her wrongful death claim. At issue was whether the "occurrence" causing Williamson's death

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272 336 F.3d 503 (6th Cir. 2003).
273 Id. at 508.
274 Id. at 504.
275 Id. at 505.
276 Id.
277 Id.
278 Westfield Ins. Co., 336 F.3d at 505.
279 Id.
280 Id.
281 Id.
282 Id. at 505-06. Tech Dry's policy provided that "Westfield will defend Tech Dry in suits seeking damages for bodily injury or property damage caused by an 'occurrence.'” Id. The policy defined occurrence as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." Id. Westfield contended that negligent hiring and retention was not a clearly defined "occurrence" under the terms of the policy and that therefore, the policy did not provide coverage for a wrongful death suit arising from the negligent hiring and retention of Furnish. Id. at 506-07.
was covered by Tech Dry’s policy. It was undisputed that Tech Dry’s negligence was the proximate cause of Williamson’s death; however, there was dispute as to whether Tech Dry’s negligent decision to hire and retain Furnish as an employee was a qualifying “occurrence” under its policy. As previously mentioned, this issue presented a matter of first impression in Kentucky. Therefore, in rendering its decision, the court of appeals had to predict how the Kentucky Supreme Court would resolve the issue.

In analyzing whether Tech Dry’s conduct was an “occurrence,” the court of appeals noted the Kentucky Supreme Court’s recognition that “[c]ourts and commentators alike are in agreement that the term ‘occurrence’ is to be broadly and liberally construed in favor of extending coverage to the insured.” The court of appeals further noted that the Kentucky Supreme Court recognizes that it “must give [policies their] plain meaning and [that it is] constrained from enlarging the risks contrary to the natural and obvious meaning of the insurance contract.”

In rendering its decision, the court of appeals stated that, under Kentucky law, even if Tech Dry’s conduct in hiring and retaining Furnish was intentional, and Williamson’s death was foreseeable, its policy nevertheless provided coverage so long as “the injury was not actually and subjectively intended.” Accordingly, Westfield could not deny coverage on the grounds that the conduct was intentional rather than accidental if Tech Dry did not possess the requisite intent to cause Williamson’s death. The court of appeals stated that while Kentucky courts will infer intent to injure from “inherently injurious” acts, conduct is not “inherently injurious” unless it is “substantially certain to result in some injury.” As such, the court of appeals reasoned that, “by nature, negligently hiring and retaining an employee is not substantially certain to result in some injury and therefore is not inherently injurious.”

Accordingly, the Sixth Circuit Court of Appeals concluded that “the Kentucky Supreme Court would hold that Tech Dry [was] entitled to coverage because Tech Dry’s negligent hiring and retention of Furnish constitute[d] an

283 Id. at 508.
284 Westfield Ins. Co., 336 F.3d at 508.
285 See Stalbosky v. Belew, 205 F.3d 890, 893-94 (6th Cir. 2000) (acknowledging that “[o]ur task [in a diversity case] is to make our best prediction, even in the absence of direct state court precedent, of what the Kentucky Supreme Court would do if it were confronted with this question” (quoting Welsh v. United States, 844 F.2d 1239, 1245 (6th Cir. 1988))).
289 Id.
290 See, e.g., Thompson, 839 S.W.2d at 581 (stating that “sexual molestation is so inherently injurious . . . that the intent to injure . . . can be inferred as a matter of law”).
291 Westfield Ins. Co., 336 F.3d at 510 (quoting Thompson, 839 S.W.2d at 581).
292 Id.
‘accident,’ and therefore an ‘occurrence,’ under the terms” of its policy with Westfield. Thus, the court of appeals affirmed the district court’s decision granting Tech Dry’s motion for summary judgment because Tech Dry’s negligent hiring and retention of Furnish constituted an “occurrence” under the terms of its policy.

6. Intentional Infliction of Emotional Distress

Under Kentucky law, in order to establish a claim for an action of intentional infliction of emotional distress, the following elements must be satisfied: (1) the wrongdoer’s conduct must be intentional or reckless; (2) the conduct must be outrageous or extreme; (3) there must be a causal connection between the conduct and the emotional distress; and (4) the emotional distress must be severe.

In Kroger Co. v. Buckley, Joanne Buckley ("Buckley") brought an action against her former employer alleging, inter alia, intentional infliction of emotional distress. The Warren County Circuit Court entered judgment on the jury verdict awarding Buckley damages, and Kroger appealed. The Kentucky Court of Appeals vacated the judgment of the circuit court, and held that Buckley’s disability discrimination claim preempted her common law claim of intentional infliction of emotional distress.

During Buckley’s employment with Kroger, she was subjected to working with an employee who suffered from manic depression, and who had allegedly threatened another employee with a knife. At one point, an incident occurred where the manic employee allegedly failed to properly label some of the products he was working on with Buckley. As a result of the incident, both employees were suspended. Buckley alleged that, “this suspension was the first of a series of events which destroyed her mental health.”

Soon after the event, Buckley was told that she would be punished for any further mistakes made by the employee; however, she was ordered not to help him avoid further mistakes. Additionally, Buckley’s supervisors ordered her to report to management not only any mistakes made by the manic employee, but

293 Id.
294 Id.
297 Id. at 644.
298 Id. at 646.
299 Id. at 647.
300 Id. at 644-45.
301 Id. at 645.
302 Kroger, 113 S.W.3d at 645.
303 Id.
304 Id.
also any mistakes made by any other employee.\textsuperscript{305} Buckley followed these orders but became "increasingly fearful of having to 'snitch' on the unstable employee."\textsuperscript{306} Subsequently, Buckley began seeing a psychiatrist and took a leave of absence, claiming that she was no longer able to work as a result of her fears in working with the manic employee.\textsuperscript{307} Thereafter, Buckley filed her suit in the Warren Circuit Court against Kroger and five individual supervisors, alleging, in addition to the intentional infliction of emotional distress claim, discrimination and retaliation under the Kentucky Civil Rights Act (KCRA).\textsuperscript{308} Kroger moved to dismiss the claim for intentional infliction of emotional distress on the basis that the claim was preempted by the disability discrimination claim; however, the motion was denied.\textsuperscript{309}

As part of Kroger's company policy, if an employee's leave of absence extended for more than one year the employee would automatically be terminated.\textsuperscript{310} Ten months after Buckley filed her claims in the Warren Circuit Court, she contacted Kroger in an attempt to return to work.\textsuperscript{311} However, Buckley's psychiatrist had placed several limitations on releasing Buckley to return to work and Kroger determined that they could not accommodate the restrictions because the restrictions would severely impair Buckley's ability to perform the functions of her job.\textsuperscript{312} Accordingly, Kroger terminated Buckley's employment.\textsuperscript{313}

\begin{footnotesize}
\textsuperscript{305} Id.
\textsuperscript{306} Id.
\textsuperscript{307} Id.
\textsuperscript{308} Kroger, 113 S.W.3d at 645. \textit{See also} KY. REV. STAT. ANN. § 344.020(1)(b) (Banks-Baldwin 2003). This section provides in pertinent part that:

The general purposes of this chapter are: \ldots (t)o safeguard all individuals within the state from discrimination because of familial status, race, color, religion, national origin, sex, age forty (40) and over, or because of the person's status as a qualified individual with a disability \ldots thereby to protect their interest in personal dignity and freedom from humiliation, to make available to the state their full productive capacities, to secure the state against domestic strife and unrest which would menace its democratic institutions, to preserve the public safety, health, and general welfare, and to further the interest, rights, and privileges of individuals within the state.

\textit{Id.}
\textsuperscript{309} Kroger, 113 S.W.3d at 645.
\textsuperscript{310} Id.
\textsuperscript{311} Id.
\textsuperscript{312} Id.
\textsuperscript{313} Id.
\end{footnotesize}
In the trial court, the jury returned a verdict in favor of Buckley on both the disability discrimination claim and the intentional infliction of emotional distress claim. Kroger appealed, arguing that the intentional infliction of emotional distress claim was preempted by the KCRA claim because both claims were based on the same facts.

Subsequent to Buckley's trial in the Warren Circuit Court, the Kentucky Court of Appeals decided Wilson v. Lowe's Home Center, which held that when a plaintiff prosecutes a K.R.S. Chapter 344 claim and an intentional infliction of emotional distress claim concurrently, the former preempts the latter. Accordingly, the Kentucky Court of Appeals stated that the holding in the Wilson case was clear; a K.R.S. § 344 claim preempts a common law claim for intentional infliction of emotional distress.

The court was not persuaded by Buckley's argument that her case was distinguishable from Wilson because her Chapter 344 disability discrimination claim related only to Kroger's failure to reasonably accommodate her disabilities while her intentional infliction of emotional distress claim related to the actions taken by her supervisors subsequent to the incident which resulted in her suspension. Accordingly, the court of appeals held that Buckley's claim for intentional infliction of emotional distress was barred by her disability discrimination claim because the facts upon which she relied for her disability discrimination claim were substantially the same as those that she relied upon to support her common law claim for intentional infliction of emotional distress.

In turn, the court of appeals vacated the judgment of the Warren Circuit Court and remanded the case for a new trial.

314 Id. at 646.
315 Kroger, 113 S.W.3d at 646.
316 See Wilson v. Lowe's Home Center, 75 S.W.3d 229, 239 (Ky. Ct. App. 2001). In Wilson, the K.R.S. Chapter 344 claims were brought against Lowe's only and not against any of its store managers. Id. However, the intentional infliction of emotional distress ("IIED") claim was brought against both Lowe's and several of its managers. Id. The court agreed with Lowe's that the plaintiff's IIED claim against them was subsumed by the K.R.S. Chapter 344 claims. Id. However, the court disagreed that the IIED claims against the supervisors were subsumed by the K.R.S. Chapter 344 claims against Lowe's. Id. The court stated that K.R.S. § 344.020(1)(b) "extends protection to the 'personal dignity and freedom from humiliation' of individuals, which has been interpreted as allowing 'claims for damages for humiliation and personal dignity.'" Id. (quoting McNeal v. Armour & Co., 660 S.W.2d 957, 958 (Ky. Ct. App. 1983)). The court added that an IIED claim seeks damages for extreme emotional distress and that, "[w]here the statute both declares the unlawful act and specifies the civil remedy available to the aggrieved party, the aggrieved party is limited by the remedy provided by the statute." Id. (quoting Grzyb v. Evans, 700 S.W.2d 399, 401 (Ky. 1985)). Accordingly, in Wilson the court held that the plaintiff's IIED claim against Lowe's was subsumed by the K.R.S. Chapter 344 claims. Id.
317 Kroger, 113 S.W.3d at 646.
318 Id. at 647.
319 Id.
320 Id.
Because an intentional infliction of emotional distress claim is often a "gap filler," being a claim that rarely succeeds due to the fact that it applies to very narrowly construed conduct of an outrageous and intolerable nature, the court's decision in Wilson—finding that the plaintiff's intentional infliction of emotional distress claim against his employer was preempted by the KCRA—is not particularly adverse to claimants, especially given that such claims may still be pursued against individual supervisors and managers. A more genuine concern, however, is that the Wilson court's preemption analysis could conceivably lead to other torts (in the employment context) being preempted by the KCRA.

7. Defamation

A cause of action for defamation may arise when an employer makes false statements about a current or former employee to his or her own employees or to a prospective employer. Under Kentucky law, the following elements must be satisfied in order to establish a cause of action for defamation: (1) defamatory language; (2) about an individual; (3) which was published; and (4) which caused injury to the individual's reputation. In order to qualify as a publication, it is necessary that there be a communication between someone other than the plaintiff and the defendant.

In Wilson v. Ashland Hospital Corp., Julia Wilson ("Wilson") was terminated from her position with King's Daughters Medical Center as a result of what the hospital claimed "was dishonesty in cashing disability checks to which she was not entitled." As a result, Wilson brought suit against the hospital and members of the human resources department, alleging various claims including defamation. The district court entered summary judgment in favor of the hospital and Wilson appealed. The Sixth Circuit Court of Appeals affirmed the district court's decision.

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321 See, e.g., Wilson, 75 S.W.3d at 229.
322 See, e.g., Columbia Sussex Corp. v. Hay, 627 S.W.2d 270 (Ky. Ct. App. 1981) (holding president and general manager liable for slander in action brought by discharged manager where words conveyed a strong assertion that either the manager or another employee were involved in a robbery on the premises).
323 CHARLES R. RICHEY, MANUAL ON EMPLOYMENT DISCRIMINATION & CIVIL RIGHTS ACTIONS Ch.8.IV.E § 8:89 (2003).
324 See Columbia Sussex Corp., 627 S.W.2d at 273.
327 Id. at *1.
328 Id.
329 Id.
330 Id.
Wilson worked in the intensive care department at King's Daughters Medical Center, a facility owned and operated by Ashland Hospital Corporation.\(^{331}\) During her employment, Wilson broke her leg and was temporarily disabled.\(^{332}\) Wilson was out of work for approximately six months during which time she received long-term disability benefits from the hospital's disability insurance carrier, UNUM Life Insurance Company of America.\(^{333}\) Despite the fact that Wilson returned to work, in a different position, she continued to receive full disability payments from UNUM.\(^{334}\) When Wilson inquired about these payments, she was allegedly told by her UNUM representative to report her earnings, and any overpayment would be handled through a reimbursement.\(^{335}\) However, contrary to the directions she received from the UNUM representative, Wilson failed to report her earnings.\(^{336}\) Consequently, Wilson was terminated when hospital administrators became aware of the fact that Wilson had been cashing, and keeping, the disability checks in addition to her regular paychecks.\(^{337}\) The administrators further learned that Wilson had not been reporting this income as she had been directed by her UNUM representative.\(^{338}\)

During the termination process Wilson received a pre-typed letter stating that her "employment was being terminated because she had 'wrongfully and fraudulently continued to accept and cash [disability] insurance checks.'"\(^{339}\) Subsequently, the hospital's payroll department was notified of Wilson's termination via a form, which indicated that Wilson had been terminated for "dishonesty."\(^{340}\) These written statements formed the basis of Wilson's defamation claim.\(^{341}\)

The court of appeals stated that Wilson could make a prima facie showing of each of the elements for a defamation claim.\(^{342}\) The court reasoned that "the statements in question were obviously about Wilson" and were published to the payroll clerk, benefits coordinator, and UNUM representatives.\(^{343}\) As for the remaining elements, the Court of Appeals stated that the use of the word

\(^{331}\) Id.

\(^{332}\) Wilson, 2000 WL 263272, at *1.

\(^{333}\) Id.

\(^{334}\) Id. at *1-2.

\(^{335}\) Id. at *2.

\(^{336}\) Id.

\(^{337}\) Id.

\(^{338}\) Id.

\(^{339}\) Wilson, 2000 WL 263272, at *2.

\(^{339}\) Id.

\(^{340}\) Id.

\(^{341}\) Id. at *5.

\(^{342}\) Id.

\(^{343}\) Id.
“dishonesty” is defamatory per se.\textsuperscript{344} Thus, the use of the word “dishonesty” satisfied the remaining two elements—defamatory language and injury to reputation—since both such elements are presumed with defamation per se.\textsuperscript{345}

The court of appeals noted, however, that Wilson could not succeed on her claim if the statements made by the hospital were “protected by a qualified privilege.”\textsuperscript{346} A communication is privileged if it is “made . . . in good faith and without actual malice . . . in connection with a legitimate and necessary business purpose and was published only to those people who needed the information.”\textsuperscript{347} The court determined that the evidence presented satisfied the conditions and thus, the statements were protected by a qualified privilege.\textsuperscript{348} Therefore, Wilson could not sustain her claim for defamation against the hospital and its administrators.\textsuperscript{349}

In Jones v. Adecco Staffing,\textsuperscript{350} Wanda Jones (“Jones”) appealed from an order of the Jefferson Circuit Court which granted summary judgment in favor of Adecco Staffing on her claim of slander per se.\textsuperscript{351} The court of appeals affirmed the decision of the Jefferson Circuit Court.\textsuperscript{352}

Jones’ claim arose after she applied for a job through the Lakeshore Staffing Agency (“Lakeshore”).\textsuperscript{353} Shortly after submitting her resume, Jones was informed that she was qualified for a position with Humana.\textsuperscript{354} Accordingly, a Lakeshore representative submitted Jones’ resume to Adecco for the Humana position (Lakeshore had an agreement with Adecco whereby Lakeshore would submit candidates to fill temporary positions, which Adecco could not fill).\textsuperscript{355} According to Lakeshore’s employment file on Jones, the Lakeshore representative was told by Steve Davis (“Davis”), the National Account Director for Adecco, that Jones was ineligible for rehire; no reasons were stated in the file.\textsuperscript{356}

Jones argued that the Lakeshore representative told her that she had received a negative report from Davis, and therefore, Jones could not be considered for

\textsuperscript{344} Wilson, 113 S.W.3d at 646. See also Columbia Sussex Corp. v. Hay, 627 S.W.2d 270, 274 (Ky. Ct. App. 1981) (holding that words conveying an assertion of suspicion of an individual’s involvement in a criminal offense are slanderous per se).
\textsuperscript{345} Wilson, 113 S.W.3d at 646.
\textsuperscript{346} Id.
\textsuperscript{347} Id. See also Wyant v. SCM Corp., 692 S.W.2d 814, 816 (Ky. Ct. App. 1985) (failing to give effect to a statement to the employer’s credit department because as part of an internal report the statement was protected by a qualified privilege as being a necessary communication).
\textsuperscript{348} Wilson, 2000 WL 263272, at *5.
\textsuperscript{349} Id.
\textsuperscript{351} Id. at *1.
\textsuperscript{352} Id.
\textsuperscript{353} Id.
\textsuperscript{354} Id.
\textsuperscript{355} Id.
\textsuperscript{356} Jones, 2003 WL 21991661, at *1.
any positions with Humana. Jones alleged that she was told that Davis "would not consider her because Jones 'threatened Adecco by sending a five page letter and that Steve Davis said that he would not have . . . [Jones] back at Humana on [her] high horse.'" In Jones' claim against Adecco, she argued that the alleged statements by Davis constituted slander per se. Jones' claim was dismissed by the circuit court because there was insufficient evidence to prove that the allegedly defamatory statement was made, and that Davis' statements were not actionable per se; Jones appealed. On appeal, the court held that Jones' testimony satisfied the requirement of "significant evidence," and that the circuit court erred in granting summary judgment on the claim.

"Slander per se differs from ordinary slander in that the words themselves, absent any development of extrinsic facts or circumstances, are actionable if they "necessarily damage [the] plaintiff." Further, "[w]ords falsely spoken are actionable per se where they impute 'unfitness to perform the duties of an office, occupation, or employment, or hav[e] a tendency to prejudice him in his trade, calling or profession, directly or indirectly import[ing] fraud, dishonesty, or sharp or unethical practices.'"

In its decision, the court of appeals agreed that the statements allegedly made by Davis, "that Jones . . . 'threatened Adecco by sending a five page letter and that Steve Davis said that he would not have . . . [Jones] back at Humana on . . . [her] high horse,' did not constitute slander per se." The court reasoned that "[n]either the act of writing threatening letters nor being on a 'high horse' import[ed] fraud, dishonesty, or unethical practices." The court further reasoned that the alleged statements did not speak to Jones' ability to perform the duties of the position for which she applied, and that such statements would not prejudice her in her profession. Accordingly, because Davis' statements did not constitute slander per se, the court of appeals held that summary judgment was appropriate.

The court of appeals also held that any "defamatory statement made by Davis was privileged." The court noted that there are two categories of

357 Id.
358 Id.
359 Id.
360 Id.
361 Id. at *2.
363 Id. (quoting Digest Publ'g Co. v. Perry Publ'g Co., 284 S.W.2d 832, 834 (Ky. 1955)).
364 Id. (quoting Shields v. Booles, 38 S.W.2d 677, 681 (Ky. 1931)).
365 Id. (quoting White v. Hanks, 255 S.W.2d 602, 603 (Ky. 1953)).
366 Id.
367 Id.
369 Id.
370 Id. at *5.
privilege – absolute and qualified – and that, under Kentucky law, a “statement expressing truth” or opinion is absolutely privileged. In the instant case, Davis’ “allegedly slanderous statement contain[ed] two parts: 1) that ‘Jones threatened Adecco by sending a five page letter’; and 2) that Davis said "he would not have [Jones] back at Humana on [her] high horse." Accordingly, the court held that Davis’ statements were protected by the absolute privilege of truth and pure opinion because the second part of his statement was pure opinion based upon truthful facts asserted in the first part of his statement.

The Kentucky Court of Appeals further held that even if Davis’ statements were not absolutely privileged, they were qualifiedly privileged. The court stated that under Kentucky law a statement is qualifiedly privileged “if made in good faith, without actual malice, by one who believes he has a duty or an interest to a person with a corresponding duty or interest." Because Jones failed to present evidence that Davis’ statement was made maliciously, and because Davis and the Lakeshore representative were acting as agents for a common employer, Davis reasonably could have believed that he had a duty to disclose this information to Lakeshore. Thus, his statements were protected.

See, e.g., Bell v. Courier Journal Louisville Times Co., 402 S.W.2d 84, 87 (Ky. 1966). The Bell court held: “A statement expressing truth is absolutely privileged regardless of whether its publication was inspired by malice or ill-will or if it is actionable per se.” Id. See also Jones, 2003 WL 2199166, at *6 n.10.

Jones, 2003 WL 21991661, at *5. “Pure opinion occurs where the commentator states the facts on which the opinion is based, or where both parties to the communication know or assume the exclusive facts on which the comment is clearly based.” Id. (quoting Yancey v. Hamilton, 786 S.W.2d 854, 857 (Ky. 1989)). This contrasts with statements containing mixed opinion in that

[T]he mixed type is apparently based on facts regarding the plaintiff or his conduct that have not been stated by the defendant or assumed to exist by the parties to the communication. [With mixed opinion], if the recipient draws the reasonable conclusion that the derogatory opinion expressed in the comment must have been based on undisclosed defamatory facts, the defendant is subject to liability.

Yancey, 786 S.W.2d at 857.

Jones, 2003 WL 21991661, at *5.

Jones, 2003 WL 21991661, at *5.

Id. After reviewing Jones’ letter, the Court of Appeals held that the letter “operated to threaten Adecco, or, at the very least, could have been interpreted reasonably by their employee Davis as threatening. Thus, a statement expressing the fact that Jones threatened Adecco by sending this letter is one of truth.” Id. Accordingly, the court held that the fact that the letter could be viewed as threatening provided a basis for which Davis could reasonably base his pure opinion with regard to Jones’ attitude and no additional facts were necessary to support his opinion that Jones was on a "high horse." Id.

Id. at *6.

Id. (quoting Brewer v. Am. Nat’l Ins. Co., 636 F.2d 150, 154 (6th Cir. 1980)).
by the qualified privilege. Accordingly, the court of appeals held that Jones did not have a cause of action for slander, and summary judgment was appropriate because Davis’ statements were both absolutely and qualifiedly privileged.

8. Drug Testing

In Relford v. Lexington-Fayette Urban Appellee County Government Civil Service Commission, Robert Relford (“Relford”) appealed an order from the Fayette Circuit Court denying his motion for reinstatement to his civil service position and reimbursement for back pay. The Kentucky Court of Appeals affirmed the decision of the Fayette Circuit Court.

Relford was employed as an electrician for the Lexington-Fayette Urban County Government (“LFUCG”). Pursuant to LFUCG’s drug testing policies, Relford was served with a “Notification of Reasonable Cause Testing” requiring him to undergo a drug test after an earlier arrest for possession of drug paraphernalia was brought to the attention of his supervisors. However, the notification erroneously stated that Relford had been arrested not only for possession of drug paraphernalia, but also for possession of a controlled substance. On the advice of counsel, Relford requested that the notification be changed in order to correctly reflect the charges. However, Relford’s supervisor refused to make the changes, and Relford thus refused to submit to the drug test. As a result of his refusal to submit to the drug testing, LFUCG filed charges seeking to terminate Relford’s employment. A hearing on the charges was heard before the LFUCG Civil Service Commission.

The Commission determined that reasonable grounds existed in requesting Relford to submit to the drug test; however, the Commission reduced Relford’s punishment to a 30-day suspension, as opposed to termination, because of procedural deficiencies in the case. The Commission also ordered that “Relford submit forthwith to the Employee Assistance Program [EAP] for

379 Id.
382 Id. at *1
383 Id.
384 Id.
385 Id.
386 Id.
388 Id.
389 Id.
390 Id.
391 Id. LFUCG failed to adequately advise Mr. Relford of their reasons for requesting him to submit to the drug test. Id.
evaluation for drug dependency.” 392 Under the provisions of LFUCG’s Alcohol and Drug Free Workplace Guidelines, Relford was subsequently required to submit to random drug testing due to his participation in EAP. 393

Relford appealed the Commission’s decision pursuant to K.R.S. § 67A.290. 394 The Fayette Circuit Court reversed the Commission’s order because Relford was required to submit to drug testing based upon his previous arrest for possession of drug paraphernalia, which the circuit court determined was arbitrary and therefore inconsistent with LFUCG’s policy for ordering drug testing. 395 The Commission appealed the circuit court’s decision to the Kentucky Court of Appeals, which affirmed the circuit court’s decision. 396

K.R.S. § 67A.290 provides that “enforcement of a Commissioner’s order shall not be suspended pending appeal.” 397 Accordingly, subsequent to his participation in EAP, Relford was selected for random testing and the results were positive for cocaine. 398 Thereafter, LFUCG requested that the Commission terminate Relford, and as a result, he was suspended without pay pending a hearing before the Commission on the charges. 399 Before the hearing could be scheduled, Relford tendered his resignation. 400

Following the circuit court’s reversal of the Commission’s decision, which occurred three years after Relford’s resignation, Relford filed a claim seeking reimbursement of benefits and lost pay and reinstatement to his former position. 401 The circuit court issued an order for Relford to receive benefits and lost pay during his suspension period; however, the circuit court denied reinstatement and back pay after the termination of his services, holding that Relford voluntarily resigned his position. 402

On appeal, Relford argued the trial court erred in determining “that LFUCG’s actions in improperly drug testing him and in issuing charges for his termination based upon the improper drug testing did not constitute a constructive discharge.” 403 Relford argued that his resignation amounted to a constructive discharge because LFUCG:

[1] Improperly ordered him to take the first drug test in contravention of its own drug testing
In other words, Relford argued that because the employer contravened its own policies, his termination was a constructive discharge rather than a resignation.\footnote{405}

In its opinion, the court of appeals noted that the standard for constructive discharge was "whether, based upon objective criteria, the conditions created by the employer's action are so intolerable that a reasonable person would feel compelled to resign."\footnote{406} In turn, the court of appeals determined that LFUCG's actions were not "so intolerable that a reasonable person would feel compelled to resign."\footnote{407} The court of appeals stated that while the initial order which required Relford to be tested was improper, the record clearly indicated that this was a result of a poorly drafted policy, and not a result of a deliberately arbitrary action.\footnote{408}

Additionally, the court of appeals found that the implementation of the order requiring Relford to participate in EAP, and the subsequent random testing associated with the program, was consistent with the provisions of K.R.S. § 67A.290.\footnote{409} Since such actions were lawful, they could not be considered "so intolerable that a reasonable person would feel compelled to resign."\footnote{410} Accordingly, the court held that the factors cited by Relford would not compel a reasonable person to resign, and that there was no constructive discharge.\footnote{411} Thus, the court of appeals affirmed the Fayette Circuit Court's decision to deny Relford's reinstatement to his former position with LFUCG because his actions constituted a voluntary resignation; he was not terminated as a result of any part of LFUCG's drug testing policy.\footnote{412}

\footnote{404} Id.\footnote{405} Relford, 2003 WL 21126798, at *3.\footnote{406} Id. at *4 (quoting Northeast Health Mgmt., Inc. v. Cotton, 56 S.W.3d 440, 445 (Ky. Ct. App. 2001)).\footnote{407} Id. at *6.\footnote{408} Id. LFUCG interpreted the arrest of Mr. Relford as triggering the provisions of their drug testing policies; however, Mr. Relford's arrest for possession of drug paraphernalia did not trigger such testing. \textit{Id.} The court found that LFUCG's misinterpretation of their policy was legitimate and not the result of any unfair motives. \textit{Id.}\footnote{409} Id. An order of the Commission shall not be suspended pending appeal. \textit{Id.}\footnote{410} Id.\footnote{411} Relford, 2003 WL 21126798, at *6.\footnote{412} Id.
B. Statutory Claims

1. Workers’ Compensation Retaliation

Under Kentucky law, in order to establish that an employee’s termination was made in retaliation for seeking workers’ compensation benefits, the plaintiff must establish that the discharge occurred as a result of the employer’s desire to punish the employee for seeking the benefits. Further, the plaintiff must establish that the filing of the workers’ compensation claim “was a substantial motivating factor” in the termination. In establishing that the workers’ compensation claim was a “substantial motivating factor,” the court must use a “but for” standard to prove that, except for the workers’ compensation claim, the employer would have had no basis for terminating the employee.

In Henderson v. Ardco Inc., Dana Henderson (“Henderson”) brought an action against her employer alleging “retaliation for filing a workers’ compensation claim.” The United States District Court for the Western District of Kentucky granted summary judgment in favor of Ardco. Henderson appealed the decision and the court of appeals held that Henderson did not establish a connection between her filing of the workers’ compensation claim and her subsequent discharge by Ardco.

Henderson had been employed with Ardco for several years as a welder on the assembly line making doors and doorframes, when she injured her back and was forced to take a leave of absence. Several months after her injury, Henderson was released to return to work; however, Henderson’s physician placed several restrictions upon her return. When Henderson presented these limitations to the plant manager, she was told that the company policy required an employee to be 100% healed in order to work in the plant. Accordingly, Henderson sought employment elsewhere.

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414 See First Prop. Mgmt. Corp. v. Zarebidaki, 867 S.W.2d 185, 189 (Ky. 1993).
415 See id. at 188.
417 Id.
418 Id.
419 Id.
420 Id. at 647. Henderson sustained her injuries on July 14, 1994. Id.
421 Id. Henderson was ordered not to lift more than twenty-five pounds or “[forty] pounds frequently.” Id.
422 Henderson, 247 F.3d at 647. This rule was well-known and consistently applied within the plant. Id.
423 Id. at 648.
Following her injury, Henderson applied for workers' compensation benefits. Henderson asserted that her application for these benefits "motivated, at least in part, Ardco's failure to re-employ her until June 1998." This assertion formed the basis of Henderson's claim for retaliatory discharge under K.R.S. § 342.197(1). Under Kentucky law, the "minimum" burden on Henderson was "to provide evidence [that] she (1) 'engaged in statutorily protected activity', (2) was discharged, and (3) 'there was a connection between the protected activity and the discharge.'" Satisfying the third element of the test required Henderson to show that the claim was a "substantial and motivating factor but for which [she] would not have been discharged."

The court of appeals agreed with the district court and found that Henderson failed to satisfy the third element of the test, as the evidence she provided was insufficient to show a connection between her workers' compensation claim and her eventual termination. The court of appeals reasoned that in light of Ardco's "100% healed rule," Henderson would have been terminated from her welding position, irrespective of her filing the workers' compensation claim. The court went on to state that the only evidence that Henderson presented which potentially indicated that her claim may have been a substantial and motivating factor was testimony presented by one of Henderson's co-workers who had allegedly been threatened with discharge after filing a similar claim. However, outside of the alleged threat, no action was taken against the co-worker.

Additionally, the court of appeals stated that Henderson had admitted that she did not have a factual basis for her belief that she was fired as a result of filing the workers' compensation claim. Accordingly, the court affirmed the decision of the district court, and granted summary judgment in favor of Ardco on Henderson's retaliation claim, finding that she had failed to provide sufficient evidence that her termination was the subject of a retaliatory discharge.

In Grassman v. Landry's Seafood House, Charlotte Grassman ("Grassman") filed suit against her former employer alleging that she was fired
in retaliation for filing a claim for workers' compensation benefits.\textsuperscript{436} The trial court granted summary judgment in favor of Landry's.\textsuperscript{437} Grassman appealed, and the court of appeals held that the trial court erred in granting summary judgment.\textsuperscript{438}

Grassman was employed as a waitress with Landry's.\textsuperscript{439} On two separate occasions during her employment Grassman fell and was injured in the workplace.\textsuperscript{440} After the first injury, she was told by the general manager not to run up medical expenses because her injury was not covered by workers' compensation.\textsuperscript{441} The company eventually took care of the medical bills; however, when Grassman returned to work, she was treated differently by management.\textsuperscript{442}

After her second fall, Grassman was forced to work the remainder of her shift even though she was obviously injured.\textsuperscript{443} At the end of the shift, Grassman completed all of her assigned duties, and attempted to check out.\textsuperscript{444} However, Grassman was told that she could not check out until she placed comment cards on each of her tables.\textsuperscript{445} Since she could not find any comment cards, Grassman took comment cards from surrounding tables and placed them on each of her tables.\textsuperscript{446} As a result, Grassman was fired by one of the assistant managers.\textsuperscript{447}

When Grassman called to speak to the general manager, he told her that they did not have anything to discuss.\textsuperscript{448} Grassman subsequently filed, and settled, a claim for workers' compensation benefits relating to her second fall.\textsuperscript{449} Grassman also filed a complaint alleging that she had been discharged from her employment with Landry's in violation of K.R.S. § 342.197.\textsuperscript{450}

\textsuperscript{436} Id. at *1
\textsuperscript{437} Id.
\textsuperscript{438} Id. at *5.
\textsuperscript{439} Id. at *1.
\textsuperscript{440} Id.
\textsuperscript{441} Grassman, 2003 WL 1240617, at *1.
\textsuperscript{442} Id. Grassman was assigned to the least profitable tables; she was harassed about not being able to dance (a requirement at the restaurant); she was required to complete duties that were not assigned to any other employees; and she was told she was too old to be a server. Id.
\textsuperscript{443} Id.
\textsuperscript{444} Id.
\textsuperscript{445} Id.
\textsuperscript{446} Id. The comment cards were not in their usual storage location and, Grassman testified that she heard one of the other servers say that they were out of comment cards. Id.
\textsuperscript{447} Grassman, 2003 WL 1240617, at *1. The disciplinary action report states that Grassman was terminated for "stealing condiments." Id. The general manager testified that he considered comment cards to be condiments. Id.
\textsuperscript{448} Id. at *2.
\textsuperscript{449} Id. After the second fall, Grassman was diagnosed with a broken coccyx. Id.
\textsuperscript{450} Id. See also KY. REV. STAT. ANN. § 342.197 (Banks-Baldwin 2003). This section provides in pertinent part:
The trial court granted summary judgment in favor of Landry's, holding that the assistant manager did not know about Grassman's fall until after he terminated her, thereby negating her theory of retaliatory discharge. On appeal, the court found that the record revealed several factors whereby a jury could reasonably infer that Grassman's termination was a result of her pursuit of workers' compensation benefits. Accordingly, the court of appeals held that the trial court erred in granting summary judgment.

Landry's argued that it was entitled to summary judgment because Grassman's termination occurred before she filed her claim for workers' compensation benefits. However, neither the trial court nor the court of appeals was persuaded by this argument, emphasizing that "the actual filing of a claim need not occur prior to the adverse employment action in order to activate and implicate the anti-retaliation provisions of [K.R.S. § 342.197]." The court found that the evidence established that, at the time of her termination, Grassman had a viable potential claim for workers' compensation benefits; she was injured just hours before the termination; the injury was reported to the general manager; she requested to have an accident report filled out; and prior to the general manager confirming the termination she had received treatment for her injuries. Therefore, the court of appeals held that Grassman was acting in pursuit of a claim for workers' compensation benefits at the time of her termination.

Additionally, the court held that Landry's failed to present a legitimate business reason for terminating Grassman. Accordingly, the court held that

(1) No employee shall be harassed, coerced, discharged, or discriminated against in any manner whatsoever for filing and pursuing a lawful claim under this chapter... (3) Any individual injured by any act in violation of the provisions of subsection (1)... of this section shall have a civil cause of action in Circuit Court to enjoin further violations, and to recover the actual damages sustained by him, together with the cost of the law suit, including a reasonable fee for his attorney.

Grassman, 2003 WL 1240617, at *3. The Court of Appeals mentioned the pattern of hostile treatment after her first workers' compensation claim, the coincidental timing of her termination, the minor infraction for which she was allegedly terminated and the unfair manner in which she was treated in relation to her co-workers. Id.
Id. (quoting Overnite Transp. Co. v. Gaddis, 793 S.W.2d 129, 132 (Ky. Ct. App. 1990)).
Id.
Id. at *4. There was no evidence presented which indicated that Landry's had a "policy for firing servers for any misfeasance related to comment cards" and the company had never fired an
there was a jury question with regard to the company's motive for terminating her employment.\textsuperscript{459}

2. Kentucky Civil Rights Act

In \textit{Layne v. Huish Detergents, Inc.},\textsuperscript{460} Barbara Layne ("Layne") filed a state court action against Huish Detergents, Inc. ("Huish") alleging sexual harassment and retaliatory discharge under the Kentucky Civil Rights Statute.\textsuperscript{461} Layne subsequently added a federal Title VII claim, and Huish removed the case to federal court.\textsuperscript{462} The United States District Court for the Western District of Kentucky entered judgment in favor of Layne on the retaliation claim and Huish appealed.\textsuperscript{463} The court of appeals affirmed the judgment of the district court.\textsuperscript{464}

Layne was employed with Huish from February 1996 until November 1996, when her employment with the company was terminated.\textsuperscript{465} In her suit, Layne alleged that she was subject to persistent, degrading and humiliating harassment during her tenure with Huish.\textsuperscript{466} Although she reported the harassment to her immediate supervisor, Norris Ray ("Ray"), he never followed the company's formal policy with respect to the claims, and the harassment continued.\textsuperscript{467} Layne finally brought the allegations of sexual harassment to the attention of the human resources manager, Pam Pendleton ("Pendleton"), in November 1996.\textsuperscript{468} As a result of the continuing harassment, Layne finally decided to file a formal complaint with the human resources department.\textsuperscript{469} Just three days after filing the formal complaint with Pendleton, Layne's employment with Huish was

\begin{thebibliography}{99}
\bibitem{1} Layne, 40 Fed. Appx. at 202.
\bibitem{2} Id. at 202.
\bibitem{3} Id. at 201.
\bibitem{4} Id. at 210.
\bibitem{5} Id. at 201-02.
\bibitem{6} Id. at 202.
\bibitem{7} Id. at 210.
\bibitem{8} Id. at 202.
\bibitem{9} Id. at 201.
\bibitem{10} Id. at 202.
\bibitem{11} Id.
\bibitem{12} Id.
\bibitem{13} Id.
\bibitem{14} Id.
\bibitem{15} Id.
\bibitem{16} Id.
\bibitem{17} Id.
\bibitem{18} Id.
\end{thebibliography}
terminated. The company told Layne that she was being terminated due to her poor attendance record.

Layne's claim was submitted to the jury under the Kentucky Civil Rights Act. The court determined that Huish was aware of the fact that Layne had complained of sexual harassment, and that Layne had offered sufficient circumstantial evidence to establish a prima facie case. However, the court also determined that Huish presented a legitimate, non-retaliatory cause for terminating Layne - poor attendance. Accordingly, it was necessary for Layne to prove that the cause offered by Huish was pretextual. The district court determined that Layne satisfied this requirement, and held that the evidence offered by Layne was sufficient to support the finding that Huish's explanation for Layne's termination was pretextual.

On appeal, Huish argued that Layne failed to present sufficient evidence to support a finding of retaliation because Layne relied primarily upon the timing of her discharge to support the claim. Huish further contended that Layne was tardy two days after filing her formal complaint, negating any inference that could have been made with regard to the timing of her termination. Layne argued that she had had a poor attendance record prior to filing the formal complaint without suffering any adverse employment consequences, but had been terminated almost immediately upon the filing of the formal complaint. The court of appeals determined that Layne presented sufficient evidence from which the jury could have concluded that Layne's filing of the formal sexual harassment complaint was the motivating factor in her termination.

The court of appeals also affirmed Layne's award of punitive damages, holding that punitive damages are available in a claim predicated upon a violation of the Kentucky Civil Rights Act. The court of appeals reasoned that since the Kentucky Act follows the Federal Civil Rights Act, which allows punitive damages, the district court did not err in concluding that punitive damages were available as a remedy.

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470 Id.
471 Id. Huish's attendance policy was not specific as to how many absences or tardies were necessary before an employee would be terminated for poor attendance. Id. Layne did not dispute that she had a poor attendance record. Id.
472 Layne, 40 Fed. Appx. at 206.
473 Id.
474 Id. Not only was evidence presented regarding Layne's poor attendance, Layne also was tardy for work two days after filing her formal harassment complaint. Id. at 202.
475 Id. at 206.
476 Id.
477 Id.
478 Id.
479 Id.
480 Id.
481 Id. at 208.
482 Id.
In *Stewart v. University of Louisville*, Jeannette Stewart ("Stewart") sued the University of Louisville ("the University") alleging, *inter alia*, that the "rescission of her fellowship constituted sex and age discrimination in violation of state discrimination statute" and illegal retaliation. The Jefferson County Circuit Court granted summary judgment in favor of the University, and Stewart appealed. On appeal, the court of appeals held that Stewart was not an employee for purposes of the discrimination statute and that the University was immune from suit on Stewart's remaining claims.

Upon receiving a Regent's Fellowship that provided full tuition and a yearly stipend, Stewart entered the University's graduate program in psychology at the age of forty-four. In order to maintain her fellowship Stewart had to fulfill several requirements. During the course of her studies, Stewart received a number of communications notifying her that the progress she had made toward fulfilling these requirements, especially as it related to her thesis proposal, was insufficient. Finally, at the end of her third year of studies, due to her insufficient progress in fulfilling the University's requirements, Stewart was notified that her fellowship had been rescinded. Eventually, the University further recommended that Stewart be dismissed from the program altogether. As a result of the dismissal, Stewart filed suit against the University in the Jefferson Circuit Court.

The allegations in Stewart's lawsuit included "sex and age discrimination in violation of K.R.S. Chapter 344, violation of K.R.S. § 61.102," and

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484 Id. at 536.
485 Id. at 536-37.
486 Id. at 537.
487 Id.
488 Id. One of the requirements was that Stewart had to show proof of progress towards completing her thesis for the program. Id. at 538. Additionally, Stewart was not able to seek outside employment without first receiving permission from the University. Id. at 537.
489 Stewart, 65 S.W.3d at 538.
490 Id.
491 Id.
492 Id.
493 KY. REV. STAT. ANN. § 344.040(1) (Banks-Baldwin 2003). K.R.S. Chapter 344 makes it unlawful for an employer "[t]o fail or refuse to hire, or to discharge any individual, or otherwise to discriminate against an individual with respect to compensation, terms, conditions, or privileges of employment, because of the individual's race, color, religion, national origin, sex, age forty (40) and over . . . ."
494 Stewart, 65 S.W.3d at 538. See also KY. REV. STAT. ANN. § 61.102(1) (Banks-Baldwin 2003). This statute provides that:
The trial court granted summary judgment in favor of the University on all claims, holding that Stewart did not have a cause of action under K.R.S. Chapter 344 because she was not an employee of the University, and the statute was limited to actions involving an employer-employee relationship. Stewart appealed the decision after the trial court denied her motion to reconsider. The primary issue on appeal was whether the trial court properly held that Stewart was not an employee of the University.

On appeal, Stewart argued that the stipend supplied by the University "constituted an employment relationship because she was required to perform duties above those expected of unassisted students." Additionally, she argued "that the treatment of her stipend as wages for tax purposes by the [U]niversity bolster[ed] her alleged employment status." In determining Stewart's status with the University, the court of appeals relied upon the decision in Randolph v. Budget Rent-A-Car, whereby the court stated that the "imposition of scholarship conditions is far from the direction and supervision found in the traditional employment setting." Additionally, the court of appeals stated that

No employer shall subject to reprisal, or directly or indirectly use, or threaten to use, any official authority or influence, in any manner whatsoever, which tends to discourage, restrain, depress, dissuade, deter, prevent, interfere with, coerce, or discriminate against any employee who in good faith reports, discloses, divulges, or otherwise brings to the attention of the Kentucky Legislative Ethics Commission, the Attorney General . . . or any other appropriate body or authority, any facts or information relative to an actual or suspected violation of any law, statute, [or] executive order . . . .

Id.

Stewart, 65 S.W.3d at 538.

For purposes of the statute prohibiting reprisal against employees, an employee is defined as

"[A] person in the service of the Commonwealth of Kentucky, or any of its political subdivisions, who is under contract of hire, express or implied, oral or written, where the Commonwealth, or any of its political subdivisions, has the power or right to control and direct the material details of work performance."

Stewart, 65 S.W.3d at 538.

Stewart, 65 S.W.3d at 538.

Id.

Id. at 539.

Id.

Id.

97 F.3d 319, 326 (9th Cir. 1996).

Stewart, 65 S.W.3d at 539.
in determining whether an individual is an employee for purposes of Title VII, \(^{504}\) "one must examine the economic realities underlying the relationship between the individual and the so-called principal in an effort to determine whether that individual is likely to be susceptible to the discriminatory practices which the act was designed to eliminate." \(^{505}\)

Applying the aforementioned principles, the court of appeals determined that the "mere fact the [University] imposed conditions on Stewart's fellowship which required her to perform more duties than those expected of other students did not create an employer-employee relationship." \(^{506}\) Also, "although the treatment of [Stewart's] stipend as wages for tax purposes was relevant, it was not dispositive of the issue." \(^{507}\) Additionally, the court determined that a significant portion of Stewart's activities and duties were in relation to her academic pursuits and not in relation to providing services to the University. \(^{508}\) Accordingly, the court of appeals held that the trial court properly dismissed Stewart's Chapter 344 and Chapter 61 claims because she was not an employee of the University. \(^{509}\)

In the 2001 publication of this survey article, \(^{510}\) the authors expressed their concerns regarding the Kentucky Supreme Court's decision in \(\textit{Vaezkoroni v. Domino's Pizza, Inc.}\) \(^{511}\) and the Kentucky Court of Appeals decision in \(\textit{Founder v. Cabinet for Human Resources}\). \(^{512}\) In \(\textit{Vaezkoroni}\), the Kentucky Supreme Court stated as follows:

\[\text{We hold that KRS Chapter 344 authorizes alternative avenues of relief, one administrative and one judicial. The administrative avenue also includes alternatives; the individual may bring a complaint of discrimination before either the Ky. Commission or the local commission. Once any avenue of relief is chosen, the complainant must follow that avenue through to its final conclusion.}\] \(^{513}\)

\(^{504}\) \textit{Id}. "KRS Chapter 344 was modeled after Title VII of the Civil Rights Act of 1964" and therefore, "Kentucky courts generally follow federal law in interpreting the Kentucky discrimination statute." \textit{Id}.

\(^{505}\) \textit{Id}. (quoting Armbruster v. Quinn, 711 F.2d 1332, 1340 (6th Cir. 1983)).

\(^{506}\) \textit{Id}. at 539-40.

\(^{507}\) \textit{Id}. at 540.

\(^{508}\) \textit{Id}.

\(^{509}\) \textit{Stewart}, 65 S.W.3d at 540.


\(^{511}\) 914 S.W.2d 341 (Ky. 1995).

\(^{512}\) 23 S.W.3d 221 (Ky. Ct. App. 1999).

\(^{513}\) \textit{Vaezkoroni}, 914 S.W.2d at 343.
As noted in the 2001 Survey of Kentucky employment law, the above-quoted language implied that once a claimant filed an administrative charge, he could not subsequently revoke that charge prior to a final determination of its merits, at which point the claimant would be barred from filing a civil action in circuit court.514

In Founder v. Cabinet for Human Resources,515 the Kentucky Court of Appeals, relying on Vaezkoroni, stated:

From our reading of the language in KRS [§] 344.270 and Vaezkoroni, once a complaint is filed with the Commission, a subsequent action in circuit court based on the same civil rights violation(s) is barred.516

In other words, Founder held that once a claimant has filed an administrative charge with the Kentucky Commission on Human Rights ("KCHR"), he is forever barred from seeking judicial relief for the same claim, even if he withdraws his charge before the KCHR has taken any action.517 In short, Vaezkoroni and Founder not only mystified plaintiffs' attorneys, but they also had the unintended (but certain) effect of rendering the KCHR a nullity due to the stringent disincentive of filing an administrative claim.518

In Wilson v. Lowe's Home Care Center,519 however, the Kentucky Court of Appeals clarified Vaezkoroni and Founder. In Wilson, the aggrieved employee filed a complaint with the Kentucky Commission on Human Rights ("KCHR") alleging racial discrimination and a racially hostile work environment.520 Subsequently, the employee withdrew his claim, and an order was entered allowing the claim to be withdrawn without prejudice.521 Further, the Equal Employment Opportunity Commission ("EEOC") provided the employee with a Notice of Right to Sue.522 Thereafter, the employee filed a civil complaint in the Jefferson Circuit Court.523 The defendant argued, and the trial court agreed, that the employee's claims under K.R.S. Chapter 344 were barred by the doctrine of

514 Bales & Burns, supra note 510, at 265.
516 Id. at 223.
517 Id.
518 Id.
520 Id. at 230.
521 Id. at 231.
522 Id.
523 Id.
election of remedies. On appeal, the court reversed, holding, in relevant part, as follows:

[W]e conclude that Kentucky law does not prohibit Wilson from filing his civil action in the circuit court even though he had previously filed a complaint with the KCHR.

With respect to Vaezkoroni and Founder, the court held that the pertinent language in each case - asserting that an aggrieved employee could not subsequently file a civil suit based on the same facts for which he had already filed an administrative claim - was simply dicta, and not binding:

As we have noted, in the Vaezkoroni case the Kentucky Supreme Court stated that "[o]nce any avenue of relief is chosen, the complainant must follow that avenue through to its final conclusion." Since the Vaezkoroni case involved an employee who had prosecuted his claims to the administrative body to a final determination, that language is clearly dicta. Similarly, in the Founder case a panel of this court stated that "[f]rom our reading of the language in KRS 344.270 and Vaezkoroni, once a complaint is filed with the Commission, a subsequent action in circuit court based on the same civil rights violation[s] is barred." Since the employee's circuit court complaint in Founder was barred by KRS 344.270 for lack of jurisdiction because the complaint was still pending with an administrative body, this language in the Founder case is also dicta.

The court also noted, however, that the temporal proximity between an employee's withdrawal of an administrative claim and the date of the final hearing may present an issue:

Assuming we are correct in concluding that Wilson had a right to withdraw his claim before

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524 Id.
525 Wilson, 75 S.W.3d at 231.
526 Id. at 235.
527 Id. (internal citations omitted).
the KCHR prior to a final determination on the merits and to file a complaint with the circuit court, there may be a question concerning how long before a final determination Wilson was required to withdraw his claim. Obviously, a party may not file a claim, proceed to trial or hearing, and then withdraw his claim before the ruling body issues a final determination.\footnote{Id. at 235.}

In sum, despite the courts' earlier language in \textit{Vaezkoroni} and \textit{Founder}, it is now somewhat more clear that an aggrieved employee may file an administrative claim, and then subsequently withdraw that claim, and file a civil suit in circuit court based on the same alleged violations of K.R.S. Chapter 344.\footnote{See \textit{ supra} Part II.A.1-8, Part II.B.1-2 and note 7.}

\section*{III. Conclusion}

While Kentucky generally recognizes the right of an employer to terminate an employment relationship at any time under the employment-at-will doctrine, the above cases highlight several exceptions where the courts have found that an employee has a viable cause of action against a former employer under either a statutory or common law principle.\footnote{See \textit{ supra} notes 10-14 and accompanying text.} As evidenced by the cases in this survey, Kentucky courts have shown a willingness to allow a plaintiff to prove that the at-will status has been altered or affected during the employment relationship. It is clear, however, that the courts favor a narrow construction of these exceptions.\footnote{See \textit{ supra} notes 10-14 and accompanying text.} In order for an employer to avoid liability for wrongfully terminating the employment relationship, it is important that employers implement and follow sensible personnel policies and practices.
A SURVEY OF KENTUCKY INSURANCE LAW: A LOOK AT THE BAD FAITH CAUSE OF ACTION

by V. Brandon McGrath, Esq. * and Blaine J. Edmonds III †

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I. INTRODUCTION

The purpose of this survey is to provide a practical insight into the bad faith cause of action against insurers both at common-law and under the Kentucky Unfair Claims Settlement Practices Act and to discuss issues that have arisen in this area of law in Kentucky within the past two years. The survey will begin by explaining the elements a plaintiff must prove in order to succeed at common-law, various nuances of the common-law action, including when the cause of action accrues, as well as the statutory claim. This article will also discuss modern trends with particular attention to how Kentucky courts may apply recent United States Supreme Court decisions regarding punitive damages.

Bad faith claims against insurance companies often make a breach of contract action pursuant to an insurance policy a worthwhile effort for many plaintiffs. Generally, any breach of contract action against an insurance company includes a bad faith claim, whether or not there is any evidence of bad faith. Consequently, the cost of litigation is greatly increased for the insurer because the insurer generally wants to resolve the bad faith issue (favorably or unfavorably) through summary judgment before evaluating whether to proceed to trial. The potential for a large punitive damages award often presents an unacceptable risk to proceed to trial. Accordingly, if a plaintiff can survive summary judgment on bad faith claims, the insurer can be forced to settle even in cases where no liability exists.

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1 KY. REV. STAT. ANN. § 304.12-230 (Banks-Baldwin 1988).
3 See generally 16 AM. JUR. 3D PROOF OF FACTS 3D 419 §§ 4-19, 37-45 (2003) (noting that many courts have eroded the principles of contract law that protected insurance companies from paying claims to their insureds or those injured by their insureds).
4 See id § 1.
5 Id.
6 Id. §§ 4-19, 37-45.
II. DISCUSSION

A. The Common-Law Bad Faith Action

1. The Elements of the Cause of Action

The foundation of the modern common-law bad faith action was laid by the Kentucky Supreme Court in Wittmer v. Jones. It was there that the court set forth the three elements required to sustain a cause of action for bad faith against an insurer. The court ruled:

[A]n insured must prove three elements in order to prevail against an insurance company for alleged refusal in bad faith to pay the insured's claim: (1) the insurer must be obligated to pay the insured's claim under the terms of the policy; (2) the insurer must lack a reasonable basis in law or fact for denying the claim; and (3) it must be shown that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed...[A]n insurer is...entitled to challenge a claim and litigate it if the claim is debatable on the law or the facts.

In other words, the plaintiff/insured must show not only that the insurer had an obligation to pay under the terms of the policy, but also that the insurer had no reasonable basis in law to deny the claim and either knew or should have known that there was no such basis. This rule applies to both first-party and third-party bad faith claims. A first-party claim is one which is asserted by an insured against that insured's insurance company. A third-party claim is one...
which is asserted by an injured party against the insurance company of the party that caused the injury. The court went on to note, “[b]efore the cause of action exists in the first place, there must be evidence sufficient to warrant punitive damages.” In order to determine whether this requirement is met, the court must first consider whether there is proof of bad faith and subsequently whether there is adequate proof present for the jury to conclude that there was “conduct that is outrageous, because of the defendant’s evil motive or his reckless indifference to the rights of others.”

Additionally, for a party to be successful upon a claim of bad faith, that party must proffer and prove more than mere negligence. Some courts have held bad faith implies intentionally wrongful conduct. However, courts disagree as to the level of wrongful conduct necessary to establish bad faith. Nevertheless, the general rule is still that enunciated in Wittmer, where reckless conduct was held sufficient to establish such a claim.

Generally, bad faith is a tort claim. The Kentucky Court of Appeals’ most recent decision in the area of insurance bad faith was decided in June 2003. In United Services Automobile Association v. Bult, the court of appeals was asked to determine whether the defendant insurer, United Services Automobile Association (USAA), acted in bad faith when it assigned two separate claims adjusters to settle one claim and whether the insurer’s settlement offer or tardy communication rose to the level of bad faith.

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13 Id.
14 Wittmer, 864 S.W.2d at 890.
15 Id. (citing RESTATEMENT (SECOND) OF TORTS § 909(2) (1979)).
17 Combs, 163 F. Supp. 2d at 696 (holding that errors in judgment are insufficient to sustain a finding of bad faith). But see Wittmer, 864 S.W.2d at 890 (holding that outrageous or reckless conduct may be enough to warrant a successful bad faith action); Naugle v. Allstate Ins. Co., 72 Fed. Appx. 307, 310 (6th Cir. July 30, 2003) (holding outrageous or reckless conduct may be sufficient).
18 Compare Globe, 2003 WL 21246382, at *3 (more than mere negligence must be shown in order to succeed), Wittmer, 864 S.W.2d at 890 (outrageous or reckless conduct may suffice), and Naugle, 72 Fed. Appx. at 310 (outrageous or reckless conduct will suffice), with Combs, 163 F. Supp. 2d at 696 (holding intentional wrongful conduct is necessary to sustain a bad faith cause of action).
19 864 S.W.2d 885 (Ky. 1993).
20 Id. at 890. The court stated the third element which plaintiff must prove is “that the insurer either knew there was no reasonable basis for denying the claim or acted with reckless disregard for whether such a basis existed.” Id. Therefore, the requisite standard of conduct is recklessness. Id. See also Globe, 2003 WL 21246382, at *3.
21 Combs, 163 F. Supp. 2d at 696.
23 Id.
24 Id.
On July 18, 1997, Ashley Bult was fatally injured in an automobile accident in which she was a passenger. The driver of the vehicle was Chad Metcalfe; both the Metcalfes and the Bults owned automobile liability insurance policies with USAA. Shortly after the accident, on July 21, John Moriarty was assigned by USAA to handle the claims arising from the accident. Mr. Moriarty contacted the Bults on August 8 via a telephone call; he called a second time on October 9, informing Mrs. Bult of the policy limits.

On January 8, 1998, the Bults filed a claim, in the Jefferson County Circuit Court, against Hal, Cheryl and Chad Metcalfe seeking damages for Ashley Bult's wrongful death and loss of consortium. In June 1999, the Bults filed a third amended complaint, adding USAA as a party and claiming bad faith conduct in both its handling of the Metcalfes' claim and in the handling of the Bults' under-insured motorist (UIM) claim.

The bad faith issue went before the Jefferson County jury in October 2001. The jury found for USAA as to the Bults' assigned claim; nonetheless, the jury awarded the Bults $100,000 in compensatory damages and $1,000,000 in punitive damages for its conduct in regard to their claim. USAA appealed. On appeal, the court adhered to the Wittmer test in dismissing the Bults' case, deciding in favor of USAA. The court reasoned that USAA merely delayed

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25 Id. at *1.
26 Id.
27 Id.
28 Bult, 2003 WL 21473286, at *1 (noting that policy limits of $100,000 were available under the Metcalfes' policy).
29 Id. at *2. Mr. and Mrs. Bult sought damages for loss of their daughter's consortium and Holly Bult for the loss of her sister's consortium. Id.
30 Id. at *3. The Bults had filed an amended complaint alleging entitlement to $200,000 of underinsured motorist coverage which was provided by the Metcalfes' policy. Id. at *2. Additionally, the Bults filed a second amended complaint in September 1998, whereby they alleged CSX Transportation, Inc. was jointly liable for their daughter's death. Id. CSX Transportation, Inc., the Bults alleged, was negligent in their maintenance of the railroad crossing where the accident occurred. Id. Prior to trial, the court had dismissed Holly Bult's claim for loss of consortium, granted USAA's motion for summary judgment as to entitlement of the Metcalfes' UIM coverage and granted CSX's motion for summary judgment as to its liability. Id.
31 Id. at *3. The Bults settled their action against the Metcalfes on the day of the trial. Id. In so doing, the Metcalfes agreed to pay the Bults $25,000 immediately, $25,000 due in six months, secured by a note and a lien on the Metcalfes' home and their policy limits of $100,000. Id. at *3. Furthermore, the Metcalfes assigned any cause of action they may have against USAA for bad faith and the Bults agreed to release the Metcalfes from any further liability. Id.
32 Id. at *3.
33 Id. (awarding the Bults $366,667 in attorney's fees).
34 Bult, 2003 WL 21473286, at *3.
35 Id. at *4.
36 Id. at *8. The court held the Bults, in fact, had received all of the benefits to which they were entitled under their policy. Id. While USAA's agent was slow, payments were made and no claim was denied. Id. The Bults' claim was based on nothing more than a delay in the payment of their claims which the court held was not in bad faith. Id.
payment to the Bults, lacking the requisite outrageous conduct needed to sustain the bad faith claim.  

In **Globe American Casualty Co. v. Bowman**, the court was asked to decide whether Globe acted in bad faith when it assigned separate claims representatives to each of two parties involved in an automobile accident in which it insured both vehicles and did not offer to settle plaintiffs' claims until one and one-half years after commencement of litigation. The court applied the *Wittmer* test to plaintiffs' claims for common-law bad faith and violations of the Kentucky Unfair Claims Settlement Practices Act in affirming the trial court's judgment in plaintiffs' favor.

Globe asserted three arguments in its defense to the bad faith claim. First, Globe argued that until the estates of the deceased children were opened, there could be no bad faith to settle the claims. However, the court reasoned that Globe should have known that the parents would be handling their children's estates and should have agreed to pay the amount due under the policy when the issue of liability was settled. Moreover, the absence of an administratrix to handle the estates was not a hindrance to Globe's payment of the claims.

Globe's second argument in their defense was that the Bowmans should have exhausted the funds available to them under Mills' policy before seeking benefits under their own under-insured motorist (UIM) policy. In support of

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37 *Id.* The court held a mere delay in payment does not amount to bad faith. *Id.* Accord *Motorists Mut. Ins. Co. v. Glass*, 996 S.W.2d 437, 452 (Ky. 1997). There the Kentucky Supreme Court held:

> Mere delay in payment does not amount to outrageous conduct absent some affirmative act of harassment or deception . . . there must be proof or evidence supporting a reasonable inference that the purpose of the delay was to extort a more favorable settlement or to deceive the insured with respect to the applicable coverage.

*Id.* *See also Bult*, 2003 WL 21473286, at *8 (emphasis omitted).


39 *Id.* at *1. The plaintiffs, Carolyn and George Bowman, were both seriously injured and their three children killed in the accident. *Id.* Their claims against the other driver and against Globe for underinsured motorist coverage were settled and only their claim for bad faith tried. *Id.*

40 *Id.* at *2.

41 *Wittmer v. Jones*, 864 S.W.2d 885, 890 (Ky. 1993).

42 **KY. REV. STAT. ANN. § 304.12-230 (Banks-Baldwin 2003).**

43 **Globe**, 2003 WL 21246382, at *3. The Bowmans were awarded $250,000 for mental anguish and $50,000 in punitive damages as well as attorney's fees and interest. *Id.* at *2.

44 *See id.* at *4-5.

45 *Id.* at *4.

46 *Id.* Liability was determined by the police officer whom responded to the accident. *Id.* Mills, the other party to the accident, was at fault. *Id.* at *3.

47 *Id.* at *4.

48 *Id.*
this argument, Globe relied upon the rule enunciated in *Coots v. Allstate Insurance Company.* 49 *Coots* held, and Globe argued, that "it cannot be bad faith to wait until after the tortfeasor tenders his policy limit or the insured wishes to settle for a full release before attempting to settle the underinsured claim to be raised by the insured." 50 However, the Bowmans argued, and the court agreed, that a UIM carrier, such as Globe, cannot, in the absence of bad faith, fail to "negotiate a one million dollar claim until the UIM insured can process a claim against the tortfeasor covered by a $25,000 limited liability policy to judgment." 51

Third, Globe argued that "whether [it] was acting in bad faith for failing to offer a full settlement under both policies rather than first requiring a settlement under the Mills policy" was a debatable issue. 52 Globe attempted to rely upon *Wittmer* in asserting that it is not bad faith to challenge a claim that is fairly debatable upon the law or the facts. 53 The court disagreed with this argument and relied upon the reasoning discussed under Globe's second argument. 54

All of the cases addressing common law bad faith claims in Kentucky since *Wittmer* apply the same test. 55 With any bad faith claim, the *Wittmer* test must be satisfied in order for a plaintiff to succeed. 56 Accordingly, plaintiffs face a difficult test in proving bad faith under Kentucky law. 57

The "reasonable basis in law" standard expressed in *Wittmer* can be very difficult for a plaintiff to overcome. 58 A well-kept claims file detailing the actions of the insurer's claims personnel can generally defeat the generic, "included because it is an insurance case" bad faith claim. Thus, an insurer will want to push the bad faith issue to the summary judgment phase as quickly as possible. Although this may not prevent broad discovery, 59 it will create a significant bargaining chip in any settlement negotiations. Accordingly, an insurer can address the contractual issues up front without any significant fear of the case proceeding to trial on a bad faith claim. 60

Although there is always the potential for an extremely high punitive damages award, 61 anecdotal verdicts in the hundreds of millions of dollars are

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49 853 S.W.2d 895 (Ky. 1993).
51 *Id.* at *5 (quoting *Coots,* 853 S.W.2d at 902). This rule is especially paramount where the insurer provides both the tortfeasor's and the UIM policies. See *id.*
52 *Id.*
53 *Id.*
54 *Id.*
55 *Wittmer v. Jones,* 864 S.W.2d 885, 890 (Ky. 1993).
57 *Wittmer,* 864 S.W.2d at 890.
58 *Id.*
59 *See infra* Part II.C.2.
60 *Wittmer,* 864 S.W.2d at 890.
clearly not the norm. The Wittmer standard does provide a shield for the normal and rational disagreements that occur between an insured and the insurer regarding coverage and the value of claims.\textsuperscript{62} Just because the insured feels that the denial of the claim is a personal attack, that feeling alone is not sufficient to create an unreasonable basis for the insurer’s actions—something more must be present.\textsuperscript{63}

2. The Duty to Defend

Generally, insurers are under a duty to defend their insureds for their insureds’ wrongful or harmful conduct if there is an allegation asserted against an insured, which may potentially or possibly be contained within the coverage of the policy.\textsuperscript{64} In Ayers v. C & D General Contractors,\textsuperscript{65} the District Court for the Western District of Kentucky, relying upon decisions promulgated by the Supreme Court of Kentucky,\textsuperscript{66} explained the duty to defend.\textsuperscript{67}

There the court was faced with an issue of first impression.\textsuperscript{68} The court was asked to decide whether a consent judgment between plaintiff and one defendant was appropriate when another defendant contested that judgment.\textsuperscript{69}

Plaintiff’s decedent, an employee of defendant C & D General Contractors, Inc. (C & D), was killed in a work-related accident.\textsuperscript{70} C & D had employer liability, commercial general liability and umbrella insurance policies with defendants American States Insurance Company and American Economy Insurance Company (American).\textsuperscript{71} However, American denied C & D insurance coverage as well as a defense in the litigation plaintiff had initiated against C & D.\textsuperscript{72}

Plaintiff and C & D filed a motion for consent judgment whereby C & D assigned to plaintiff any cause of action it may have had against American in exchange for plaintiff’s refusal to execute the judgment it had received against C

\textsuperscript{62} Wittmer, 864 S.W.2d at 890.
\textsuperscript{63} Id.
\textsuperscript{65} 269 F. Supp. 2d 911 (W.D. Ky. 2003).
\textsuperscript{66} See James Graham Brown Found., Inc., 814 S.W.2d at 279-80. See also Eskridge v. Educator & Executive Ins., Inc., 677 S.W.2d 887, 889 (Ky. 1984); Cincinnati Ins. Co. v. Vance, 730 S.W.2d 521, 522-24 (Ky. 1987).
\textsuperscript{67} Ayers, 269 F. Supp. 2d at 911.
\textsuperscript{68} See id. at 913.
\textsuperscript{69} Id.
\textsuperscript{70} Id. at 911.
\textsuperscript{71} Id. at 913.
\textsuperscript{72} Id.
& D for $1 million on its prior motion for summary judgment. American filed an objection to the consent judgment.

The court reasoned that if an insurer denies coverage based upon a mistake of fact or mistaken interpretation, then denial may result in serious and severe legal consequences. Therefore, an insurer may be liable for wrongful denials if it is judicially determined that the insured's claim fell within its coverage. Nonetheless, insurers may elect to deny a defense to their insureds at their own risk of liability.

Similarly, "even if an insurance company denies coverage based on the mistaken belief that it is justified in doing so, the company may still breach its contract with the insured," thereby creating a possibility for recovery by the insured on a bad faith theory. In Lenning v. Commercial Union Insurance Co., the court stated "the determination of whether a defense is required must be made at the outset of the litigation" by reference to the complaint and known facts. The Sixth Circuit Court of Appeals affirmed the district court's determination that the insurer did not act in bad faith or breach the terms of the insurance contract by denying the insured a defense to a suit initiated against the insured. No duty to defend was owed because the insured was pursuing a business interest which was contrary to and outside the scope of the insurance policy.

Additionally, a defendant insurer may be justified in denying an insured a defense if that insured failed to comply with a necessary condition precedent to

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73 See Ayers, 269 F. Supp. 2d at 913. Plaintiff had obtained a $1 million judgment against C & D on a motion for summary judgment. Id. C & D assigned its rights against American to Plaintiff for Plaintiff's promise not to execute that judgment. Id.
74 Id.
75 Id. at 914.
76 See id.
77 Id.
78 Lenning v. Commercial Union Ins. Co., 260 F.3d 574, 581 (6th Cir. 2001) (relying on Eskridge v. Educator & Executive Ins., Inc., 677 S.W.2d 887, 889 (Ky. 1984)).
79 Eskridge, 677 S.W.2d at 889.
80 260 F.3d 574 (6th Cir. 2001).
81 Id. at 581 (quoting James Graham Brown Found., Inc. v. St. Paul Fire & Marine Ins. Co., 814 S.W.2d 273, 279 (Ky. 1991)).
82 Id. at 577. The district court determined that the insurer had no duty to defend because the complaint filed against the insured did not assert an action covered in the policy. Id. at 580. Since the insured was engaged in a business practice which was not covered by the policy of insurance, the insurer had no duty to defend. Id.
83 Id. at 580. Plaintiff had purchased a homeowner's policy but, in fact, had been in the business of selling the homes. See id. at 578. The insurance agent who sold the policy to Plaintiff testified that he believed she was to live in the home and that Plaintiff never informed him of the fact that she intended to sell the home and, in fact, entered into a third-party contract to do so prior to the home's completion. Id. at 579. Further, Plaintiff later admitted that, at all times, she intended to purchase the home and then to sell it, never intending to live in the home. Id.
Courts appear to be split as to whether the insurer has the burden to show that it was, in fact, prejudiced by any delay in or lack of compliance before that insurer shall defeat liability.\textsuperscript{85} A duty to defend is a fundamental aspect of many insurance policies.\textsuperscript{86} Considering the potential harm that can come to an insured if the insurer wrongfully denies a defense, an insurer is wise to consider defending under a reservation of rights.\textsuperscript{87} Although the insurer will incur expenses in paying for the defense, it will surely defeat any claim for bad faith based upon a breach of the duty to defend.\textsuperscript{88}

This aspect of bad faith claims generally arises in the homeowner's and automobile liability context.\textsuperscript{89} In the typical scenario, a claim is made against the insured for damages and the insurer determines that there is no coverage under the policy and therefore denies a defense. A common example is a tort claim alleging an intentional act by the insured (an assault, for example). On the face of the pleadings, the plaintiff claims that the insured acted intentionally in causing harm. The defendant insured makes a claim for coverage under the insured's policy (homeowner's, for example) and the insurer denies coverage.

On the face of the pleadings, it appears clear that there is no coverage under the policy because intentional acts are generally not covered under insurance policies.\textsuperscript{90} At this point, the insurer has a reasonable basis in law to deny coverage. If the defendant insured later presents evidence that the harm was caused by negligence, however, the insurer would be wise to consider assuming the cost of defense. Generally speaking, the cost of defending, even under a reservation of rights, will be less significant than defending a bad faith action later.\textsuperscript{91} Although many factors must be considered, the cost of defending the underlying tort claim is generally cheaper than defending a bad faith claim.

\textsuperscript{84} See, e.g., Cincinnati Ins. Co., v. Taylor, No. 1:01CV-102-M, 2003 WL 1742148 (W.D. Ky. Mar. 26, 2003). The Plaintiffs did not strictly adhere to an "examination under oath" or a provision requiring claimants to provide a proof of loss. \textit{Id.} at *2. However, the court held that the insurer has an affirmative duty to show it actually suffered a prejudicial effect due to the claimant's failure to comply with such provisions. \textit{Id.} at *4.

\textsuperscript{85} \textit{Id.} at *4 (holding that insurer must show prejudice from non-compliance to defeat liability). But see Hiscox Dedicated Corporate Member Ltd. v. Wilson, 246 F. Supp. 2d 684, 693 (E.D. Ky. 2003) (holding that insurer does not have to demonstrate prejudice prior to defeating liability).


\textsuperscript{87} See, e.g., \textit{id.}

\textsuperscript{88} See 44 AM. JUR. 2D Insurance § 1405 (2003).


\textsuperscript{90} A good rule of thumb is that insurance covers events that are outside the control of the insured, not the choice of the insured. See W.E. Shipley, Annotation, Liability Insurance as Covering Accident, Damage, or Injury Due to Wanton or Willful Misconduct or Gross Negligence, 20 A.L.R.3d 320 § 2 (2004).

\textsuperscript{91} See 44 AM. JUR. 2D Insurance § 1407 (2003).
3. Accrual of the Cause of Action

A problem often arises as to when exactly a cause of action for bad faith accrues.\(^92\) Given the nature of the conduct leading to such claims, it is often difficult to determine when the statute of limitations\(^93\) for bad faith claims begins to run.\(^94\)

In *Combs v. International Insurance Co.*,\(^95\) the United States District Court for the Eastern District of Kentucky addressed this issue.\(^96\) There the court was faced with a bad faith claim against an insurer of a "Director and Officer's liability policy"\(^97\) for failure to cover a settlement paid by the insured.\(^98\)

The *Combs*\(^99\) court noted, "the concept of accrual is similar to the idea of vesting, which was the primary basis of the traditional vested rights approach to


\(^93\) *Id.* at 695. Generally, bad faith actions are brought under a breach of contract theory and therefore are subject to Kentucky's fifteen-year statute of limitations. *Id.* at 690. *See also* KY. REV. STAT. ANN. § 413.090(2) (Banks-Baldwin 2003). This section provides that any claim arising out of a written contract must be brought within fifteen years from the accrual of the cause of action. *Id.* However, claims arising under the Kentucky Unfair Claims Settlement Practices Act are governed by K.R.S. § 413.120(2). *Combs*, 163 F. Supp. 2d at 695. That section states "[a]n action upon a liability created by statute, when no other time is fixed by the statute creating the liability" must be brought within five years. KY. REV. STAT. ANN. § 413.120(2) (Banks-Baldwin 2003). Ordinarily, the dispute is not which statutory period applies but rather when the cause of action accrues, beginning the running of the statute of limitations. *See, e.g.*, *Combs*, 163 F. Supp. 2d at 690.

\(^94\) *See Combs*, 163 F. Supp. 2d at 690-96.


\(^96\) *See id.* (addressing when the statutory period for a bad faith cause of action begins to run).

\(^97\) *Id.* at 688. Mr. Leslie Combs II was President of Spendthrift Farm. *Id.* As president, he was insured by a Director and Officer's liability policy which provided coverage as follows:

If during the policy period any claim or claims are made against the insureds ... any of them for a *Wrongful Act* ... while acting in their individual or collective capacities as Directors or Officers, the Insurer will pay on behalf of the Insureds or any of them, their Executor, Administrator, Assigns 95% of all losses ... which the Insureds or any of them shall become legally obligated to pay ....

*Id.* at 689.

\(^98\) *Id.* at 688. Mr. Combs was sued, individually and as an agent of Spendthrift Farm, along with others, by Mr. Fred L. Fredricks. *Id.* This suit was consolidated with others in the Northern District of California and became known as the "California Litigation." *Id.* Ultimately, Mr. Combs paid a court-approved settlement for $2,000,000. *Id.* This is the payment Mr. Combs claims to have been covered by his policy with International Insurance Company giving rise to this suit. *Id.* at 689.

\(^99\) *Id.*
choice of law."\textsuperscript{100} According to this vested rights theory, legal rights and obligations "vest at the happening of the last event creating a cause of action."\textsuperscript{101} Therefore, bad faith causes of action accrue upon the happening of "the last event" necessary for a party to assert wrongful conduct.\textsuperscript{102}

The court held that this occurred when the defendant insurer "made the decision to deny insurance coverage and mailed a letter to that effect" to the plaintiff.\textsuperscript{103} The court believed that "[t]his denial by [defendant] ... transformed the contractual liability into a cause of action for Mr. Combs."\textsuperscript{104}

More recently, this issue was addressed in \textit{King v. Liberty Mutual Insurance Co.}\textsuperscript{105} The \textit{King}\textsuperscript{106} court was faced with a third party claim\textsuperscript{107} against Liberty Mutual for failing to comply with the terms of a settlement agreement it had entered into with Mrs. King approximately nine years earlier.\textsuperscript{108} The court held, "[u]ntil the claim is finally settled and paid in full, we conclude that the processing of the claim is not final and the transaction is still covered by [the Kentucky Unfair Claims Settlement Practices Act]."\textsuperscript{109} This holding affirmed the ruling in \textit{Combs}.

Therefore, the time in which to bring a claim accrues when either a decision has been made to deny the claim and the insured has been notified of same,\textsuperscript{111} or the processing of the claim is "finally settled and paid in full."\textsuperscript{112}

Accrual of the bad faith claim can be of paramount importance to the viability of an action.\textsuperscript{113} In most cases, when the insurer makes the decision to
deny benefits, no payments will have been made to the insured or the insurer will immediately stop paying benefits. In those cases, the accrual of the claim is easily defined. In other cases, however, an insurer may inform the insured that benefits will cease at a time certain, but the insured will continue to receive payments until that time. Applying the Combs and King analysis, it seems likely that the bad faith cause of action will not arise until benefits actually cease. Arguably, though, “the last event” necessary for a party to assert wrongful conduct would be the decision on the denial of benefits and not the actual cessation of payments.

In other cases, however, an insurer may make a decision to deny benefits but the insured will continue to receive payments for a period of time. It does not appear that Kentucky courts have directly addressed this issue but experience in other jurisdictions may be instructive. In Flynn v. Paul Revere Insurance Group the Court of Appeals for the Ninth Circuit, applying California law, determined that a claim accrues when the decision to deny benefits occurs. In Flynn, the Ninth Circuit determined that the plaintiff’s claim accrued when the insurer informed the plaintiff as to the date that benefits under her policy would cease. Although this case involved ERISA, the court’s reasoning is persuasive. This factual scenario differs from King, because in King the full amount of the benefits had not been paid under a settlement agreement.

B. Statutory Bad Faith

In 1988, the Kentucky Legislature adopted the Kentucky Unfair Claims Settlement Practices Act (UCSPA). The UCSPA makes it an “unfair claims

114 Id.
115 Id. at 693-94 (holding “the last event” necessary will begin the statute of limitations to run). See also King, 54 Fed. Appx. at 836 (holding that cause of action accrues upon claim being “finally settled and paid in full”).
116 Combs, 163 F. Supp. 2d at 693-94.
118 Id. at 887.
120 KY. REV. STAT. ANN. § 304.12-230 (Banks-Baldwin 1988). That section provides:

- It is an unfair claims settlement practice for any person to commit or perform any of the following acts or omissions:
  1. Misrepresenting pertinent facts or insurance policy provisions relating to coverages at issue;
  2. Failing to acknowledge and act reasonably promptly upon communications with respect to claims arising under insurance policies;
  3. Failing to adopt and implement reasonable standards for the prompt investigation of claims arising under insurance policies;
(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;

(8) Attempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made a part of an application;

(9) Attempting to settle claims on the basis of an application which was altered without notice to, or knowledge or consent of the insured;

(10) Making claims payments to insureds or beneficiaries not accompanied by statement setting forth the coverage under which the payments are being made;

(11) Making known to insureds or claimants a policy of appealing from arbitration awards in favor of insureds or claimants for the purpose of compelling them to accept settlements or compromises less than the amount awarded in arbitration;

(12) Delaying the investigation or payment of claims by requiring an insured, claimant, or the physician of either to submit a preliminary claim report and then requiring the subsequent submission of formal proof of loss forms, both of which submissions contain substantially the same information;

(13) Failing to promptly settle claims, where liability has become reasonably clear, under one (1) portion of the insurance policy coverage in order to influence settlements under other portions of the insurance policy coverage;

(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; or

(15) Failing to comply with the decision of an independent review entity to provide coverage for a covered person as a result of an external review in accordance with KRS 304.17A-621, 304.17A-623, and 304.17A-625.

Id.
settlement practice” to “commit or perform” any one of fifteen separate offenses.\cite{121} Furthermore, the UCSPA “is intended ‘to protect the public from unfair trade practices and fraud.’”\cite{122}

The fifteen offenses prohibited by the UCSPA include: (1) misrepresenting pertinent facts or policy provisions;\footnote{123} (2) failing to reply in a reasonably prompt manner to communications;\footnote{124} (3) failing to use reasonable standards in investigating claims;\footnote{125} (4) refusing to pay claims in the absence of a reasonable investigation into the claim;\footnote{126} (5) failing to approve or deny coverage in a reasonable time subsequent to proof of loss statements being submitted;\footnote{127} (6) failing to attempt to reasonably settle claims in which liability is clear;\footnote{128} (7) compelling the insured to litigate by offering unreasonable settlements;\footnote{129} (8) offering amounts substantially less than that to which a reasonable person would believe he or she is entitled;\footnote{130} (9) attempting to settle the claim upon an altered application for coverage;\footnote{131} (10) making payments without explanation as to the policy provision or coverage under which the payments are being made;\footnote{132} (11) overtly practicing a policy of appealing arbitration awards, attempting to coerce the insured into accepting settlements which are substantially less than that to which they are entitled;\footnote{133} (12) unreasonably delaying the investigation or payment of a claim by requiring both a preliminary claim report and a subsequent claim report which both require substantially the same information;\footnote{134} (13) attempting to influence settlement under one portion of a policy by delaying payment under another portion;\footnote{135} (14) failing to provide an explanation, in law or fact, as to the basis for denial of settlement offers;\footnote{136} and (15) failing to comply with the decision made by an external review entity to provide coverage.\footnote{137}

In \textit{Naugle v. Allstate Insurance Co.},\footnote{138} the court ruled that for a party to succeed on a UCSPA claim, that party must show that the insurer behaved

\begin{footnotes}
\item[121] See \textit{id.}
\item[122] \textit{King}, 54 Fed. Appx. at 836.
\item[124] \textit{Id.}, § 304.12-230(2).
\item[125] \textit{Id.}, § 304.12-230(3).
\item[126] \textit{Id.}, § 304.12-230(4).
\item[127] \textit{Id.}, § 304.12-230(5).
\item[128] \textit{Id.}, § 304.12-230(6).
\item[130] \textit{Id.}, § 304.12-230(8).
\item[131] \textit{Id.}, § 304.12-230(9).
\item[132] \textit{Id.}, § 304.12-230(10).
\item[133] \textit{Id.}, § 304.12-230(11).
\item[134] \textit{Id.}, § 304.12-230(12).
\item[136] \textit{Id.}, § 304.12-230(14).
\item[137] \textit{Id.}, § 304.12-230(15).
\end{footnotes}
outrageously or acted due to an "evil motive or reckless indifference" to the party's rights. In Naugle, the plaintiff filed an action in state court claiming a violation of the UCSPA by the tortfeasor's automobile liability insurer. The claim was settled for policy limits nearly thirty-five months following the initial accident.

Approximately two months subsequent to the settlement, plaintiff brought suit against Allstate, alleging violations of numerous provisions of the UCSPA. At issue was the standard which the court should apply to UCSPA claims. Allstate argued that the proper standard forced the court to determine whether there existed "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." However, plaintiff proffered the proper standard as that espoused in Wittmer, namely "there must be sufficient evidence of intentional misconduct or reckless disregard of the rights of . . . a claimant to warrant submitting the right to award punitive damages to the jury." In Wittmer, the court was faced with "recurring issues in claims of this nature." In addition to laying the elements needed to be proved to sustain a common-law bad faith action, the court provided "that there is no such thing as a 'technical violation' of the UCSPA, at least in the sense of establishing a private cause of action for tortuous misconduct justifying a claim of bad faith." While there may be violations of the literal language of

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139 Id. at 309. See also Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky. 1993) (noting that the standard of conduct necessary to succeed upon an UCSPA claim is the same as that required to succeed upon a claim at common law); Davidson v. Am. Freightways, Inc., 25 S.W.3d 94, 102 (Ky. 2000) (holding in the absence of a contractual liability between the insurer and the claimant there can be no finding of bad faith).

140 Naugle, 72 Fed. Appx. at 308. Plaintiff was injured on January 24, 1996 in an automobile accident when the vehicle which he was driving was struck in the rear by Rebecca Everhart on Interstate 75 in Kenton County, Kentucky. Id. As a result of the accident, plaintiff suffered back injuries requiring surgery. Id.

141 Id. at 309 (stating that the tortfeasor's automobile liability insurance policy limit was $100,000).

142 Id. Allstate offered to settle for policy limits on December 9, 1998 and plaintiff accepted this offer nearly two months later. Id. Additionally, via this settlement, plaintiff released Allstate from all liability it may have had arising from the accident. Id.

143 Id. (filing suit in state court and Allstate subsequently removing to Federal Court).

144 Id. (alleging violations of subsections (2), (3), (4), (6) and (14)).

145 Id.


147 Id. (quoting Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky. 1993)).

148 Wittmer, 864 S.W.2d at 888 (considering matters in regard to violations of the Kentucky Unfair Claims Settlement Practices Act, conduct amounting to bad faith, and punitive damages all in the context of an automobile accident).

149 Id. at 890. State Farm proposed that the jury's finding of a violation of the UCSPA was merely a "technical violation," hence the award of $0. Id. See also Wilson v. Horace Mann Ins. Co., Nos.
the UCSPA, there will be no recovery unless the elements of the common-law bad faith action are met as well.\textsuperscript{150}

In determining that Allstate violated no provision of UCSPA, the court in \textit{Naugle} noted as significant the fact that, at no point, did Allstate ever attempt to settle plaintiff's claim for an "unreasonable amount," or for anything but full policy limits.\textsuperscript{151} It appears as though in reaching this decision the court placed paramount importance upon subsection (8) of the UCSPA.\textsuperscript{152} That section prohibits "[a]ttempting to settle a claim for less than the amount to which a reasonable man would have believed he was entitled by reference to written or printed advertising material accompanying or made part of an application."\textsuperscript{153}

In \textit{King v. Liberty Mutual Insurance Co.},\textsuperscript{154} the court held that Kentucky courts adhere to "a single test" which is applicable to bad faith actions, whether first or third party and whether "premised upon common law or a statutory violation."\textsuperscript{155} Therefore, claims alleging violation of the UCSPA and those alleging common law claims are generally treated as one in the same.\textsuperscript{156}

Moreover, it has been held that in order to succeed upon an UCSPA claim, the plaintiff must prove all three elements of the \textit{Wittmer} test.\textsuperscript{157} This is because before a cause of action for a violation of the UCSPA exists, there must be sufficient evidence to warrant the imposition of punitive damages.\textsuperscript{158}

\textit{Tharpe v. Illinois Nat'l Ins. Co.}, 199 F.R.D. 213, 215 (W.D. Ky. 2001). The court also acknowledged that bifurcation is generally "warranted in third-party actions in which the plaintiff asserts a claim for liability against a defendant and a claim for bad faith against the defendant's insurer." \textit{Id.} at 214. The court also reasoned that liability insurance should not be "interjected needlessly" during trial of a negligence issue. \textit{Id. See also Wittmer v. Jones}, 864 S.W.2d 885, 890 (Ky. 1993); Davidson v. Am. Freighthways, Inc., 25 S.W.3d 94, 100 (Ky. 2000).

\textit{Wittmer}, 864 S.W.2d at 890. The court explained:

\begin{quote}
The essence of the question as to whether the dispute is merely contractual or whether there are tortuous elements justifying an award of punitive damages depends first on whether there is proof of bad faith and next whether the proof is sufficient for the jury to conclude that there was 'conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others.'
\end{quote}
the court reasoned there must be evidence of "intentional misconduct or reckless disregard"159 by an insurer of an insured's rights in order to justify the imposition of punitive damages upon the insurer.160 This can only be shown by proving the three elements required for the common-law bad faith action.161

Additionally, King held the UCSPA "applies only to insurance companies and their agents in the negotiations, settlement and payment of claims made against policies, certificates or contracts of insurance."162 However, "claimants are entitled to bring a cause of action for damages when an insurance company violates any of the provisions of UCSPA."163

In Cowan v. Paul Revere Life Insurance Co.,164 an insulin dependent, diabetic school bus driver asserted a claim for bad faith against his disability insurer, Paul Revere, including a claim for punitive damages because Paul Revere denied his claim.165 The plaintiff also sought a judgment declaring that he was, in fact, eligible for benefits under his policy.166 Applying Kentucky law, the Sixth Circuit ruled that a bad faith action may be supported by UCSPA, Kentucky's Consumer Protection Act,168 or the common law.169 Additionally,
the court ruled “that an insured’s claim of bad faith must fail where the claim is ‘fairly debatable’ on the law or the facts.”

The Supreme Court of Kentucky determined that the UCSPA is not preempted by federal statute. It is also important to note that the UCSPA, by its own language, provides no cause of action by a private person. In order for a claim to be brought for a violation of the UCSPA it must be combined with a reading of K.R.S. § 446.070. That section allows a private cause of action for an injury caused by a violation of any statute, thereby allowing a cause of action for a violation of the UCSPA.

One of the most important aspects of the statutory bad faith claim is that it is analyzed under the same standards as the common law claim. In other words, whether the cause of action is asserted under common law or the UCSPA, the court will apply the Wittmer test. Accordingly, there is little difference with respect to the necessary elements of proof to defeat a statutory or common law bad faith claim.

Under the above rule, it should be impossible for a court to grant summary judgment on behalf of the insurer on one type of bad faith claim and not the other. If the above rule is a correct statement of the law and the same analysis should be applied to the statutory bad faith claim and the common law bad faith claim, then there should be no logical basis to grant summary judgment under one and not the other. The above rule may present an issue for the Kentucky Supreme Court to resolve.

C. Modern Trends

Recently, two areas of bad faith law have succumbed to drastic change: punitive damages and discovery. This section first discusses punitive damages

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170 Cowan, 30 Fed. Appx. at 387.
171 See, e.g., Dailey v. Am. Growers Ins., 103 S.W.3d 60, 65 (Ky. 2003) (holding that the UCSPA is not preempted by the Federal Crop Insurance Act because the UCSPA is consistent with the federal act).
173 KY. REV. STAT. ANN. § 446.070 (Banks-Baldwin 2003). This section provides, “[a] person injured by the violation of any statute may recover from the offender such damages as he sustained by reason of the violation, although a penalty or forfeiture is imposed for such violation.” Id. See also Davidson, 25 S.W.3d at 99.
174 See, e.g., Davidson, 25 S.W.3d 94. See also KY. REV. STAT. ANN. §§ 304.12-230, 446.070 (Banks-Baldwin 2002).
176 See Tharpe, 199 F.R.D. at 215.
177 Id.
178 See Davidson, 25 S.W.3d at 97.
in light of a recent United States Supreme Court decision. Next, it focuses on the changes with regard to discovery.

1. Punitive Damages

It is generally accepted that bad faith actions are brought in order to recover punitive damages; moreover, before a claimant even has a cause of action, there must be evidence warranting punitive damages. Therefore, any limitation upon the recovery of punitive damages is of paramount importance to potential claimants as well as the insurers.

In April 2003, the Supreme Court of the United States applied its punitive damage limiting guideposts to a bad faith action in *State Farm Mutual Automobile Insurance Co. v. Campbell*. These guideposts are: "(1) the degree of reprehensibility of the defendant’s misconduct, (2) the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award, and (3) the difference between the punitive damages awarded by the jury and the civil penalties authorized or imposed in comparable cases."

In *Campbell*, the Court held "[w]hile states possess discretion over the imposition of punitive damages, it is well established that there are procedural and substantive constitutional limitations on these awards." Moreover, "[t]he Due Process Clause of the Fourteenth Amendment prohibits the imposition of grossly excessive or arbitrary punishments on a tortfeasor." The Court provided:

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180 See id.
181 Id.
182 See Wittmer v. Jones, 864 S.W.2d 885, 890 (Ky. 1993).
183 See generally Derek D. Humfleet, *Justifying Punitive Damages in Light of State Farm v. Campbell*, *The Advocate*, July-Aug. 2003, at 6. The article discusses what Kentucky courts may do with punitive awards in light of recent United States Supreme Court decisions. Id. There it was noted that following *Campbell*, plaintiff’s evidence of defendant’s egregious behavior must "bear some reasonable relationship to the plaintiff’s injury... [t]he wealth of the defendant is not something that should be focused upon, rather the evidence of the bad behavior that led up to the plaintiff’s injury should be presented to the jury..." Id. at 8.
184 See BMW of N. Am. v. Gore, 517 U.S 559, 575 (1995) (holding that three guideposts should be considered when determining whether punitive damage awards are grossly excessive).
185 123 S. Ct. 1513 (2003). Although it was concluded that Campbell caused an accident in which one person was killed and another permanently disabled, his insurer contested liability, declined to settle the ensuing claims for the policy limit, ignored its own investigator’s advice, and took the case to trial assuring Campbell that he had no liability for the accident, that the insurer would defend him, and that he did not need separate counsel. Id. at 1514-15. A Utah jury returned a judgment for over three times the policy limit and the insurer refused to appeal. Id. at 1515. The Utah Supreme Court denied Campbell’s appeal, and the insurer paid the entire judgment. Id. Campbell subsequently sued the insurer for bad faith. Id.
186 Id. at 1520. See also *Gore*, 517 U.S. at 573-85.
187 *Campbell*, 123 S. Ct. at 1519.
188 Id. at 1519-20.
([T]his constitutional concern. . . arises out of the basic unfairness of depriving citizens of life, liberty, or property, through the application, not of law and legal processes, but of arbitrary coercion.) The reason is that '[e]lementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty that a State may impose.'

Furthermore, an award furthers no legitimate purpose when it is grossly excessive, thus constituting an arbitrary property deprivation. In *Campbell*, the Court reversed a punitive award of $145 million where compensatory damages were only $2.6 million.

a. *The Degree of Reprehensibility of the Defendant's Conduct*

The Court ruled, "[t]he most important indicium of the reasonableness of a punitive damages award is the degree of reprehensibility of the defendant's conduct." In considering this "guidepost," the Court instructed consideration of the following five factors: (1) whether the harm caused was physical or merely economic; (2) whether the tortuous conduct suggested reckless disregard for or an indifference to the health and safety of others; (3) the financial vulnerability of the recipient of the harmful conduct; (4) whether the conduct was isolated or involved repeated acts; and (5) whether the harm was the intentional product of malice, trickery or deceit or mere negligence.

Furthermore, the Court ruled that while the absence of all of these factors renders any award of punitive damages suspect, the mere existence of solely one of them may or may not be sufficient to sustain such an award. The Court went on to hold, "[i]t should be presumed a plaintiff has been made whole for his injuries by compensatory damages, so punitive damages should only be awarded

189 Id. at 1520 (quoting *Gore*, 517 U.S. at 574).
190 Id.
191 Id. at 1519. The jury awarded plaintiff $2.6 million in compensatory damages and $145 million in punitive damages, although the trial court reduced this to $1 million and $25 million, respectively. Id. However, both parties appealed and the Utah Supreme Court reinstated the jury's punitive damage award, roughly a fifty-six-to-one punitive damage to compensatory damage ratio. Id.
192 Id. at 1521 (quoting *Gore*, 517 U.S. at 575).
193 *Campbell*, 123 S. Ct. at 1521.
194 Id.
if the defendant’s culpability, after having paid compensatory damages, is so reprehensible as to warrant the imposition of further sanctions to achieve punishment or deterrence."\(^{195}\)

b. *The Disparity Between the Actual or Potential Harm Suffered by the Plaintiff and the Punitive Damages Award*

Turning to the second "guidepost," the Court admitted that it has "been reluctant to identify concrete constitutional limits on the ratio between harm, or potential harm, to the plaintiff and the punitive damages award."\(^{196}\) While rejecting the "notion that the constitutional line is marked by a simple mathematical formula" the Court declined to "impose a bright-line ratio which a punitive damages award cannot exceed."\(^{197}\)

Of paramount importance was the Court’s comment "in practice, few awards exceeding a single-digit ratio between punitive and compensatory damages, to a significant degree, will satisfy due process;" moreover, "an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety."\(^{198}\) Additionally, the Court ruled "[s]ingle-digit multipliers are more likely to comport with due process, while still achieving the State’s goals of deterrence and retribution, than awards with ratios in range of 500 to 1... or, in this case, of 145 to 1."\(^{199}\)

The Court allowed for ratios greater than those recommended where "a particularly egregious act has resulted in only a small amount of economic damages,"\(^{200}\) such as the ordinary bad faith action. In other words, "low awards of compensatory damages may properly support a higher ratio than high compensatory awards."\(^{201}\) In sum, when compensatory damages are high, the ratio of punitive damages to compensatory damages should be lesser, perhaps only one-to-one.\(^{202}\) However, when compensatory damages are lower, such as in bad faith awards, the ratio may be higher, if justified by particularly egregious conduct.\(^{203}\)

Perhaps the biggest practical problem with this analysis is the lack of attention by the Court to what constitutes a substantial compensatory award.\(^{204}\)

\(^{195}\) *Id.*  
\(^{196}\) *Id.* at 1524.  
\(^{197}\) *Id.*  
\(^{198}\) *Id.*  
\(^{199}\) *Campbell*, 123 S. Ct. at 1524. See also BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 583 (1996).  
\(^{200}\) *Campbell*, 123 S. Ct. at 1524 (quoting Gore, 517 U.S. at 582).  
\(^{201}\) Gore, 517 U.S. at 582.  
\(^{202}\) *Campbell*, 123 S. Ct. at 1524.  
\(^{203}\) *Id.*  
\(^{204}\) See *id.*
c. The Difference Between the Punitive Damages Awarded by the Jury and the Civil Penalties Authorized or Imposed in Comparable Cases

Finally, the Court addressed the third and final guidepost. This guidepost deals with any relevant civil sanctions which might be imposed on the defendant for its alleged conduct and how they compare to the punitive damages awarded. The Court began its discussion of this guidepost noting its relative insignificance by stating that “we need not dwell long” on it.

The Court also noted that “[t]he existence of a criminal penalty does have bearing on the seriousness with which a State views the wrongful action;” however, “[w]hen used to determine the dollar amount of the award . . . the criminal penalty has less utility.” Nonetheless, “[p]unitive damages are not a substitute for the criminal process, and the remote possibility of a criminal sanction does not automatically sustain a punitive damages award.”

d. The Dissenting Opinions

Three of the Supreme Court Justices filed dissenting opinions. First, Justice Scalia, reaffirming his dissenting views in Gore, stated that “the Due process Clause provides no substantive protections against excessive or unreasonable awards of punitive damages.” Justice Scalia added that he would affirm the decision of the Utah Supreme Court underlying the Campbell decision. Similarly, Justice Thomas simply stated that he continued “to believe that the Constitution does not constrain the size of punitive damages awards.” Finally, Justice Ginsburg noted that regulating the amount and size of punitive awards may best be left to State legislatures. Moreover, Justice Ginsburg adhered to the belief that “th[e] Court has no warrant to reform state law governing awards of punitive damages.”

e. Predicting What Kentucky Courts Will Do

In February 2001, the Supreme Court of Kentucky announced its most recent decision in regard to punitive damages in the bad faith context in Farmland...
In that case, the Supreme Court of Kentucky affirmed a decision awarding the plaintiffs $2 million in punitive damages where the compensatory damages awarded were merely $71,013.47. In that case, the plaintiffs, Lemuel and Virginia Johnson, owned a commercial building which was destroyed by fire; the defendant, Farmland Mutual Insurance Company, was the insurer. Subsequent to the accident, Farmland retained an outside company, Crawford and Company, to adjust the claim. Richard Shields was assigned by Crawford to adjust the claim.

A dispute arose as to whether the building should be rebuilt or merely repaired. Mr. Shields made only one offer to settle the claim, in the amount of $168,993.18. The Johnsons maintained that this claim was too low; thus, they filed a complaint in the Simpson County Circuit Court “alleging breach of the insurance contract and violations” of the UCSPA.

At trial for the bad faith claims, the Johnsons argued that Farmland “committed four violations of the UCSPA.” The Johnsons also offered evidence as to possible collusion between the adjustor, Mr. Shields, and Paul Davis Systems, a fire restoration service contractor. After hearing all of the evidence submitted, the jury found that Farmland had violated the UCSPA in addition to the common-law bad faith requirements.

As previously noted, the Supreme Court of Kentucky upheld the decision of the trial court awarding the Johnsons compensatory damages of $71,013.47 and punitive damages.

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217 Id. at 374. The jury, in circuit court, awarded $71,013.47 in compensatory damages and $2 million in punitive damages against Farmland and $1.1 million against another insurer and its adjuster. Id. However, the latter claim was settled prior to the plaintiffs’ appeal. Id.
218 Id. at 371.
219 Id.
220 Id.
221 Id.
222 Farmland, 36 S.W.3d at 371.
223 Id. at 371-72. The trial court severed the contract and bad faith claims. Id. In the contract claim, the jury found that the actual amount needed to repair the building was approximately $251,541, or about $45,000 more than Mr. Shields’ sole offer. Id. This decision was affirmed on appeal. Id.
224 Id. The Johnsons argued that Farmland (1) misrepresented pertinent provisions of their insurance policy; (2) failed to “conduct a reasonable investigation;” (3) failed to fairly and equitably settle their claim; and (4) compelled them, as insureds, “to initiate litigation by offering an amount substantially less than the amount ultimately recovered.” Id. See also KY. REV. STAT. ANN. §§ 304.12-230(1), (4), (6), (7) (Banks-Baldwin 2003).
225 Farmland, 36 S.W.3d at 372. The Johnsons alleged that Mr. Shields allowed Paul Davis Systems to submit a repair estimate which both parties knew, in fact, to be too low, thereby excluding other contractors from competing for the job. Id. In fact, Mr. Shields admitted on cross examination to basing his sole offer on the estimate submitted by Paul Davis Systems, which he knew to be too low. Id.
226 See id. at 372-74.
227 Id. at 374. The jury found that Farmland lacked a reasonable basis in law or fact for its conduct and knew there was no reasonable basis for its denial or acted with reckless disregard thereof. Id.
punitive damages of $2 million.\footnote{228} This is roughly a twenty-eight-to-one ratio.\footnote{229} The paramount issue facing bad faith actions in Kentucky today is how the decision in \textit{Farmland}, holding virtually no limit to the awarding of punitive damages, will be modified or applied in light of the United States Supreme Court's decision in \textit{Campbell}.\footnote{230}

On May 19, 2003 the Supreme Court of the United States remanded \textit{Ford Motor Co. v. Estate of Smith}.\footnote{231} This case, while not a bad faith issue, will be the first opportunity for the Kentucky Supreme Court to apply the punitive damage provisions of the \textit{Campbell} opinion.\footnote{232} In a court that is in great disaccord\footnote{234} over the limitations of punitive damages, predicting what will be done in light of \textit{Campbell} appears daunting.

\footnote{228}Id.\footnote{229} The calculation is $2,000,000 / $71,013.47 = 28.16.\footnote{230} \textit{Compare Farmland}, 36 S.W.3d at 368, with State Farm Mut. Auto. Ins. Co. v. Campbell, 123 S. Ct. 1513 (2003), and \textit{BMW} of N. Am., Inc. v. Gore, 517 U.S. 559 (1996).\footnote{231} Id.\footnote{123 S.Ct. 2072 (2003)}, \textit{vacating and remanding} Sand Hill Energy, Inc. v. Ford Motor Co., 83 S.W.3d 483 (Ky. 2002). That decision stated:

\begin{quote}
\end{quote}

\textit{Id}. This case is of paramount importance because it will be the first in which the Supreme Court of Kentucky applies the principles in the \textit{Campbell} decision. \textit{Id}. \textit{See also Campbell}, 123 S. Ct. 1513 (2003).\footnote{232} 123 S. Ct. 1513 (2003).\footnote{231} \textit{See Ford Motor Co. v. Estate of Smith}, 123 S. Ct. 2072 (2003).\footnote{234} \textit{See Sand Hill Energy, Inc. v. Ford Motor Co.}, 83 S.W.3d 483 (Ky. 2002), \textit{cert. granted sub nom. Ford Motor Co. v. Estate of Smith}, 123 S. Ct. 2072 (2003). In \textit{Sand Hill}, the majority affirmed a punitive award of $20 million, while reducing it to $15 million, where compensatory damages were $3 million. \textit{Id}. at 497. In so doing, while applying the \textit{Gore} guideposts, the majority stated "no court has yet discovered an infallible constitutional line or simple mathematical formula for determining whether an award of punitive damages is proper." \textit{Id}. at 496. \textit{See also BMW of N. Am., Inc. v. Gore}, 517 U.S. 559, 582 (1996). \textit{But see Sand Hill}, 83 S.W.3d at 501. In his dissent, Justice Cooper admonished:

\begin{quote}
In its haste to place its imprimatur on this outrageous verdict by a Clay County "runaway" jury and, presumably, to redistribute the wealth of an out-of-state corporation with requisite deep pockets to stimulate the economy of eastern Kentucky, the majority opinion ignores the facts of this case, our own long-standing precedents, and the Equal Protection and Due Process Clauses of the Fourteenth Amendment of the United States Constitution as interpreted by the United State Supreme Court.
\end{quote}
Sand Hill Energy, Inc. v. Ford Motor Co.,235 the most recent Kentucky Supreme Court decision addressing punitive damages, although not a bad faith case, may be indicative of what will be done in the future.236

In Sand Hill, a products liability action, the plaintiff brought suit for wrongful death because the deceased was crushed to death due to the negligent design of defendant's truck.237 The Kentucky Supreme Court affirmed the imposition of punitive damages, while reducing the jury's punitive damage award from $20 million to $15 million where compensatory damages were only $3 million.238 In reaching its decision, however, the court applied the Gore guideposts which were also relied upon in Campbell.239 While affirming the five-to-one punitive award, the court noted "no court has yet discovered an infallible constitutional line or simple mathematical formula for determining whether an award of punitive damages is proper."240

It now appears that Campbell is exactly the decision the Sand Hill court stated did not exist.241 The Campbell Court urged "that an award of more than four times the amount of compensatory damages might be close to the line of constitutional impropriety."242 However, the Court expressly declined to adopt a bright-line rule by which punitive awards could be measured.243

This recommendation of a four-to-one multiplier244 may be the closest the Kentucky Supreme Court gets to an "infallible constitutional line."245 In view of that, the highly disputed award in Sand Hill was five-to-one.246 Therefore, the recommended four-to-one multiplier of the United States Supreme Court247 and the actual multiplier used by the Kentucky Supreme Court248 are nearly the same.

Id. That dissenting opinion also stated "[i]t is now clear that the majority of this Court is incapable of enforcing the constitutional restraints against excessive punitive damages verdicts in this jurisdiction." Id. at 514.

235 83 S.W.3d 483 (Ky. 2002).

236 See id.

237 Id. at 486. Plaintiff's decedent was employed by Sand Hill Energy, Inc. Id. at 485. While unloading a 1977 Ford F-250 pick-up truck with the motor running, the truck shifted into reverse, slowly crushing him between the vehicle and a shed. Id. at 486. Plaintiff presented evidence showing that the transmission was negligently designed, which led the jury to award $3 million in compensatory damages and $20 million in punitive damages. Id. at 497.

238 Id. at 496.

239 Id. at 493-96. See also Gore, 517 U.S. at 575; State Farm Mut. Auto. Ins. Co. v. Campbell, 123 S.Ct. 1513, 1520 (2003).

240 Sand Hill, 83 S.W.3d at 496.

241 Id.

242 Campbell, 123 S. Ct. at 1524.

243 Id.

244 Id.

245 Sand Hill, 83 S.W.3d at 496.

246 See id.

247 See Campbell, 123 S. Ct. at 1524.

248 See Sand Hill, 83 S.W.3d at 496.
Therefore, the Kentucky Supreme Court is likely to affirm its decision on remand, due to the nearness between the ratios of the punitive damages awarded and those recommended by the Campbell court, and especially in light of the fact that Campbell itself allowed for higher ratios where particularly egregious conduct had occurred. In Sand Hill, when applying the relevant Gore guidepost the court stated “it would be impossible to overstate the degree of harm.” This is exactly the situation for which the Campbell decision allowed higher ratios. Therefore, the Sand Hill decision and its five-to-one punitive to compensatory damage ratio will likely be affirmed in the Kentucky Supreme Court.

However, some observers foretell the Kentucky Supreme Court reversing its decision on remand. This is because, despite the small ratio of the punitive damages to the compensatory damages, five-to-one, the $3 million compensatory damage award seems substantial. Therefore, a five-to-one ratio seems excessive when applying Campbell. Even with reprehensible conduct, these observers believe it unlikely that a $15 million punitive damages award in addition to a $3 million compensatory damages award would withstand scrutiny. A one-to-one ratio may be more appropriate in light of the discussion in Campbell.

2. Broad Discovery

Another potential effect Campbell will have on state law is to broaden the scope of discovery. In the action underlying the Campbell decision, the plaintiffs introduced evidence which ordinarily would not be allowed.

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249 Compare Sand Hill, 83 S.W.3d at 483 (applying a five-to-one ratio), with Campbell, 123 S. Ct. at 1513 (recommending a four-to-one ratio but allowing for larger ratios where the defendant’s conduct was particularly egregious). Applying the recommendations in the Campbell decision, the Kentucky Supreme Court is likely to uphold its decision due to the reprehensibility of the defendant’s conduct. See Campbell, 123 S.Ct. at 1524.

250 See Campbell, 123 S. Ct. at 1524 (recommending a four-to-one ratio).

251 See Sand Hill, 83 S.W.3d at 494. The court was considering the guidepost which looks at the “disparity between the harm suffered by the plaintiff and the punitive damages awarded.” Id.

252 See Sand Hill, 83 S.W.3d at 494.

253 See Sand Hill, 83 S.W.3d at 493.

254 Compare Sand Hill, 83 S.W.3d at 483 (applying a five-to-one ratio), with Campbell, 123 S. Ct. at 1513 (recommending a four-to-one ratio but allowing for larger ratios where the defendant’s conduct was particularly egregious).

255 See Campbell, 123 S. Ct. at 1524.

256 See id.

257 See id.

258 Id.

259 See id.

260 Id.

261 Id. at 1518-19.

262 Id.
The Campbells were allowed to introduce "evidence that State Farm's decision to take the case to trial was part of a national scheme to meet corporate fiscal goals by capping payouts on claims company wide."263 This scheme was referred to as State Farm's 'Performance, Planning and Review,' or PP&R, policy.264 In order to prove this scheme, "the trial court allowed the Campbells to introduce extensive expert testimony regarding the fraudulent practices by State Farm in its nation-wide operations."265 The trial court ruled, despite State Farm's motion to exclude the evidence, "that such evidence was admissible to determine whether State Farm's conduct in the Campbell case was indeed intentional and sufficiently egregious to warrant punitive damages."266 This evidence pertained to State Farm's "business practices for over 20 years in numerous States."267

Moreover, most of the evidence the Campbells were allowed to admit "bore no relation to third-party automobile insurance claims, the type of claim underlying the Campbells' complaint against" State Farm.268 Nonetheless, the Utah Supreme Court reinstated the jury's award of $145 million in punitive damages.269

In Campbell, the United States Supreme Court stated "[l]awful out-of-state conduct may be probative when it demonstrates the deliberateness and culpability of the defendant's action in the State where it is tortuous, but that conduct must have a nexus to the specific harm suffered by the plaintiff."270 The Court suggested this broad evidence may be used under the second guidepost.271 However, "[a] jury must be instructed . . . that it may not use evidence of out-of-state conduct to punish a defendant for action that was lawful in the jurisdiction where it occurred."272

The Court relied upon a "basic principle of Federalism"273 in that "each state may make its own reasoned judgment about what conduct is permitted or proscribed within its borders, and each State alone can determine what measure of punishment, if any, to impose on a defendant who acts within its jurisdiction."274

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263 Campbell, 123 S. Ct. at 1518.
264 Id. at 1518-19.
265 Id. at 1519.
266 Id.
267 Id.
268 Id.
269 Campbell, 123 S. Ct. at 1510.
270 Id. at 1522.
271 Id. at 1523. The second guidepost is "the disparity between the actual or potential harm suffered by the plaintiff and the punitive damages award." Id. at 1520.
272 Id. at 1522-23.
273 Id. at 1523.
274 Id.
More importantly, the Court instructed, "[a] defendant’s dissimilar acts, independent from the acts upon which liability [is] premised, may not serve as the basis for punitive damages."\(^{275}\) Moreover, "[a] defendant should be punished for the conduct that harmed the plaintiff, not for being an unsavory individual or business."\(^{276}\) The Court acknowledged "[d]ue process does not permit courts, in the calculation of punitive damages, to adjudicate the merits of other parties’ hypothetical claims against a defendant under the guise of the reprehensibility analysis."\(^{277}\) Nonetheless, the Court implied that repetitive conduct amounting to bad faith may be punished more severely than if that conduct was a first for that particular defendant.\(^{278}\)

The Court leaves open the issue as to whether similar evidence to that presented by the Campbell plaintiffs may be presented in other cases.\(^{279}\) However, it does allow similar, lawful out-of-state misconduct\(^{280}\) to be introduced in order to show that the defendant may be a recidivist.\(^{281}\) Nevertheless, in order to present such evidence, it must at least have a nexus of some sort to the harm suffered by the plaintiff.\(^{282}\) The extent and nature of the nexus required, however, is not clear.\(^{283}\)

IV. CONCLUSION

Kentucky courts appear to have a uniform method of handling statutory and common-law bad faith claims. All of the recent cases consistently apply the Wittmer test and address the statutory and common-law claims together. Although bad faith claims will remain a staple in actions against insurers, it is

\(^{275}\) Campbell, 123 S. Ct. at 1523.
\(^{276}\) Id.
\(^{277}\) Id.
\(^{278}\) Id. The Court stated:

[T]he Utah Supreme Court's decision cannot be justified on the grounds that State Farm was a recidivist. Although 'our holdings that a recidivist may be punished more severely than a first offender recognize that repeated misconduct is more reprehensible than an individual instance of malfeasance,' in the context of civil actions courts must ensure the conduct in question replicates the prior transgressions.

\(^{279}\) Id. at 1523.
\(^{280}\) Id.
\(^{281}\) Id. at 1522.
\(^{282}\) Campbell, 123 S. Ct. at 1523.
\(^{283}\) Id. at 1522.
\(^{284}\) See id.
unclear exactly how large punitive damages awards may be. As Kentucky state and federal courts interpret and apply *Campbell*, the legitimacy of large punitive damage awards may change. It will be important to keep a close watch on those cases.\textsuperscript{284}

\textsuperscript{284} As of the printing of this article, the Kentucky Supreme Court had not yet announced its decision on remand in Sand Hill Energy, Inc. v. Ford Motor Co., 83 S.W.3d 483 (Ky. 2002). Therefore, it is important to keep an eye on the outcome of the case.
I. INTRODUCTION

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III. ANALYSIS

IV. CONCLUSION
I. INTRODUCTION

Perhaps the most common area of family law is the dissolution of a marriage proceeding.\(^1\) With the growing prevalence of high divorce rates in America, it is imperative that family law practitioners be aware of and understand the implications of current case law within the field. The purpose of this article is to provide practitioners with an overview of current court decisions in Kentucky relating to issues that may arise during a dissolution of marriage including: the division of property, maintenance awards, and determination of child support. Although custody and visitation are inevitably linked to divorce, those issues will not be discussed in this article. The breadth of information available in the area of custody and visitation is expansive enough to warrant treatment in a separate article. However, this survey article concludes by providing a limited discussion on the issue of relocation, a custody matter that arises subsequent to the initial custody and visitation determination.

II. CASE SUMMARIES

A. Division of Property

This section addresses specific issues related to the division of property in a dissolution of marriage. The first case discusses the division of property in general, noting that in a dissolution of marriage action, the division of property generally requires a three step process: (1) characterizing each item of property as marital or nonmarital; (2) assigning each party’s nonmarital property to that party; and (3) equitably dividing marital property between the parties.\(^2\) The second case addresses the circumstances under which fraud may justify reopening a property division decree.\(^3\) Specifically, the Kentucky Supreme Court found that the husband’s knowing undervaluation of marital assets during divorce negotiations constituted a “fraud affecting the proceedings” which justified reopening the property division decree.\(^4\) The third case provides a detailed summary of classification of certain retirement benefits as marital or nonmarital property.\(^5\) In particular, the Kentucky Supreme Court found that an ex-husband’s future, post-dissolution disability retirement benefits, which replaced his future nonmarital earnings as a firefighter, were his separate nonmarital property and hence not subject to equitable division.\(^6\) The final case in this section relates to dower rights of engaged persons.\(^7\) There, the Kentucky Supreme Court held that a husband’s transfer of property on the night before the

\(^1\) STEPHEN J. BAHR, 4 J.L. & FAM. STUD. PART I-II (2002).
\(^2\) Travis v. Travis, 59 S.W.3d 904, 909 (Ky. 2001).
\(^3\) Terwilliger v. Terwilliger, 64 S.W.3d 816 (Ky. 2002).
\(^4\) Id. at 820-21.
\(^5\) Holman v. Holman, 84 S.W.3d 903 (Ky. 2002).
\(^6\) Id. at 910.
\(^7\) Mathias v. Martin, 87 S.W.3d 859 (Ky. 2002).
wedding did not constitute fraud on the wife’s dower rights because, even though the wife did not sign an antenuptial agreement, she nonetheless had knowledge of the transfer and proceeded with the marriage anyway.8

1. Disposition of Property in General

Travis v. Travis, 59 S.W.3d 904 (Ky. 2001). Shortly after their marriage, Jeffrey and Lora Travis jointly obtained a $39,368.90 loan from Fredonia Valley Bank.9 Using the proceeds of the loan and an additional $7,500 of Jeffrey’s premarital property, the couple purchased a house and moved it onto land owned by Jeffrey.10 Although Jeffrey and Lora were unable to reduce the loan’s principal balance, they did make some improvements on the house, including the addition of a second story.11 Lora made some additional improvements, including wallpapering, painting, and staining.12

After the parties separated, but before the dissolution, the house was destroyed by a fire, and the parties received a $63,000 insurance payment for the damage.13 Of this amount, $39,635.86 went towards the loan’s outstanding balance, with the remaining $23,364.14 placed into escrow for distribution by the trial court.14 While both Jeffrey and Lora agreed that $7,500 of the remaining proceeds constituted Jeffrey’s nonmarital property, there was disagreement as to whether any of the remaining $15,864.14 constituted Jeffrey’s nonmarital property.15

Using the Brandenburg v. Brandenburg formula,16 Jeffrey argued that he should receive a percentage of the proceeds proportionate to his nonmarital contribution based on the appreciation of such contribution from general economic conditions.17 Lora argued that only the $7,500 contribution represented Jeffrey’s nonmarital portion and that according to Goderwis v. Goderwis,18 the

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8 Id. at 864.
9 Travis v. Travis, 59 S.W.3d 904, 905 (Ky. 2001).
10 Id.
11 Id.
12 Id.
13 Id. at 905-06.
14 Id. at 906.
15 Travis, 59 S.W.3d at 906.
16 Brandenburg v. Brandenburg, 617 S.W.2d 871, 872-74 (Ky. Ct. App. 1981) (setting forth the following formulas: nmc/tc x e = nonmarital property, and mc/tc x e = marital property, where “nmc” was the nonmarital contribution, “mc” was the marital contribution, “tc” was the sum of nonmarital and marital contributions, and “e” was equity in the property at the time of distribution).
17 Travis, 59 S.W.3d at 906.
18 Goderwis v. Goderwis, 780 S.W.2d 39, 40 (Ky. 1989). The court in Goderwis addressed the issue of how to treat a business property acquired before marriage, which was the main source of income during the marriage and which increased in value during the marriage. Id. at 40. In holding that the increase in value was the result of the joint efforts of the parties and therefore marital property, the court provided:

[Smith v. Smith, 497 S.W.2d 418 (Ky. 1973)] holds that where the value of property increases after marriage due to general economic conditions, such increase is not marital
A disputed amount should be divided equally between the parties as it resulted from their joint efforts during the marriage. The Commissioner agreed with Jeffrey and found that the marital contribution of $1,000 (the value of Lora's painting, wallpapering, and staining) would be 12% of the total contribution ($8,500) and the nonmarital contribution of $7,500 by Jeffrey would be 88% of the total contribution. Therefore, the Commissioner divided the remaining house proceeds of $23,064.14 by giving $21,962.20 to Jeffrey and $1,401.85 to Lora. The trial court adopted the Commissioner's report.

On appeal, the court of appeals reversed and remanded, instructing the trial court to divide the insurance proceeds, minus the amount paid towards the loan and the $7,500 of Jeffrey's nonmarital contribution, between the parties as marital property. The court of appeals based its decision on the fact that Jeffrey had failed to overcome the presumption under K.R.S. § 403.190(3) that "all property acquired by either spouse after the marriage and before a decree of legal separation is marital property." Jeffrey sought discretionary review in the Supreme Court of Kentucky.

property, but the opposite is true when the increase in value is a result of the joint efforts of the parties. An increase in value of nonmarital property may be marital or nonmarital depending on why the increase in value occurred. Id. at 40, (citing Stallings v. Stallings, 606 S.W.3d 163 (Ky. 1980)). An increase in value of nonmarital property during the marriage which is the result of a joint effort of the parties establishes the increase in value of the nonmarital property as marital property. Id. The efforts of the parties may include the contribution of one spouse as a primary operator of the business and the other spouse as primarily a homemaker.


19 Travis, 59 S.W.3d at 906.
20 Id. at 907.
21 Id.
22 Id.
23 Id.
24 Id. at 908.
25 Travis, 59 S.W.3d at 908.
The court began its analysis with K.R.S. § 403.190, the statute governing the disposition of property in a dissolution of marriage action. Based on this statute, the court added that a trial court’s disposition of property in a dissolution of marriage action requires three steps: (1) characterization of each item as either marital or nonmarital; (2) assignment of each party’s nonmarital property to that party; and (3) equitable division of the marital property between the parties. The court opined that when property acquired during marriage increases in value and contains components of marital and nonmarital property, it is up to the trial court to decide why the increase in value occurred.

According to Goderwis, when nonmarital property value increases during the marriage because of general economic conditions, the increase is considered

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26 Ky. Rev. Stat. Ann. § 403.190 (Banks-Baldwin 2003) provides as follows:

(1) In a proceeding for dissolution of the marriage . . . , the court shall assign each spouses’ property to him. It also shall divide the marital property without regard to marital misconduct in just proportions considering all relevant factors including: (a) Contribution of each spouse to acquisition of the marital property, including contribution of a spouse as a homemaker; (b) Value of the property set apart to each spouse; (c) Duration of the marriage; and (d) Economic circumstances of each spouse when the division of property is to become effective . . . .

(2) For the purpose of this chapter, “marital property” means all property acquired by either spouse subsequent to the marriage except: (a) Property acquired by gift, bequest, devise, or descent during the marriage and the income derived therefrom unless there are significant activities of either spouse which contributed to the increase in value of said property and the income earned therefrom; (b) Property acquired in exchange for property acquired before the marriage or in exchange for property acquired by gift, bequest, devise, or descent; (c) Property acquired by a spouse after a decree of legal separation; (d) Property excluded by valid agreement of the parties; and (e) The increase in value of property acquired before the marriage to the extent that such increase did not result from the efforts of the parties during the marriage.

(3) All property acquired by either spouse after the marriage and before a decree of legal separation is presumed to be marital property, regardless of whether title is held individually or by the spouses in some form of co-ownership such as joint tenancy, tenancy in common, tenancy by the entirety, and community property. The presumption of marital property is overcome by a showing that the property was acquired by a method listed in subsection (2) of this section.

27 Travis, 59 S.W.3d at 908.
28 Id. at 909.
29 Id. at 910.
nonmarital, but when value increases because of the parties' joint efforts, it is to be divided as marital property.\textsuperscript{30} The court added, however, as noted by the court of appeals, that K.R.S. § 403.190(3) creates a rebuttable presumption that any increase in value is marital property.\textsuperscript{31} This same section explicitly puts the burden of proof on the party asserting that he or she should receive appreciation upon a nonmarital contribution as his or her nonmarital property, here Jeffrey.\textsuperscript{32} The court agreed with the court of appeals that Jeffrey had failed to introduce any evidence to rebut this presumption.\textsuperscript{33} Jeffrey's evidence merely established the amount invested in the house and the amount received from the insurance proceeds.\textsuperscript{34} Therefore, the court held that the trial court should not have characterized any portion of the proceeds in dispute as nonmarital property, and remanded the case with instructions to distribute the amount in dispute as marital property pursuant to K.R.S. § 403.190(1).\textsuperscript{35}

2. "Fraud Affecting the Proceeding"

Terwilliger v. Terwilliger, 64 S.W.3d 816 (Ky. 2002). Pursuant to Kentucky Rules of Civil Procedure 60.02\textsuperscript{36} and K.R.S. § 403.250,\textsuperscript{37} Judith Terwilliger

\textsuperscript{30} Goderwis v. Goderwis, 780 S.W.2d 39, 40 (Ky. 1989).
\textsuperscript{31} Travis, 59 S.W.3d at 910.
\textsuperscript{32} Id. at 912.
\textsuperscript{33} Id.
\textsuperscript{34} Id.
\textsuperscript{35} Id. at 913.
\textsuperscript{36} KY. R. CIV. P. 60.02 provides in relevant part:

On motion a court may, upon such terms as are just, relieve a party or his legal representative from its final judgment, order, or proceeding upon the following grounds: . . . (b) newly discovered evidence which by due diligence could not have been discovered in time to move for a new trial under Rule 59.02; . . . (d) fraud affecting the proceedings, other than perjury or falsified evidence; . . . or (f) any other reason of an extraordinary nature justifying relief.

\textsuperscript{37} KY. REV. STAT. ANN. § 403. 250 (Banks-Baldwin 2003) deals with modification or termination of provisions for maintenance and property division. This section provides:

(1) Except as otherwise provided in subsection (6) of K.R.S. 403.180, the provisions of any decree respecting maintenance may be modified only upon a showing of changed circumstances so substantial and continuing as to make the terms unconscionable. The provisions as to property disposition may not be revoked or modified, unless the court finds the existence of conditions that justify the reopening of a judgment under the laws of this state.
(2) Unless otherwise agreed in writing or expressly provided in the decree, the obligation to pay future
moved the court to reopen a decree of dissolution and modify a settlement agreement. Both acting pro se, Judith and her ex-husband, Thomas Terwilliger, entered into a separation agreement drafted by Mr. Terwilliger, which provided for custody, visitation, and support of their children, as well as the division of the marital property and debts. Thomas assured Judith that the corporations they owned were experiencing financial difficulties, were on the verge of bankruptcy, and that she had to act quickly to avoid losing her home to creditors. However, less than two weeks after the divorce decree was entered, Thomas agreed to sell one of these corporations for $1.6 million dollars.

Judith moved to reopen the decree of dissolution on the grounds that the settlement was procured through fraud, misrepresentation, lack of full disclosure, and overreaching. The trial court granted the motion, and thereafter modified the property division to give Judith one-half of the profits realized from the sale of the corporation. On appeal, Thomas argued that his actions did not amount to "fraud affecting the proceedings" under Kentucky Rules of Civil Procedure 60.02(d). Relying on Rasnick v. Rasnick, the court of appeals agreed with Thomas and reversed the family court's order modifying the property settlement. On review, the Supreme Court of Kentucky first decided that the definition of "fraud affecting the proceedings" in Rasnick was overly restrictive.

The court then adopted a more flexible approach, stating that fraud on a party is, in fact, "fraud affecting the proceedings," including conduct outside of the courtroom that effectively prevents the other party from presenting his or her side of the case fully and fairly. The court noted that "while finality of judgment is a laudable goal, it cannot take precedence over the fair and equitable resolution of disputes." Given this newly articulated standard, the court held that Thomas’ knowing undervaluation of the marital assets during divorce negotiations, when neither party was represented by counsel, was a fraud

maintenance is terminated upon the death of either party or the remarriage of the party receiving maintenance.

Id.
38 Terwilliger v. Terwilliger, 64 S.W.3d 816, 817 (Ky. 2002).
39 Id.
40 Id.
41 Id.
42 Id.
43 Id.
44 Terwilliger, 64 S.W.3d at 817.
45 Rasnick v. Rasnick, 982 S.W.2d 218, 219 (Ky. Ct. App. 1998) (drawing a distinction between fraud intrinsic to the proceedings, such as perjury or nondisclosure during pretrial discovery which causes injury to a single litigant, and "extrinsic" fraud, which the court held constitutes "fraud affecting the proceedings").
46 Terwilliger, 64 S.W.3d at 818.
47 Id.
48 Id.
49 Id. at 819.
"affecting the proceedings" and the trial court's reopening of the settlement agreement was proper under Kentucky Rules of Civil Procedure 60.02(d).

The supreme court next discussed the trial court's decision to set aside $200,000 of the proceeds from the sale of the corporation as Thomas' separate nonmarital property. Thomas argued that this portion, allegedly originating from the settlement of a lawsuit which preceded the marriage, represented the amount he invested on his own and was therefore nonmarital property. In rejecting this argument, the supreme court relied on the K.R.S. § 403.190(2) presumption that all property acquired during the marriage is marital property. As the party claiming that the $200,000 was not marital property, Thomas had the burden of proof on this issue. The supreme court found it significant that although Thomas was an experienced businessman who was expected to have maintained detailed and accurate records of where the assets came from, he was nevertheless unable to adequately trace the funds to a separate source. Concluding that the trial court's decision to set aside the $200,000 was apparently based on its misconception of the tracing requirements rather than a finding that Thomas was more credible than Judith in his testimony concerning the disputed amount, the supreme court remanded the case for the trial court to consider whether the claimed nonmarital share was sufficiently established.

3. Classification of Retirement and Disability Benefits

Holman v. Holman, 84 S.W.3d 903 (Ky. 2002). James Holman was a firefighter for thirteen years when he became totally and permanently occupationally disabled. As a result, James retired and began collecting disability retirement benefits each month. In his subsequent divorce proceeding, the trial court classified James' future entitlement to disability retirement benefits as marital property and awarded his wife, Sue, a portion of those benefits. The trial court based its decision on the fact that James was still able to work in another capacity. The court of appeals affirmed the trial court, holding that since the legislature did not specifically exclude disability benefits

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50 Id. at 821.
51 Id. at 819.
52 Terwilliger, 64 S.W.3d at 819-20.
53 Id. at 820.
54 Id.
55 Id. See also Chenault v. Chenault, 799 S.W.2d 575, 578 (Ky. 1990) (holding that "while such precise requirements for nonmarital asset-tracing may be appropriate for skilled business persons who maintain comprehensive records of their financial affairs, such may not be appropriate for persons of lesser business skill or persons who are imprecise in their record-keeping abilities").
56 Terwilliger, 64 S.W.3d at 821.
57 Holman v. Holman, 84 S.W.3d 903, 903-04 (Ky. 2002).
58 Id. at 904.
59 Id.
60 Id. at 905.
from the statutory definition of marital property, such payments must be deemed marital.61

In addressing the issue of how to classify James' firefighter retirement benefits, the supreme court first looked to approaches taken by other jurisdictions, as this was an issue of first impression in Kentucky.62 The court identified three different approaches taken by other jurisdictions: (1) the mechanistic approach, (2) the analytical approach, and (3) the approach taken by the American Law Institute.63 Under the mechanistic approach, courts look at whether the benefits are specifically excepted from the statutory definition of marital property, and if not expressly excluded, then such benefits are classified as marital property.64 However, under the analytical approach, which has been adopted by a majority of courts considering this issue, the focus is on the nature and purpose of the benefits.65 Specifically, benefits which actually compensate for loss of good health and replace lost earning capacity are not classified as marital property.66 Finally, under the approach recommended by the American Law Institute, benefits are classified "according to the nature of the property they replace rather than by the source of the funds used to acquire the benefit."67 For example, benefits such as disability pay and workers' compensation are classified "as marital property to the extent they replace earnings during the marriage, and as separate property to the extent they replace earnings before or after the marriage, without regard to how or when the benefit was acquired."68

Before deciding which approach to adopt, the supreme court discussed prior Kentucky appellate decisions69 addressing personal injury and workers'
Analogizing personal injury awards and workers' compensation awards to the disability benefits in this case, the supreme court used these cases to further support its position that property can be nonmarital even if not expressly exempted from the statutory definition of marital property. 70

Based on the foregoing, the supreme court rejected the mechanistic approach taken by the court of appeals, and adopted the approach recommended by the American Law Institute. 71 Rather than classifying benefits based on whether or not they are expressly excluded from the statutory definition or whether the source of funds used to obtain the benefits were marital, the classification should be based on the nature of the wages they replace. 72 Accordingly, the supreme court held that James' future post-dissolution disability retirement benefits, which replaced his future nonmarital earnings as a firefighter, were his separate nonmarital property. 73 In reversing the court of appeals, the supreme court remanded the case to the trial court for it to assign James' firefighter disability benefits to him as his nonmarital property. 74

4. Dower Rights of Engaged Persons

**Mathias v. Martin, 87 S.W.3d 859 (Ky. 2002).** Joseph and Lillian Martin were married for twelve years. 75 While they were engaged, and only a week before the wedding, Joseph requested that Lillian sign an antenuptial agreement. 76 On the day before the wedding, based on advice from her attorney, Lillian informed Joseph that she had decided not to sign the agreement. 77 That same day, Joseph told Lillian that he had recently conveyed valuable real estate that he owned to an irrevocable trust controlled by him. 78 This conveyance effectively prevented Lillian from acquiring any rights in the property as a result of the marriage. 79 Despite the conveyance and Lillian's knowledge thereof, the couple proceeded to get married and remained husband and wife for twelve years. 80 Upon Joseph's death, Lillian brought an action as widow and administratrix of his estate, claiming that the antenuptial conveyance constituted fraud upon her dower rights. 81

Both the trial court and the court of appeals, in ordering all transfers of property to be set aside and voiding the deed conveying the farm to the trust, reasoned that recent Kentucky cases had changed the prevailing rule that

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70 *Holman*, 84 S.W.3d at 909.
71 *Id.*
72 *Id.* at 910.
73 *Id.*
74 *Id.*
75 *Id.* at 911.
76 *Mathias v. Martin*, 87 S.W.3d 859, 860 (Ky. 2002).
77 *Id.*
78 *Id.*
79 *Id.*
80 *Id.*
81 *Id.*
82 *Mathias*, 87 S.W.3d at 860.
knowledge of the transfers by a prospective spouse would defeat a claim of fraud upon dower.83 Specifically, the court of appeals held that while the older cases84 were still valid, the law had been modified by subsequent cases.85 These courts therefore found that in addition to having knowledge of the transfer of property, the intended spouse must also consent to the transfer before marriage to prevent fraud on dower rights.86

On review by the Supreme Court of Kentucky, appellants, as trustees of the Joseph Martin Trust, argued that there was no fraud because consent could be implied when an intended spouse married with knowledge of a transfer of property before the marriage.87 Lillian argued that her consent to the transfer could not be implied by the marriage because of her express refusal to sign the antenuptial agreement.88 The supreme court agreed with appellants and reversed the court of appeals.89

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83 Id. at 861.
84 See Chesire v. Payne, 55 Ky. (16 B. Mon.) 618, 627 (1855) (holding when plaintiff found out only moments before the wedding that fiancé had conveyed real estate to her brother, he had no claim for fraud). See also Murray v. Murray, 13 S.W. 244, 245 (Ky. 1890) (holding that "a conveyance upon the eve of marriage, to be regarded in equity as a fraud upon the marital rights of the intended wife, and, consequently not binding upon her, must be made without her consent or knowledge"); Anderson v. Anderson, 240 S.W. 1061, 1063 (Ky. 1922). The court provided:

It has long been the settled rule in this state that a conveyance of real estate, made by one after an agreement to marry, without consideration and without the knowledge or consent of his intended wife, is a fraud on the wife and will be declared void to the extent that it deprives her of dower in the real estate conveyed.

Id.
85 See Rowe v. Ratliff, 104 S.W.2d 437, 439 (Ky. 1937) (stating that "[i]f a husband makes a gift of all or a greater part of his property . . . without the . . . consent of his wife, a prima facie case of fraud arises, and it rests upon the beneficiaries to explain away such presumption"). See also Harris v. Rock, 799 S.W.2d 10, 12 (Ky. 1990) (holding that "absent an agreement of the parties, a disposition of property with the intent to defeat the right of dower creates a presumption of fraud upon the surviving spouse"); Anderson v. Anderson, 583 S.W.2d 504,505 (Ky. Ct. App. 1979) (ruling in favor of spouse claiming right to money that husband transferred to separate bank account held jointly with children when, despite her knowledge of the transfer, husband clearly intended to deprive the wife of property in which she had a statutory right to claim); Martin v. Martin, 138 S.W.2d 509, 515 (Ky. 1940). The Martin court provided:

[A] man may not make a voluntary transfer of either his real or personal estate with the intent to prevent his wife, or intended wife, from sharing in such property at his death and that the wife, on the husband’s death, may assert her marital rights in such property in the hands of the donee.

Id.
86 Mathias, 87 S.W.3d at 861.
87 Id.
88 Id.
89 Id. at 864.
The supreme court noted that most of the recent cases involved the transfer of property after the marriage, whereas the present case involved a transfer before the marriage.\footnote{Id. at 863.} Hence, while consent is required to preclude a claim of fraud if the transfer occurs after marriage, mere knowledge of the transfer by the intended spouse will suffice to defeat a claim of fraud in the case of a pre-marital transfer of property.\footnote{Id. at 863-64.}

B. Maintenance

In general, K.R.S. § 403.200 seeks to enable an unemployable spouse to acquire the skills necessary to support himself or herself in the current workforce so that he or she does not rely upon the maintenance payments from the working spouse indefinitely.\footnote{Clark v. Clark, 782 S.W.2d 56, 61 (Ky. Ct. App. 1990).} The award of maintenance is within the sound discretion of the trial court.\footnote{Perrine v. Christine, 833 S.W.2d 825, 826 (Ky. 1992).} The cases in this section address the general standard courts must follow in making this determination, and more specifically, if and when a court may award retroactive maintenance payments.

1. General Standard

\textit{Powell v. Powell}, 107 S.W.3d 222 (Ky. 2003). After eighteen years of marriage, Doris and Dr. James Powell divorced and entered into a separation agreement.\footnote{Powell v. Powell, 107 S.W.3d 222, 223 (Ky. 2003).} Although the parties were able to agree on the terms regarding property division and child support, they reserved the issues of maintenance, attorney fees, and costs for a hearing before the Domestic Relations Commissioner.\footnote{Id.} In adopting the commissioner's recommendations, the trial court ordered James to pay all attorney fees and costs of litigation, and awarded Doris maintenance in the amount of $3,000 per month for three years.\footnote{Id.} The court of appeals affirmed and Doris appealed to the Supreme Court of Kentucky.\footnote{Id. at 224.}

While acknowledging that the trial court has the discretion to determine the appropriate maintenance award, the supreme court added that if the trial court abused its discretion or made clearly erroneous findings, the reviewing court could overturn the award.\footnote{Id. at 224-25.} The supreme court found that the trial court in this case had abused its discretion in awarding Doris only $3,000 per month for three years.\footnote{Id.} In making its decision, the supreme court considered a variety of factors

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\footnote{Id. at 863.} \footnote{Id. at 863-64.} \footnote{Clark v. Clark, 782 S.W.2d 56, 61 (Ky. Ct. App. 1990).} \footnote{Perrine v. Christine, 833 S.W.2d 825, 826 (Ky. 1992).} \footnote{Powell v. Powell, 107 S.W.3d 222, 223 (Ky. 2003).} \footnote{Id.} \footnote{Id.} \footnote{Id.} \footnote{Id.} \footnote{Id. at 224.} \footnote{Id. at 224-25.}
pursuant to K.R.S. § 403.200,\textsuperscript{100} including: the great disparity in the parties' incomes; the eighteen-year marriage; the facts that Doris had been out of the workforce for several years to raise their children, was now fifty years old, and had back problems limiting her ability to work; the luxurious standard of living the parties enjoyed while married; and the fact that Doris had supported James during his residency and internship.\textsuperscript{101}

While noting that K.R.S. § 403.200 seeks to allow an unemployable spouse to gain the skills necessary to support himself or herself so that he or she does not rely on the maintenance indefinitely, the supreme court added that "in situations where the marriage was long term, the dependent spouse is near retirement age, the discrepancy in the incomes is great, or the prospects for self-sufficiency appear dismal," courts have awarded maintenance for larger amounts and longer periods.\textsuperscript{102} In considering the fact that Doris was the primary breadwinner during James' residency and internship, the supreme court cautioned that this was merely a factor to consider and courts should not grant maintenance solely because the nonprofessional spouse helped support the professional spouse in obtaining a degree.\textsuperscript{103}

\textsuperscript{100} KY. REV. STAT. ANN. § 403.200 (Banks-Baldwin 2003) governs spousal maintenance and provides in pertinent part:

(1) In a proceeding for dissolution of marriage . . . the court may grant a maintenance order for either spouse only if it finds that the spouse seeking maintenance: (a) Lacks sufficient property, including marital property apportioned to him, to provide for his reasonable needs; and (b) Is unable to support himself through appropriate employment . . . . (2) The maintenance order shall be in such amounts and for such periods of time as the court deems just, and after considering all relevant factors including: (a) The financial resources of the party seeking maintenance, including marital property apportioned to him, and his ability to meet his needs independently . . . ; (b) The time necessary to acquire sufficient education or training to enable the party seeking maintenance to find appropriate employment; (c) The standard of living established during the marriage; (d) The duration of the marriage; (e) The age, and the physical and emotional condition of the spouse seeking maintenance; and (f) The ability of the spouse from whom maintenance is sought to meet his needs while meeting those of the spouse seeking maintenance.

\textsuperscript{101} Powell, 107 S.W.3d at 224-25.

\textsuperscript{102} Id. at 224. See also Clark v. Clark, 782 S.W.2d 56, 62 (Ky. Ct. App. 1990) (holding that the trial court properly awarded maintenance when it considered that appellee was not currently working at the time of the dissolution because she was taking care of the couple's young daughter, the marriage lasted close to twenty years, and appellee had come to enjoy a very comfortable standard of living).

\textsuperscript{103} Powell, 107 S.W.3d at 225 (citing Clark, 782 S.W.2d at 61). Powell stands for the proposition that, when determining whether to award maintenance, the court should consider whether the spouse is capable of supporting herself through employment in the workforce, which would enable
The supreme court further noted that although the Commissioner may rely on income generated from the investment of amounts received from a property settlement in granting maintenance, there was no duty to invest such proceeds in order to reduce the amount of maintenance required to satisfy that spouse's needs. In this case, the Commissioner considered the $360,000 awarded to Doris in the property settlement in making its maintenance recommendation. The supreme court stated that since Doris would likely have to spend a large portion of the property settlement on buying a new home, the Commissioner's reliance on the income received from the investment of such proceeds was likely "overstated."

Finally, the supreme court addressed the issue of whether the Commissioner should have considered Doris' net income in deciding whether she was able to support herself on the budget presented. The supreme court concluded by stating, "[w]e think that common sense dictates that a court consider the parties' net income when determining whether or not the spouse seeking maintenance will be able to meet his or her needs, as well as the payor spouse's ability to continue meeting his or her own needs." The court of appeals was therefore reversed with instructions to amend the maintenance award in conformity with the supreme court's opinion.

Id.

It is especially acceptable for the trial court to consider the impact of the divorce on the nonprofessional's standard of living and award an appropriate amount that the professional spouse can afford. Finally, the trial court should not automatically grant a monetary award simply because one spouse contributed to the other spouse obtaining a professional degree, but these efforts should be considered and compensated especially if the spouses' incomes or salaries are uneven.

Id.

Powell, 107 S.W.3d at 225. See also Atwood v. Atwood, 643 S.W.2d 263, 265 (Ky. Ct. App. 1982). In Atwood, the court held that while K.R.S. § 403.200(1)(a) requires that a spouse must "lack sufficient property to provide for his reasonable needs" in order to be entitled to a maintenance award, and while "there would be a reasonable expectation that the spouse entitled to maintenance would not fritter away his or her portion of the marital property and would use same properly to help provide for his needs," there was no duty to invest "all or nearly all of her cash portion of the marital settlement into the uninsured and speculative money market." Id. at 265.

Id.

Id.

Id. at 226.

Id.

Id.
2. Retroactive Payments

_Higbee v. Higbee_, 89 S.W.3d 409 (Ky. 2002). This case arose from the dissolution of marriage of John and Jerrilyn Higbee. On the first appeal, the court of appeals remanded the case for the Domestic Relations Commissioner to hear evidence on the issue of maintenance. While the commissioner found that maintenance was not appropriate, the circuit court concluded otherwise. The circuit court awarded Jerrilyn maintenance retroactive to the date she filed exceptions to the Domestic Relations Commissioner’s report.

On appeal, a divided court of appeals held that the trial court had abused its discretion in making the maintenance award retroactive, and directed it to order the maintenance payments payable effective as of the date the maintenance award was entered. The court of appeals based their decision on the fact that John would likely incur debt in an effort to pay the arrearage, Jerrilyn’s attorney fees, and the monthly maintenance award. Jerrilyn appealed to the Supreme Court of Kentucky.

The supreme court, citing the dissenting opinion of the court below, noted that “Jerrilyn should not be deprived of the maintenance to which she was entitled simply ‘because it has taken nine years to recover what she should have been awarded in the first place.” The supreme court also cited to existing precedent in _Weldon v. Weldon_, a Kentucky court of appeals case upholding retroactive maintenance awards. Accordingly, the decision of the court of appeals was reversed and the trial court’s order providing for retroactive maintenance payments was reinstated.

C. Child Support

This section of the article focuses on the many intricacies of child support. In the first case, a Kentucky appeals court confronted the issue of determining child support...
support when a parent’s income exceeded the highest level in the child support guidelines. In rejecting the trial court’s strictly mathematical approach to determining the appropriate amount of child support, the court of appeals held that any decision to set child support above the guidelines must be based on the child’s needs. Factors to consider in assessing the child’s needs include the standard of living which the children enjoyed during and after the marriage, the parent’s financial ability to meet those needs, the parties’ station in life, age and physical condition of the parties, and educational expenses for the child(ren). In the second case, the Kentucky Supreme Court determined that although child support generally has to be based on documented income of the parties, it is within the trial court’s discretion to consider income not susceptible to documentation if such income is properly established by the evidence. In the third case, a Kentucky appeals court determined that while student loans should not be taken into account in computing a father’s child support obligation, the money the father received from his parents, which he used for living expenses and vehicle maintenance, should be considered in the determination of child support. The remaining cases address whether, and to what extent, non-recurring income may be considered in determining child support obligations, and under what circumstances a child support order may be modified to reflect a reduction in child care expenses.

1. Gross Income Exceeding Highest Level in Guidelines

Downing v. Downing, 45 S.W.3d 449 (Ky. Ct. App. 2001). Donald Downing appealed an order of the Jefferson Family Court raising his child support obligation from $2,112 per month to $3,475 per month. Sharon, Donald’s ex-wife and custodian of their two children, petitioned for the increased support based on a $40,000 per month increase in his income. On appeal, Donald argued that the trial court erred when it based the amount of child support almost entirely on a mathematical extrapolation from the child support guidelines. The court of appeals agreed, vacated the order increasing Donald’s child support obligation, and remanded the case to the trial court for further findings as discussed below.

123 Id. at 456.
124 Id. at 456-57.
125 Schoenbachler v. Minyard, 110 S.W.3d 776, 778 (Ky. 2003).
127 See infra Part II.C.4-5.
129 Id. at 452. As the sole owner of a collection agency known as Independent Contractors, Inc., Mr. Downing’s income increased from $17,491 per month in 1994 to $57,000 per month by the end of 1997. Id. The court did not account for this substantial increase in Mr. Downing’s monthly income. Id.
130 Id.
131 Id. at 454.
132 Id. at 457.
Based on K.R.S. § 403.211(3) the court of appeals acknowledged that “combined monthly adjusted parental gross income in excess of the Kentucky child support guidelines” is grounds for deviation from those guidelines. The court of appeals then noted that the trial court has considerable discretion in determining child support in such a situation. Considering that the child support table ends at parental income of $15,000 per month, the court found it “clearly appropriate” to deviate from the guidelines in this case.

The court of appeals then discussed the “Income Shares Model” on which the Kentucky Child Support Guidelines are based. The premise of this model is that the child should have access to any parental income that the child would have received but for the parents’ divorce. The idea is that divorce should have as little impact as possible on the child’s life or standard of living. The difficulty, the court of appeals acknowledged, is determining the appropriate amount of child support when parental income exceeds the highest amount set out in the guidelines.

Sharon argued that the court of appeals should adopt the “share the wealth” model, under which children are entitled to “share in fruits of one parent’s good fortune after a divorce.” This approach involves a mathematical calculation of child support without entering specific findings as to the children’s needs and standard of living. In rejecting this model as the appropriate standard for determining child support, the court of appeals opined that if child support is awarded beyond the reasonable needs of the child, the increase primarily accrues to benefit the custodial parent rather than the child. Instead, the court of appeals accepted the “Three Pony Rule,” which essentially requires that child support be set in an amount which is rationally and reasonably related to the realistic needs of the child.

133 Id. at 454.
134 Downing, 45 S.W.3d at 454.
135 Id.
136 Id. at 455. The court noted that “a review of the Kentucky child support table further shows that [the Income Shares Model] is based upon the assumption that as parental income increases, the proportion of income spent on child support decreases.” Id. For example, on the child support table where the combined monthly adjusted parental gross income is: $1,000, the base child support for two children is $303 (30.3%); at $5,000, the base child support is $1,010 (20.2%); at $10,000, the base child support is $1,515 (15.15%); and at the highest income on the chart, $15,000, the base child support is $1,844 (12.23%). Id. at 455 n.14.
137 Id. at 455.
138 Id.
139 Id. at 457.
140 Downing, 45 S.W.3d at 455.
141 Id.
142 Id.
143 Id.
144 Id. at 456. In explaining the “Three Pony Rule” the court stated that:

Beyond a certain point, additional child support serves no purpose but to provide extravagance and an unwarranted transfer of wealth. While to some degree children have a right to share in each parent’s standard of living...
Considering the "Three Pony Rule" as well as the Income Shares Model, the court of appeals held that although the amount of child support was not unreasonable per se, the commissioner's over-reliance on mathematical extrapolation without any other supporting findings or evidence was an abuse of discretion and therefore concluded that the amount awarded was arbitrary. Hence, the child's needs, including the standard of living which the children enjoyed during and after the marriage, must be the primary basis in deciding to deviate from the child support guidelines. While determining the child's reasonable needs, the court should also consider the parent's financial ability to meet those needs, as well as the parent's station in life, the parent's age and physical condition, and expenses in educating the children. Cautioning that these factors were not exhaustive, the court of appeals suggested that the court should assess any factors under the circumstances which have a bearing on the child's reasonable needs.

On remand, the court of appeals instructed the trial court to consider any relevant factors that affect the reasonable needs of the children, including increases in cost of living since the original child support award, as well as the amount of time the children reside with each parent. As such, so long as there is a reasonable basis and evidence in the record warranting a deviation from the guidelines, a reviewing court will not interfere with the trial court's discretion.

2. "Income" Not Restricted to Documented Income

_Schoenbachler v. Minyard_, 110 S.W.3d 776 (Ky. 2003). Angela Minyard and Bruce Schoenbachler divorced after nearly five years of marriage and the birth of one child. In the dissolution of marriage proceedings, Angela produced tax returns reflecting a monthly income of $1,710 and testified to an additional monthly income of $30 from the sale of Kentucky Derby tickets. Bruce reported a gross monthly income of $3,333 from his employment. In deciding the issue of child support, the trial court found that Angela's "lifestyle and property exceeded that which could be obtained" from the monthly income she reported, and, assuming that the she must have been receiving income child, no matter how wealthy the parents, needs to be provided more than three ponies.
from another source, determined her income to be equivalent to Bruce’s and refused to award child support to either party. The court of appeals vacated the order and remanded, instructing the trial court to “calculate child support based upon the documented income of the parties.”

On review, the Supreme Court of Kentucky held that although the general rule is that child support should be based on the documented income of the parents, undocumented income may be considered by the trial court if adequately established in the record. In support of its holding, the supreme court addressed K.R.S. § 403.212(2), the provision relied upon by the court of appeals in holding that only documented income may be considered when determining child support obligations. The supreme court interpreted this provision as imposing a requirement on parties in dissolution cases involving child support to file fully documented income statements. While recognizing that this requirement was implicit in the language of the provision, the supreme court added that by filing properly documented income statements, “parties can facilitate and expedite the resolution of child support issues and thereby reduce the need for expansive and time-and-expense-consuming discovery that would otherwise be necessary to ascertain the parties’ incomes and to determine the proper amount of child support.”

Although the supreme court read the statute as imposing this requirement, it clarified that a trial court’s consideration of parental income is not restricted to documented income. In order to achieve an accurate estimate of the parental gross income, the supreme court suggested that both documented and undocumented income should be used in the calculation. However, the supreme court found no evidence to support the trial court’s assignment of income to Angela, noting that “[n]either a ‘windshield appraisal’ that Appellee’s ‘lifestyle and property reflected an income greater than her W-2’s and tax returns indicated’ nor Appellant’s bare allegations of additional income are sufficient to support the trial court’s finding of additional income.” Therefore, in accord with the court of appeals, the supreme court vacated the trial court’s judgment

155 Id. at 779. The trial court’s finding of facts stated as follows: “Angela clearly has cash flow in excess of IRS reported income, and has admitted to receiving income from the scalping of tickets and placing bets with bookies . . . . This court has the right to impute income to the Petitioner for the purposes of assigning child support and will do so.” Id.
156 Id. at 779.
157 Schoenbachler, 110 S.W.3d at 780-81.
158 Id. at 784.
159 Ky. REV. STAT. ANN. § 403.212(2)(f) (Banks-Baldwin 2003) provides: “Income statements of the parents shall be verified by documentation of both current and past income. Suitable documentation shall include, but shall not be limited to, income tax returns, paystubs, employer statements, or receipts and expenses if self-employed.”
160 Schoenbachler, 110 S.W.3d at 782-83.
161 Id. at 784.
162 Id.
163 Id.
164 Id.
165 Id. at 785.
and remanded for the trial court to reexamine the child support issue based upon the parties' documented income.166

3. Gifts from Parents and Student Loans

_Stewart v. Burton_, 108 S.W.3d 647 (Ky. Ct. App. 2003). The Fayette Circuit Court modified Kyle Stewart's child support obligation based on a reassessment of his gross income to include financial assistance received from his parents as well as income from student loans.167 Kyle appealed, arguing that the trial court erred when it included in his gross income money received from his parents to assist with living expenses and the maintenance of his car, and by including the amount of his student loans.168

The court of appeals first discussed whether the financial assistance received from Kyle's parents constituted gross income.169 Based on the language of K.R.S. § 403.212, which states that income includes income from any source including gifts, the court of appeals found that "this was just the sort of financial enrichment that the legislature meant to reach by including gifts in the definition of gross income."170 In further reliance on a Maryland appeals court decision,171 the court of appeals held that when a parent receives contributions for living expenses from an external source, it may be necessary to increase the parent's actual income to account for such contributions.172 The rationale is that these contributions free up other sources of income that could be used for the child.173 The court of appeals added that the trial court can exercise judicial discretion to decide that a gift should not be included in income if it is "inconsequential, nonrecurring or unlikely to provide sufficient funds to pay the increased child support obligation."174

Next, the court of appeals addressed whether student loan proceeds should have been imputed to Kyle as gross income.175 The court of appeals first noted that even though loans were not specifically included within the definition of gross income, the items listed within the definition of gross income were not exclusive.176 Nonetheless, the court of appeals found that loans were not income under the statutory definition because of the repayment requirement and the fact that there was no evidence that the loans were to be used for anything other than

166 Schoenbachler, 110 S.W.3d at 785.
168 Id. at 647-48.
169 Id. at 648.
170 Id.
171 Petrini v. Petrini, 648 A.2d 1016, 1019 (Md. 1994) (holding that under certain circumstances it may be appropriate to increase the parent's actual income to account for contribution from outside sources when determining child support obligations).
172 Stewart, 108 S.W.3d at 648.
173 Id.
174 Id. at 648-49.
175 Id. at 649.
176 Id.
Kyle’s education. The trial court was therefore affirmed as to the inclusion of gifts and financial assistance from his parents as income, but remanded for recomputation of Kyle’s child support obligation without the inclusion of his student loan proceeds.

4. Non-Recurring Income

Clary v. Clary, 54 S.W.3d 568 (Ky. Ct. App. 2001). Lisa Clary filed a motion seeking an increase in child support based on a change of circumstances pursuant to K.R.S. Chapter 403. Specifically, Lisa alleged that her ex-husband, James Clary, had increased income resulting from the sale of certain realty. At the hearing before the commissioner, Lisa’s attorney argued that one-half of the capital gain from the sale of the property should be included in James’ income for the year it was received for purposes of determining his child support obligation. In reliance on K.R.S. § 403.213(1), which requires a showing of “a substantial and continuing change in circumstances” to modify child support, James argued that since the sale of his property was a one-time event, his child support obligation should not increase. The commissioner recommended that one-half of the proceeds from the sale of the real estate be included in James’ income, but that such amount “be prorated over his remaining work-life expectancy to age 65.” The trial court adopted the commissioner’s recommendations and Lisa appealed.

The court of appeals affirmed the trial court’s order insofar as it included the capital gain in his gross income, but reversed its decision to prorate the proceeds over his work life expectancy. Although this precise issue was an issue of first impression in Kentucky, the court of appeals relied on the conclusion of other jurisdictions that nonrecurring income is to be considered when determining child support obligations. In support of its ruling, the court of appeals acknowledged that the broad definition of “gross income” under K.R.S. § 403.212(2)(b) included income from any source, and specifically included capital gains and other items such as prizes, bonuses, severance pay, and gifts.

177 Id.
178 Stewart, 108 S.W.3d at 650.
180 Id.
181 Id.
182 Id.
183 Id. at 569-70.
184 Id. at 570.
185 Id. at 571. See also Helbling v. Helbling, 541 N.W.2d 443, 447 (N.D. 1995) (holding that relocation expenses received by the father should be included as income despite the fact that it was nonrecurring). See also In re Marriage of Zisch, 967 P.2d 199, 201-02 (Colo. Ct. App. 1995) (holding that a $262,000 capital gain from the sale of stock should be included in the father’s income for determining the modification of child support); Howe v. Howe, 516 S.E.2d 240, 245 (Va. Ct. App. 1999) (holding that when determining child support, the emphasis should be on including, not excluding, income, particularly when inclusion results in a more accurate reflection of the parent’s economic situation).
which are usually nonrecurring.\textsuperscript{187} The court also noted that nonrecurring income was not specifically excluded.\textsuperscript{188}

Accordingly, the court of appeals held that when a parent receives a substantial amount of money in a lump sum, although it may be nonrecurring, the trial court should nevertheless include that amount in the parent’s income for the year received and then determine the child support obligation based on the child support guidelines in K.R.S. § 403.212.\textsuperscript{189} Recognizing the potential for unfairness, the court of appeals opined that the trial court retains the discretion to deviate from the guidelines when their application would produce unjust or inappropriate results.\textsuperscript{190} In exercising this discretion, the trial court can consider factors such as the “reasonable and realistic needs of the child, the standard of living the child enjoyed during the marriage, and the financial circumstances of the parents.”\textsuperscript{191}

5. Reduction in Child Care Expenses

\textit{Olson v. Olson}, 108 S.W.3d 650 (Ky. Ct. App. 2003). Mark Olson motioned for and received a reduction in child support based on a change in the amount of child care expenses incurred by Misti Olson, his former wife.\textsuperscript{192} Based on K.R.S. § 403.213,\textsuperscript{193} Misti argued that the trial court erred in reducing the amount when there was less than a 15% change in the support obligation.\textsuperscript{194} The trial court found that Mark had sufficiently rebutted the 15% presumption based on the fact that Misti had not needed work-related child care during the school year for several years, even though the existing support amount had been calculated with work-related child care in mind.\textsuperscript{195}

On appeal, however, the court of appeals found that the 15% threshold did not have to be met since it was not a child support modification.\textsuperscript{196} Under K.R.S. § 403.211(6),\textsuperscript{197} a determination of child care costs is in addition to the amount

\begin{footnotes}
\item[187] Clary, 54 S.W.3d at 573.
\item[188] Id.
\item[189] Id. at 574.
\item[190] Id.
\item[191] Id.
\item[193] KY. REV. STAT. ANN. § 403.213 (Banks-Baldwin 2003) establishes the criteria for modification of child support orders. It provides that: (1) “The provisions of any decree respecting child support may be modified only as to installments accruing subsequent to the filing of the motion for modification and only upon a showing of a material change in circumstances . . . .” Id. Subsection (2) creates a rebuttable presumption that a change in the amount of support due which is less than 15% is not a material change in circumstances. Id.
\item[194] Olson, 108 S.W.3d at 651.
\item[195] Id. at 651-52.
\item[196] Id. at 652.
\item[197] KY. REV. STAT. ANN. § 403.211(6) (Banks-Baldwin 2003) provides that: “[t]he court shall allocate between the parents, in proportion to their combined monthly adjusted parental gross income, reasonable and necessary child care costs incurred due to employment, job search, or education leading to employment, in addition to the amount ordered under the child support guidelines.”
\end{footnotes}
of child support ordered.\textsuperscript{198} Child care cost allocations are considered prepayments or reimbursements of actual costs incurred, and as such, if the expense is not incurred, the other party is entitled to repayment.\textsuperscript{199}

The court of appeals held that because the oldest child was able to watch the younger children during the school year, Misti did not incur child care during the school year.\textsuperscript{200} The court also found that some reduction may be necessary for the summer months because of help from Misti’s sister.\textsuperscript{201} Accordingly, the court of appeals directed the trial court to reconsider Mark’s motion as a motion for reimbursement of unpaid child care expenses, and to further determine, based on K.R.S. § 403.211(6), if any allocation of future child care expenses was warranted.\textsuperscript{202}

D. Relocation

The final section of this article addresses the delicate issue of custodial parent relocation, taking the child a considerable distance from the non-custodial parent. In general, a primary residential custodian may relocate as they propose.\textsuperscript{203} The case below discusses jurisdictional issues related to relocation.

Scott v. Summers, No. 2001-CA-002579-MR, 2003 WL 255939 (Ky. Ct. App. 2003). Raymond Scott and Dietta Summers were married for seven years and had two children during the marriage.\textsuperscript{204} Dietta filed for divorce, the two entered into a settlement agreement, and the dissolution of marriage was ordered by the Livingston Circuit Court in Kentucky.\textsuperscript{205} Pursuant to the settlement agreement, Raymond and Dietta received joint custody, with Dietta as the primary residential caretaker and Raymond receiving weekly visitation each Sunday through Tuesday.\textsuperscript{206} The parties were to deviate from the agreement only after agreement by both parties, and they further agreed to “confer with each other on all important matters pertaining to the child[ren]’s health, welfare, education and upbringing.”\textsuperscript{207}

Dietta remarried only sixteen days after the settlement agreement was entered and began making plans to move to Texas with the children.\textsuperscript{208} Before the move on September 6, 2000, Dietta filed a motion to modify custody with the Livingston Circuit Court since the current visitation agreement would not be workable given the long distance.\textsuperscript{209} The Livingston Circuit Court, as

\textsuperscript{198} Olson, 108 S.W.3d at 652.
\textsuperscript{199} Id.
\textsuperscript{200} Id.
\textsuperscript{201} Id.
\textsuperscript{202} Id.
\textsuperscript{203} Fenwick v. Fenwick, 114 S.W.3d 767, 786 (Ky. 2003).
\textsuperscript{205} Id.
\textsuperscript{206} Id.
\textsuperscript{207} Id.
\textsuperscript{208} Id.
\textsuperscript{209} Id.
recommended by the Domestic Relations Commissioner, held Dietta in contempt of court for failing to abide by the terms of the settlement agreement, and for intentionally interfering with Raymond’s custodial and visitation rights. 210 

Thereafter, the parties modified their agreement and an agreed order was entered on April 9, 2001 in the Livingston Circuit Court, granting Raymond visitation with the kids on specified school breaks and holidays. 211

On May 25, 2001, Dietta filed a motion in the District Court of Dallas County, Texas, to modify the Kentucky custody order and to obtain a temporary ex parte restraining order to prevent Raymond from taking the children out of the court’s jurisdiction for any purpose. 212 Pursuant to Texas’ version of the Uniform Child Custody Jurisdiction Act (UCCJA), 213 the court exercised its temporary emergency jurisdiction based on the need to protect the children, and granted the temporary ex parte restraining order. 214 The motion for modification of custody

211 Id.
212 Id.
213 KY. REV. STAT. ANN. § 403.400 (Banks-Baldwin 2003) sets forth the general purposes of the UCCJA as follows:

(1) The general purposes of K.R.S. 403.410 to 403.620 are to:
(a) Avoid jurisdictional competition and conflict with courts of other states in matters of child custody which have in the past resulted in the shifting of children from state to state with harmful effects on their well-being;
(b) Promote cooperation with the courts of other states to the end that a custody decree is rendered in that state which can best decide the case in the interest of the child;
(c) Assure that litigation concerning the custody of a child takes place ordinarily in the state with which the child and his family have the closest connection and where significant evidence concerning his care, protection, training, and personal relationships is most readily available, and that courts of this state decline the exercise of jurisdiction when the child and his family have a closer connection with another state;
(d) Discourage continuing controversies over child custody in the interest of greater stability of home environment and of secure family relationships for the child;
(e) Deter abductions and other unilateral removals of children undertaken to obtain custody awards;
(f) Avoid re-litigation of custody decisions of other states in this state insofar as feasible;
(g) Facilitate the enforcement of custody decrees of other states;
(h) Promote and expand the exchange of information and other forms of mutual assistance between the courts of this state and those of other states concerned with the same child; and
(i) Make uniform the law of those states which enact it.

and visitation was heard on June 20, 2001, and at that time the court was able to exercise jurisdiction under the Texas Family Code because the children had not been a resident of any state other than Texas for the eight months preceding the filing of the petition. At the hearing, which Raymond was notified of, but failed to attend, a child psychologist testified that the children would potentially suffer severe psychological damage by continued visitation with their father. As a result, the Dallas County District Court suspended Raymond's summer visitation privileges, ordered that any further contact with the children be supervised, and issued a temporary injunction which prohibited the children from being removed from its jurisdiction.

Subsequently, Raymond filed a motion with the Livingston Circuit Court in Kentucky to compel Dietta to show cause why she should not be held in contempt of court for her failure to abide by the previously modified visitation agreement. Raymond's motion was denied and the Livingston Circuit Court, pursuant to K.R.S. § 403.420, relinquished jurisdiction to the Dallas County

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215 Id. at *2.
216 Id.
217 Id.
218 Id.
219 KY. REV. STAT. ANN. § 403.420 (Banks-Baldwin 2003), in relevant part, provides as follows:

(1) A court of this state which is competent to decide child custody matters has jurisdiction to make a child custody determination by initial or modification decree if:
(a) This state is the home state of the child at the time of commencement of the proceeding, or had been the child's home state within six (6) months before commencement of the proceeding and the child is absent from this state because of his removal or retention by a person claiming his custody or for other reasons, and a parent or person acting as parent continues to live in this state; or
(b) It is in the best interest of the child that a court of this state assume jurisdiction because the child and his parents, or the child and at least one (1) contestant, have a significant connection with the state, and there is available in this state substantial evidence concerning the child's present or future care, protection, training, and personal relationships; or
(c) The child is physically present in this state and the child has been abandoned or it is necessary in an emergency to protect the child because he has been subjected to or threatened with mistreatment or abuse or is otherwise neglected or dependent; or
(d) It appears that no other state would have jurisdiction under prerequisites substantially in accordance with paragraphs (a), (b), or (c), or another state has declined to exercise jurisdiction on the ground that this state is the more appropriate forum to determine the custody of the child, and it is in the best interest of the child that this court assume jurisdiction.
District Court under K.R.S. § 403.420. Raymond appealed, arguing that a contempt proceeding is not a custody proceeding under the UCCJA, and therefore K.R.S. § 403.420 was inapplicable.

In order to resolve the question before it, the court of appeals had to consider whether the Texas order modifying the parties' existing agreement was valid. The court of appeals began by citing Brighty v. Brighty for the proposition that where no modification is sought or obtained, the UCCJA has no application to contempt proceedings brought to enforce an existing visitation or custody order. In Brighty, no modification had been sought or obtained so the UCCJA did not apply. In this case, modification had been sought and obtained through another jurisdiction, and therefore, the issue became whether the modification was valid. In order for the modification to be recognized and enforced by Kentucky courts, K.R.S. § 403.520 provides that the Texas court must have "assumed jurisdiction under statutory provisions substantially in accordance with K.R.S. §§ 403.420 to 403.620." In other words, the Texas court had to satisfy one of the K.R.S. § 403.420 jurisdictional requirements prior to modifying the Kentucky order.

The court of appeals noted one such requirement is that the state is the "home state" of the child at the time of commencement of the proceeding. Under K.R.S. § 403.410(5), "home state" means "the state in which the child lived with a parent for at least six consecutive months immediately preceding the time of commencement of the proceeding." Accordingly, the court of appeals held that since the children had been living with Dietta for at least six consecutive months prior to Dietta filing her modification motion, and since there was no pending motion in Kentucky related to custody at that time, Texas had properly assumed "home state" jurisdiction under the UCCJA. The court of appeals acknowledged that Raymond no longer had an enforceable visitation order to enforce through a contempt motion once the Texas court had assumed jurisdiction and modified the Kentucky order. The Texas order had superseded, and therefore invalidated, the Kentucky visitation order. "To hold otherwise would be contrary to the UCCJA, which was enacted primarily to prevent jurisdictional conflicts between the states in matters of child custody."
III. ANALYSIS

A. Division of Property

The characterization of divorcing parties' property as marital and nonmarital property remains open to dispute. Since the burden of proof must be maintained by the challenging party pursuant to K.R.S. § 403.190, sufficient records should be preserved so that assets may be properly traced and documented. The Travis v. Travis case is a reminder that merely challenging a rebuttable presumption is insufficient. Carefully maintaining evidentiary documents to substantiate a non-marital claim is crucial to a final division of property.

Correspondingly, in Hunter v. Hunter, the wife challenged the assignment of a real property interest to her husband as nonmarital property and the husband claimed his interest was a gift from his parents. The appeals court agreed with the husband despite the fact that the recorded title indicated both parties. The appeals court advised that all circumstances surrounding the transfer must be carefully scrutinized for a proper characterization.

B. Maintenance

Spousal maintenance remains an elusive issue for most family law practitioners, partly due to the discretion of the trial court and partly due to the difficulties with quantifying the statutory factors of K.R.S. § 403.200, which are discussed in the previous section on the general standard for maintenance. Consequently, careful consideration must be afforded every statutory factor prior to presenting a claim.

Moreover, a party's separation agreement should be carefully constructed regarding the termination of spousal maintenance. In John v. John, the court of appeals reviewed the termination of maintenance for remarriage pursuant to K.R.S. § 403.250(2), the statute governing modification or termination of maintenance.
termination of provisions for maintenance and property disposition. The court in John stated:

The word 'expressly' refers, not to the parties' agreement, but to a court's decree. Parties are allowed to reach their own agreements concerning all issues regarding their marital affairs . . . . Thus, if any contractual obligation is conditioned on the other party's forbearance of the exercise of a particular act or right (e.g., remarrying), such would have to be clearly set forth in the agreement to be enforceable. As with any other contract, and this one states it 'contains the entire understanding of the parties,' the court cannot add terms or conditions not set forth by the parties. 247

Accordingly, in order for the spousal maintenance to be terminated upon certain acts such as the remarriage of either party, these terms must not only be agreed upon by both parties, but these terms also must be expressly set forth in the court's decree. 248 Otherwise, such an act will not terminate spousal maintenance. 249

C. Child Support

While child support is a constant source of litigation, issues other than the earning capacity of the parties may cause consternation. Child care expenses are often daunting for parties with young children and a source of protracted legal

(1) Except as otherwise provided in subsection (6) of K.R.S. 403.180, the provisions of any decree respecting maintenance may be modified only upon a showing of changed circumstances so substantial and continuing as to make the terms unconscionable. The provisions as to property disposition may not be revoked or modified, unless the court finds the existence of conditions that justify the reopening of a judgment under the laws of this state.

(2) Unless otherwise agreed in writing or expressly provided in the decree, the obligation to pay future maintenance is terminated upon the death of either party or the remarriage of the party receiving maintenance.

247 John, 893 S.W.2d at 375.
248 Id.
249 Id.
proceedings with trial courts drafting orders that include a mandatory reporting requirement when the child care expense is extinguished.\textsuperscript{250}

The issue of retroactivity for failure to report the termination of child care expenses arose in \textit{Connelly v. Degott}.\textsuperscript{251} The custodial parent did not incur the child care expenses that were included in the non-custodial parent’s child support payment.\textsuperscript{252} The non-custodial parent sought relief with a retroactive modification, and the custodial parent challenged that petition, claiming child support may not be modified retroactively.\textsuperscript{253} The appeals court held that the custodial parent was required to reimburse the non-custodial parent for child care expenses that were not incurred.\textsuperscript{254} Further, the appeals court noted that said reimbursement did not retroactively modify his child support payments since K.R.S. § 403.211(6) governed payment of child care in proportion to income.\textsuperscript{255}

D. Relocation

Relocation by a custodial parent is often the basis for protracted and acrimonious litigation.\textsuperscript{256} The non-custodial parent often claims interference with parental rights, detriment to child-parent relationships and diminution in parenting time.\textsuperscript{257} This issue has recently been addressed by the Kentucky Supreme Court in \textit{Fenwick v. Fenwick},\textsuperscript{258} also resolving \textit{Huck v. Huck}.\textsuperscript{259} The specific issue is that the primary residential custodian in a joint custody arrangement seeks to relocate with the parties’ children over the objections of the non-custodial parent.\textsuperscript{260}

In \textit{Fenwick}, the supreme court stated that the primary residential custodian’s relocation, by itself, is insufficient to require modification of a joint custody award and was neither required nor permitted in either case.\textsuperscript{261} Thus, the supreme court concluded that primary residential custodians may relocate as they propose.\textsuperscript{262} The supreme court set a standard that the non-relocating parent must challenge the designation of the primary residential custodian to succeed in preventing the relocation.\textsuperscript{263} The court specifically addressed the standard

\begin{itemize}
  \item \textsuperscript{251} \textit{Id.}
  \item \textsuperscript{252} \textit{Id.}
  \item \textsuperscript{253} \textit{Id. at *2.}
  \item \textsuperscript{254} \textit{Id.}
  \item \textsuperscript{255} \textit{Id.}
  \item \textsuperscript{257} 65 AM. JUR. 2D Trials § 1 (2003).
  \item \textsuperscript{258} 114 S.W.3d. 767 (Ky. 2003)
  \item \textsuperscript{259} \textit{Id.}
  \item \textsuperscript{260} 65 AM. JUR. 2D Trials § 1 (2003).
  \item \textsuperscript{261} \textit{Fenwick}, 114 S.W.3d at 785-86.
  \item \textsuperscript{262} \textit{Id.} at 786.
  \item \textsuperscript{263} \textit{Id.}
\end{itemize}
required pursuant to K.R.S. § 403.340 for modification of custody. Both *Fenwick* and *Huck* were decided by the court of appeals prior to the amendment to K.R.S. § 403.340 in 2001.

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1. As used in this section, “custody” means sole or joint custody, whether ordered by a court or agreed to by the parties.
2. No motion to modify a custody decree shall be made earlier than two (2) years after its date, unless the court permits it to be made on the basis of affidavits that there is reason to believe that: (a) The child’s present environment may endanger seriously his physical, mental, moral, or emotional health; or (b) The custodian appointed under the prior decree has placed the child with a de facto custodian.
3. If a court of this state has jurisdiction pursuant to the Uniform Child Custody Jurisdiction Act, the court shall not modify a prior custody decree unless after hearing it finds, upon the basis of facts that have arisen since the prior decree or that were unknown to the court at the time of entry of the prior decree, that a change has occurred in the circumstances of the child or his custodian, and that the modification is necessary to serve the best interests of the child. When determining if a change has occurred and whether a modification of custody is in the best interests of the child, the court shall consider the following: (a) Whether the custodian agrees to the modification; (b) Whether the child has been integrated into the family of the petitioner with consent of the custodian; (c) The factors set forth in K.R.S. 403.270(2) to determine the best interests of the child; (d) Whether the child’s present environment endangers seriously his physical, mental, moral, or emotional health; (e) Whether the harm likely to be caused by a change of environment is outweighed by its advantages to him; and (f) Whether the custodian has placed the child with a de facto custodian.
4. In determining whether a child’s present environment may endanger seriously his physical, mental, moral, or emotional health, the court shall consider all relevant factors, including, but not limited to: (a) The interaction and interrelationship of the child with his parent or parents, his de facto custodian, his siblings, and any other person who may significantly affect the child’s best interests; (b) The mental and physical health of all individuals involved; (c) Repeated or substantial failure, without good cause as specified in K.R.S. 403.240, of either parent to observe visitation, child support, or other provisions of the decree which affect the child, except that modification of custody orders shall not be made solely on the basis of failure to comply with visitation or child support provisions, or on the basis of which parent is more likely to allow visitation or pay child support; (d) If domestic violence and abuse, as defined in K.R.S. 403.720, is found by the court to exist, the extent to which the domestic
Of note, the Kentucky Supreme Court in *Fenwick* further expounded on joint custody and decision-making allocation between the parties when the parties have not specified any definition in their final custody agreement.\(^{266}\) Moreover, the supreme court also addressed primary custodian and modification of joint custody agreements.\(^{267}\)

IV. CONCLUSION

Despite a legislative effort to promulgate legislation that provides salient components to address the division of property, spousal maintenance and appropriate guidelines for determining child support pursuant to the dissolution of marriage, these issues continue to be contentious and highly litigated. Consequently, the characterization of the parties’ assets for division of property must be carefully scrutinized and the party claiming characterization of an asset as nonmarital property must be mindful of maintaining their burden of proof.

Likewise, a claim for spousal maintenance demands that the requesting party substantiate their economic need by providing quantifiable evidentiary proof of the required elements in K.R.S. § 403.200. Notwithstanding the comprehensive guidelines but in consideration for the mandate providing timely modification, child support should be a consideration whenever the economic circumstances of violence and abuse has affected the child and the child’s relationship to both parents.

(5) Attorney fees and costs shall be assessed against a party seeking modification if the court finds that the modification action is vexatious and constitutes harassment.

\(^{265}\) KY. REV. STAT. ANN. § 403.340 (Banks-Baldwin 2001) originally provided that:

If a court of this state has jurisdiction pursuant to the Uniform Child Custody Jurisdiction Act, the court shall not modify a prior custody decree unless it finds, upon the basis of facts that have arisen since the prior decree or that were unknown to the court at the time of entry of the prior decree, that a change has occurred in circumstances of the child or his custodian, and that the modification is necessary to serve the best interests of the child. In applying these standards, the court shall retain the custodian appointed pursuant to the prior decree unless: (a) The custodian agrees to the modification; (b) The child has been integrated into the family of the petitioner with the consent of the custodian; or (c) The child’s present environment endangers seriously his physical, mental, moral, or emotional health, and the harm likely to be caused by a change of environment is outweighed by its advantages to him.

\(^{266}\) *Fenwick*, 114 S.W.3d at 778-79.

\(^{267}\) *Id.* at 779-84.
the parties are substantially impacted or child custody is revisited. In an increasingly mobile society, relocation of a custodial parent has an impact on the parenting time for the non-custodial parent. Pursuant to the recent supreme court decision in *Fenwick*, the designation as residential parent is now determinative for relocation purposes.
A SURVEY OF KENTUCKY COMMERCIAL LAW

by Brian Michael Ellerman* and J. Robert Linneman†

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I. INTRODUCTION

This survey-article is written to be a practical tool for practitioners of Kentucky commercial law. The intent is to review and analyze recent changes in Kentucky law affected by way of statute or by holdings of Kentucky or Federal courts. The first section of the survey covers contract and tort law as it relates to sales and Article 2 of the Kentucky Uniform Commercial Code (UCC). The second section of this survey concerns secured transactions and the priority of security interests and liens under Revised Article 9 of the UCC.

II. ARTICLE 2: SALES OF GOODS – THE SALES PROVISION UNDER A SERIES OF KENTUCKY STATUTES

A. Kentucky’s Statute of Frauds

   In Commonwealth Aluminum Corp. v. Stanley Metal Associates, the court interpreted Kentucky law with respect to Kentucky’s statute of frauds and its relationship to the Rules of Evidence.

   Kentucky’s version of the statute of frauds, provided by K.R.S. § 355.2-201 forbids the enforcement of an oral contract unless there is “some writing
sufficient to indicate that a contract for sale has been made.\textsuperscript{3} The Commonwealth Aluminum court noted that Kentucky courts have interpreted this requirement very loosely.\textsuperscript{4}

The Commonwealth Aluminum court further considered the comments of the UCC drafters, observing that there are three definite and invariable requirements of the written memorandum of a contract.\textsuperscript{5} The court observed that such a memorandum (1) must evidence a contract for the sale of goods; (2) must be "signed," including any authentication identifying the party to be charged; and (3) must specify a quantity.\textsuperscript{6} The Commonwealth Aluminum court found a series of letters, e-mails and faxes that were communicated between the parties to be satisfactory to fulfill the requirements of Kentucky's statute of frauds.\textsuperscript{7} In doing so, the court noted that a writing need not be sent with the intent to acknowledge a contract, and likewise need not be "contemporaneous with the execution of the contract or of the "meeting of the minds."\textsuperscript{8}

In Commonwealth Aluminum, the defendant attempted to remove the letters, faxes and e-mails in question from the consideration of the court under Federal Rule of Evidence 408, arguing that the communications constituted admission made in the context of settlement negotiations.\textsuperscript{9} Although the court rejected this argument,\textsuperscript{10} the court's extensive discussion of it indicates that such an argument could be very persuasive under slightly different circumstances.

In the case of Enlow v. St. Jude Medical, Inc., the District Court for the Western District of Kentucky considered a product liability claim by the administrator of the estate of a woman who allegedly died as a result of a faulty heart valve made by St. Jude Medical, Inc.\textsuperscript{11} The court decided St. Jude's motion for partial summary judgment.\textsuperscript{12} The court addressed the issue, inter alia, of whether breach of warranty claims provided for under Article 2 of the UCC were preempted by the Medical Device Amendments to the Drug Cosmetic Act (MDA).\textsuperscript{13} The express preemption provision of the MDA provides:

\begin{quote}
no State or political subdivision of a State may establish or continue in effect with respect to a
\end{quote}

\textsuperscript{3} Id. at 772.
\textsuperscript{4} Id. (citing Lonnie Hayes & Sons Staves, Inc. v. Bourbon Kuberge Co., 777 S.W.2d 940 (Ky. Ct. App. 1989) ("All that is required is that the writing afford a basis for believing that the offered oral evidence rests on a real transaction.").
\textsuperscript{5} Id.
\textsuperscript{6} Id. (citing U.C.C. § 2-201 cmt. 1 (2002)).
\textsuperscript{7} Id. at 772-73.
\textsuperscript{8} Commonwealth Aluminum, 186 F. Supp. 2d at 773.
\textsuperscript{9} Id. at 773.
\textsuperscript{10} Id. at 774.
\textsuperscript{12} Id.
\textsuperscript{13} Id. at 857; 21 U.S.C. §§ 360c – 360m (2000).
device intended for human use any requirement – (1) which is different from, or in addition to, any requirement applicable under this chapter to the device, and (2) which relates to the safety or effectiveness of the device or to any other matter included in a requirement applicable to the device under this chapter.\textsuperscript{14}

The court said that for this preemption provision to apply there are certain criteria that must be met.\textsuperscript{15} First, there must be a federal requirement specifically applicable to the heart valve.\textsuperscript{16} Second, the state requirements must be applicable to the heart valve and must be different from or in addition to the federal requirements or, in the alternative, the requirements must impair or impede enforcement of the federal requirement.\textsuperscript{17}

The court concluded that the heart valve was subject to a federal requirement because it had to be approved by the FDA.\textsuperscript{18} With regard to the breach of express and implied warranties the court first laid out how express warranties are created in Kentucky.\textsuperscript{19} Namely, as follows:

(a) Any affirmations of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise. (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description. (c) Any sample of model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.\textsuperscript{20}

The court then concluded that, because “St. Jude’s express representations regarding the valve were limited to the labeling approved by the FDA,”\textsuperscript{21} a claim under Kentucky law that the valve did not meet the label representations would

\textsuperscript{14} Id. at 857-58 (citing 21 U.S.C. § 360k(a) (2000)).
\textsuperscript{15} Id. at 858.
\textsuperscript{16} Id.
\textsuperscript{17} Enlow, 210 F. Supp. 2d at 858.
\textsuperscript{18} Id.
\textsuperscript{19} Id. at 861.
\textsuperscript{20} Id. (citing KY. REV. STAT. ANN. § 355.2-313(1) (Banks-Baldwin 2002)).
\textsuperscript{21} Id.
impose a requirement different from or that adds to the federal requirement. The court then granted St. Jude’s motion for partial summary judgment with respect to, inter alia, the breach of express and implied warranties.

Kentucky Uniform Code Sales Provisions have also become the subject of consideration for other matters not strictly related to commercial transactions. Chapter 355.2 has been invoked at various times for its relevance to the ownership of an insurance policy for purposes of establishing coverage, and for its determination of the imposition of strict liability.

B. Contract Formation: Offer, Acceptance, Indefinite Terms, and the Parol Evidence Rule

Kentucky upholds the liberal and flexible rules providing for the formation of contracts set forth in the UCC. Simple acknowledgment of an order constitutes acceptance, creating a valid enforceable contract.

In A&A Mechanical, Inc. v. Thermal Equipment Sales, Inc., the Court considered a sales agreement whereby a contractor on a major public improvement contracted with a subcontractor to supply materials for the project. This case involved the classic “battle of the forms” under the UCC’s provisions on indefinite terms, with the parties offering various theories characterizing the legal effect of the subcontractor’s bid which provided the terms upon which it would furnish materials, and the contractor’s subsequent purchase order.

The contractor, A&A, argued that the subcontractor’s bid constituted merely an invitation to make an offer or, alternatively, if it was an offer the purchase order was a counter-offer, while the subcontractor, Thermal Equipment Sales (TES), impliedly contended, through its actions, that the bid was an offer which was subsequently accepted by the contractor’s purchase order. In making its ruling on this case, the Court of Appeals offered salient advice on the nature of such transactions including the effect of the Parol Evidence Rule and the rules
governing requirements contracts. First, the court held that the Parol Evidence Rule did not prevent the consideration of extrinsic evidence because the agreement between the parties was never reduced to a final written expression of terms. Therefore, the court determined that it was appropriate to consider the standard practices in the industry, the contractor’s agreement with the owner, and both the bid and the purchase order. The court relied on the fact that the subcontractor’s bid was tailored specifically to the project and the fact that it was signed, indicating a firm commitment, in holding that the bid constituted an offer and not merely an invitation to make an offer. The court further held that an additional term contained within the language of the contractor’s purchase order did not constitute rejection of the offer, creating a counteroffer; on this point, the court expressed the liberal policy of the Uniform Commercial Code of allowing open terms in the sales contract and not requiring complete certainty.

The court went on to observe that even if the court should deem the contract to be a requirements contract, the contractor would not be entitled to relief. The court observed that a twenty-nine percent excess in the amount of materials to be furnished would constitute an amount “unreasonably disproportionate to the stated estimate” as provided for under K.R.S. § 355.2-306.

The A&A case also provides an illustration of the rule of enforceability of provisions in commercial contracts for the payment of attorneys’ fees to the prevailing party. On this point, the Court upheld the broad discretion that a trial court has in such matters.

In Middletown Engineering Co. v. Climate Conditioning Co., the court reviewed a seller’s addition of terms to a purchaser’s written offer in a contract for the sale of goods. Without fanfare, the court applied K.R.S. § 355.2-204 to hold that a writing contained on the back of the seller’s acknowledgment of a purchase order was effective to integrate the seller’s terms into the contract. The seller’s terms became a part of the bargain without the signature of the purchaser.

33 Id. at 510-11.  
34 Id. at 510.  
35 A&A, 998 S.W.2d at 511.  
36 Id.  
37 Id. at 512.  
38 Id. at 509, 511-12.  
39 Id. at 512.  
40 Id.  
41 Id.  
42 Id.  
43 Id.  
44 Id.  
45 Id. at 59-59.  
46 Id. at 59.
Another federal decision interpreting Kentucky law sheds further light on the application of the Parol Evidence Rule in interpreting contracts.\[46\] In *J.P. Morgan Delaware v. Onyx Arabians II, Ltd.*, the court considered a written agreement for the purchase of thoroughbreds, in which the purchaser claimed that the seller had contemporaneously agreed orally to buy back one of the animals sold.\[47\] The court held that such a contemporaneous oral agreement did not contradict the terms of the original contract of sale.\[48\] Thus, it was appropriate to explain the terms of the contract for sale under K.R.S. § 355.2-202(b), which allows evidence of consistent additional terms.\[49\]

Sellers of goods in the modern economy must be mindful of the need to protect their rights in case a purchaser defaults on an open account.\[50\] Under the provisions of the UCC as adopted in Kentucky (and most other states), a seller may become obligated to deliver additional goods, even to a purchaser who may be delinquent on other obligations, unless the terms of acceptance of a new order specify otherwise.\[51\] A seller with fears that a faltering customer may slide into insolvency ("reasonable grounds for insecurity") may condition its delivery on assurance of payment on a past due account\[52\] or can suspend any obligation to extend further credit to a troubled business, but must do so in writing by requesting assurance of payment from its customer.\[53\]

C. Unconscionability

In the *Forsythe v. BancBoston Mortgage Corp.*, the Sixth Circuit Court of Appeals considered the claims of a mortgagor against a mortgagee related to a foreclosure action and subsequent release of claims where the mortgagor's husband's suicide allegedly resulted from the conduct of the mortgagee.\[54\] In this case, the court provided opinion on a number of issues related to consumer transactions, including unconscionability,\[55\] the covenant of good faith and fair

\[46\] See infra notes 47-49 and accompanying text.
\[48\] Id.
\[50\] See infra notes 51-53 and accompanying text.
\[51\] See H.J. Scheirich Co. v. Kitchen & Bath Distrib., Inc., 982 F.2d 945, 950-51 (6th Cir. 1993). In this case the court stated that K.R.S. § 355.2-703(a) allows a seller to withhold delivery if the buyer "fails to make a payment due on or before delivery," but the court concluded that this section did not apply because the order for goods was accepted by the seller by a response stating "Terms 2% 15 days Net 30." *Id.* The Court also concluded that, because there was no course of performance under which the seller had previously withheld delivery of accepted orders when the buyer had not yet paid for earlier orders, the seller did not have a legal right to withhold delivery. *Id.*
\[53\] *Id.* § 355.2-609.
\[54\] *Forsythe v. BancBoston Mortgage Corp.*, 135 F.3d 1069, 1072-73 (6th Cir. 1997).
\[55\] *Id.* at 1074.
dealing, outrageous conduct, and fiduciary relationship between contracting parties.

With respect to unconscionability, the court upheld a release executed between the parties whereby the mortgagee agreed to dismiss its foreclosure action and waive a portion of the past due amount in exchange for the mortgagor’s covenant not to sue. The court applied the Kentucky Rule of Unconscionability which calls for a case-by-case, fact-intensive analysis. The court observed that the Kentucky law of unconscionability “forbids only one-sided, oppressive, and unfairly surprising contracts, and not mere bad bargains.” The court further noted that the release was well supported by consideration of past due obligations and forbearance.

The Forsythe court also observed that Kentucky law provides for an implied covenant of good faith and fair dealing with every contract. The court further defined the covenant of good faith and fair dealing as requiring a party to act in a “bona fide” manner.

On the plaintiff’s claims of outrageous conduct, the court observed that Kentucky law permits damages in tort for breach of contract where the breach involves “outrageous conduct.” The court further defined outrageous conduct as conduct which is beyond all possible bounds of decency. However, the court held that such damages were only available where breach of contract had occurred and in the present case, there was no such breach.

Finally, the court predicted that Kentucky would observe the rule that the relationship between a mortgagor and mortgagee, although it may be one of immense trust, is technically not a relationship of a fiduciary character. In

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56 Id. at 1076.
57 Id.
58 Id. at 1076-77.
59 Id. at 1074.
60 Forsythe, 135 F.3d at 1074 (citing Wickliffe Farms, Inc. v. Owensboro Grain Co., 684 S.W.2d 17 (Ky. Ct. App. 1984) as an example).
61 Id. (citing Louisville Bear Safety Serve, Inc. v. South Central Bell Tel. Co., 571 S.W.2d 438, 439 (Ky. Ct. App. 1978)).
62 Id. at 1075.
63 Id. at 1076 (citing Ranier v. Mt. Sterling Nat’l Bank, 812 S.W.2d 154, 156 (Ky. 1999)).
64 Id. (citing Pearman v. West Point Nat’l Bank, 887 S.W.2d 366, 368 (Ky. Ct. App. 1994)).
65 Id. (citing Innes v. Howell Corp., 76 F.3d 702, 713 (6th Cir. 1996); Audiovox Corp. v. Moody, 737 S.W.2d 468, 469-71 (Ky. Ct. App. 1987)).
66 Forsythe, 135 F.3d at 1076 n.3 (citing Roush v. KFC Nat’l Mgmt. Co., 10 F.3d 392, 401 (6th Cir. 1993)).
67 Id.
68 Id. at 1077 (citing Lovell v. Western Nat’l Life Ins. Co., 754 S.W.2d 298, 303 (Texas Ct. App. 1988)). See also Sallee v. Fort Knox Nat’l Bank, N.A., 286 F.3d 878, 891 (6th Cir. 2002) (“The duty of good faith and fair dealing merely requires the parties to ‘deal fairly’ with one another and does not encompass the often more onerous burden that requires a party to place the interest of the other party before his own, often attributed to a fiduciary duty.”).
making this prediction, the court observed that Kentucky treats mortgage contracts the same as any other contracts.\textsuperscript{69}

D. Assignability of Contracts

In a 2000 employment case, \textit{Managed Health Care Associates, Inc. v. Kethan}, the Sixth Circuit Court of Appeals considered the assignability of a non-competition agreement.\textsuperscript{70} The defendant, Kethan, had signed an employment agreement, which contained a non-competition clause with his employer, MedEcon.\textsuperscript{71} MedEcon’s assets were then purchased by the plaintiff, Managed Healthcare Associates (MHA).\textsuperscript{72} Kethan continued working for MHA on an at-will basis, but soon tendered his resignation.\textsuperscript{73} Two days after Kethan’s separation with MHA he began working for defendant First Choice, one of MedEcon/MHA’s customers.\textsuperscript{74} MHA then sought to enforce Kethan’s non-competition agreement.\textsuperscript{75}

The agreement required that any modification to the employment contract be in writing and signed by both parties.\textsuperscript{76} The district court determined that the assignment of the contract was an unwritten modification and concluded that, consequently, Kethan was no longer bound.\textsuperscript{77} Also, the district court held that, under Kentucky law, non-competition clauses are not assignable.\textsuperscript{78}

The Sixth Circuit reversed, holding that a non-competition agreement is assignable by an employer where the employer’s rights in a contract are acquired by virtue of an asset purchase.\textsuperscript{79} In reaching this conclusion, the court also held that an assignment does not constitute a “modification” which may require the written consent of both parties.\textsuperscript{80} The federal circuit court’s holdings on both these points were prediction, the court observing that Kentucky’s highest court had not expressly ruled on either of these questions.\textsuperscript{81}

\textsuperscript{69} Id. (citing Yudkin v. Avery Fed. Sav. & Loan Ass’n, 507 S.W.2d 689, 690 (Ky. 1974)).
\textsuperscript{70} Managed Health Care Assoc., Inc. v. Kethan, 209 F.3d 923, 925 (6th Cir. 2000).
\textsuperscript{71} Id. at 926.
\textsuperscript{72} Id.
\textsuperscript{73} Id.
\textsuperscript{74} Id.
\textsuperscript{75} Id.
\textsuperscript{76} Managed Health Care, 209 F.3d at 926-27.
\textsuperscript{77} Id. at 927.
\textsuperscript{78} Id.
\textsuperscript{79} Id. at 930.
\textsuperscript{80} Id. at 927.
\textsuperscript{81} Id. at 928.
E. Warranties

In Moore v. Mack Trucks, Inc., the Kentucky Court of Appeals made several interpretations of law concerning the creation and disclaimer of warranties under Article 2. In that case, the court held that a statement by a truck salesman concerning the reconditioning of the transmission in a truck was the type of "affirmation of fact" which could create an express warranty under K.R.S. § 355.2-313(1)(a). The court considered other statements concerning the suitability of the vehicle to be statements of opinion which amounted to "mere puffing."

However, in reviewing the warranty and sales agreement, the court found that the manufacturer and distributor defendants had both effectively disclaimed any implied warranties that may have been created. The court further observed that the language employed by the distributor and manufacturer had been effective to limit their liability for any breach of warranty to exclude incidental and consequential damages, such as the loss of business, profit and expenses arising from repossession that the plaintiff was seeking. The court further held that such disclaimers and limitations of liability did not cause the warranty to fail on its essential purpose.

In an unreported opinion, Eversole v. Louisville Ladder Group, the Kentucky Court of Appeals considered a breach of implied warranty case relating to an injury suffered when a man fell off a ladder. The plaintiff, Eversole, fell from a ladder while installing cable at the Back Nine Bar in the Cincinnati/Northern Kentucky International Airport. Eversole borrowed the ladder from a

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83 Id. at 891. See also KY. REV. STAT. ANN. § 355.2-313(1) (Banks-Baldwin 2002) (see supra note 20 and accompanying text for the statutory provisions).
85 Moore, 40 S.W.3d at 891.
86 Id. (citing KY. REV. STAT. ANN. § 355.2-719 (Banks-Baldwin 2002)). See also Ford Motor Company v. Mayes, 575 S.W.2d 480, 483 (Ky. Ct. App. 1978) ("[A] seller of goods has two means of limiting warranty liability. The seller may disclaim warranties (K.R.S. § 355.2-316), or the seller may limit the remedies available to a buyer for breach of warranty (K.R.S. § 355.2-719). ").
87 Moore, 40 S.W.3d at 891. See also KY. REV. STAT. ANN. § 355.2-719(3) (Banks-Baldwin 2002) ("Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.").
88 Moore, 40 S.W.3d at 889.
89 Id. at 892 (citing KY. REV. STAT. ANN. § 355.2-719(2) which provides: "Where circumstances cause an exclusive or limited remedy to fail of its essential purpose, remedy may be had as provided in this chapter"). The Moore court said that a limited exclusive remedy fails of its essential purpose under this statute if "the warrantor fails to correct the defect within a reasonable time after a defective part is discovered." Id.
91 Id.
maintenance technician for the operator of the bar. Eversole sued the manufacturer of the ladder, defendant Louisville Ladder Group.

Kentucky law defines how far a warranty will extend in K.R.S. § 355.2-318, which provides:

[a] seller’s warranty whether express or implied extends to any natural person who is in the family or household of his buyer or who is a guest in his home if it is reasonable to expect that such a person may use, consume or be affected by the goods and who is injured in person by breach of the warranty. A seller may not exclude or limit the operation of this section.

The court concluded that Eversole was not included in the parameters of the statute because the necessary element of privity was not present. Thus, the court said that the directed verdict on this issue was properly granted.

In another case involving K.R.S. § 355.2-318, McLain v. Dana Corp., the Kentucky Court of Appeals considered an employee’s contention that he should be treated as part of his employer’s “family” for purposes of warranty protection. The plaintiff, McLain, was an employee of Dana Corporation. He was injured on the job when a piece of machinery that allegedly malfunctioned hit him on the head. McLain sued Dana for negligent operation, maintenance, and control of the equipment (despite obtaining workers’ compensation benefits) and I.S.I. Industries, the alleged manufacturer of the equipment, for negligent design and manufacture. McLain found out through discovery that I.S.I. had not in fact manufactured the machine, but only had made a component for it. He then amended his complaint to include the defendants Bay Design and Paslin, which had designed, manufactured, and installed the machine.
Both of the new defendants moved for summary judgment claiming, inter alia, that McLain's breach of warranty claim was barred by lack of privity.\textsuperscript{103} McLain responded to this by arguing that if he was not included in the coverage of K.R.S. § 355.2-318 then the statute would become "meaningless when the injured party is an employee of a corporation/buyer of the defective product."\textsuperscript{104} The trial court granted the defendants' motions for summary judgment and McLain appealed.\textsuperscript{105}

The court of appeals concluded that "the Legislature did not intend to include employees of the buyer within the parameters of the statute."\textsuperscript{106} The court noted that when the Legislature enacted the current statute it was aware of alternative constructions that would broaden the range of injured persons able to recover under a warranty theory, but chose to limit the range to those listed in the statute.\textsuperscript{107}

In another unreported opinion, Larison v. Hebron Auto Sales & Brokerage, the Kentucky Court of Appeals reviewed a breach of express warranty case which arose in the context of the sale of a used automobile.\textsuperscript{108} The court in that case interpreted K.R.S. § 355.2-313(1)(a) concerning the creation of express warranties and observed that although promises or statements of fact may create express warranties under Kentucky law, such warranties are not absolute.\textsuperscript{109} The court then invoked the provisions of K.R.S. § 355.2-316(1) for the principle that promises made which may create an express warranty must be construed wherever reasonable as being consistent with limitations of warranties made applicable to the sale; however, where such negation or limitation is unreasonable, it cannot be given effect.\textsuperscript{110} The court further noted the potent legal effect of the use of the terms "as is" in a written sales agreement to

\begin{footnotes}
\item [103] McLain, 16 S.W.3d at 323.
\item [104] Id.
\item [105] Id.
\item [106] Id. at 326.
\item [107] Id.
\item [109] Id. at *2. \textit{See supra} note 20 and accompanying text.
\item [110] Id. KY. REV. STAT. ANN. § 355.2-316(1) (Banks-Baldwin 2002) provides: \\
\textit{Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (KRS [§] 355.2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.}
\end{footnotes}
effectively and validly disclaim all warranties. The court held that the auto dealership’s use of the terms “as is – no warranty” in its sales contract was effective to negate any express warranties that may have been created through its collateral agreement to repair various defects with the subject automobile. The court also made an observation concerning the procedural posture of the case citing the appellant’s failure to produce affirmative admissible evidence to make the required showing under the summary judgment standard applicable in this decision.

In Keeneland Ass’n, Inc. v. Hollendorfer, the court reviewed another transportation-related disclaimer of warranties. The plaintiff, Keeneland Association, Inc., held a Yearling Sale at which horses were sold via consignment. The consignor deposited the radiographs for the horse in question with Keeneland’s repository. The repository was set up to allow consignors and purchasers to exchange information. Consignor participation in the repository was completely voluntary. Defendant’s assistant attempted to review the information regarding the horse in question, but was told that the information had been misplaced. Defendant then purchased the horse in question through an auction.

The “Conditions of Sale” was the only contract between the parties. It recommended that prospective bidders examine the horses before bidding. It also contained an “as is” clause regarding all sales, stating that no warranties are given. It further stated that Keeneland made no warranty as to the accuracy of the repository information.

After buying the horse, defendant had a veterinarian examine the horse and she found that it had lesions that might affect its ability to race and train. Defendant then attempted to rescind the sale and refused to pay Keeneland.

Plaintiff moved for summary judgment arguing that defendant had no defenses to the enforcement of the contract because of the “as is” clause,

111 Larrison, 2003 WL 1224232, at *2 (citing Greg Coats Cars, Inc. v. Kasey, 576 S.W.2d 251, 253 (Ky. Ct. App. 1978)).
112 Id.
113 Id. at *3.
115 Id. at 1071.
116 Id.
117 Id.
118 Id.
119 Id.
120 Keeneland, 986 F. Supp. at 1071.
121 Id.
122 Id.
123 Id. at 1071-72.
124 Id. at 1072.
125 Id.
126 Keeneland, 986 F. Supp. at 1072.
entitling plaintiff to judgment as a matter of law. Defendant responded by arguing that he is entitled to rescission because plaintiff failed to exercise ordinary care in maintaining the repository. The court concluded that defendant was not entitled to rescission for two reasons. First, the Conditions of Sale disclaimed all warranties and contained an “as is” clause. Second, plaintiff’s operation of the repository, even if negligent, was not the proximate cause of injury.

In *Gooch v. E.I. Du Pont de Nemours & Co.*, the Plaintiff was a farmer who sued the manufacturer of an herbicide under multiple theories, including breach of express and implied warranties, strict liability, and negligence. The farmer alleged that following the application of the product, which was intended to control weeds without harming crops, the farmer’s corn crop was substantially damaged. The court provided a lengthy review of Kentucky commercial law in its consideration of the effectiveness of the seller’s disclaimer and limitation of implied warranties and its limitation of liability. The court further had opportunity to consider the effect of the Uniform Commercial Code upon the Plaintiff’s tort claims.

The court reviewed the case upon the Defendant’s motion for summary judgment which argued that the Plaintiff’s warranty claims were barred by the warranty disclaimer and limitation of liability contained upon the packaging for the herbicide. The court reviewed K.R.S. § 355.2-316(2) and observed that Kentucky law permits a party to exclude or disclaim any implied warranty of merchantability or implied warranty of fitness for a particular purpose by the use of specific language. Kentucky law requires that language excluding such

127 *id.*
128 *id.*
129 *id.* at 1073.
130 *id.*
131 *id.*
133 *id.* at 867.
134 *id.* at 868-71.
135 *id.* at 874-76.
136 *id.* at 868.
137 *id.* KY. REV. STAT. ANN. § 355.2-316(2) (Banks-Baldwin 2002) provides:

Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “There are not warranties which extend beyond the description on the face hereof.”
implied warranties must mention merchantability and must be conspicuous.\textsuperscript{138} The court held that a disclaimer is deemed conspicuous if it is in larger than normal print, a different typesetting, different color, or otherwise designed to draw the attention of a potential contracting party.\textsuperscript{139} This is a pure question of law in Kentucky.\textsuperscript{140} The court’s review of the Defendant’s warranty disclaimer found that it complied in all ways and was therefore effective to disclaim implied warranties of merchantability or fitness for a particular purpose.\textsuperscript{141}

However, the court rejected the Defendant’s claim that therefore no such warranty was applicable.\textsuperscript{142} The court held that the packaging of the product warranted that the product was reasonably fit for the purpose stated in the direction for use.\textsuperscript{143} The court therefore held that the Plaintiff could proceed on its warranty claim under this express warranty.\textsuperscript{144}

The court deemed the inquiry incomplete without consideration of the Defendant’s limitation of liability.\textsuperscript{145} Under Kentucky’s version of the Uniform Commercial Code, sellers are legally entitled to exclude liability for incidental, consequential or special damages resulting from use of a product.\textsuperscript{146} The court found that the Defendant’s highly detailed and lengthy disclaimer and limitation of liability was effective to so limit causes of action for damages of incidental and consequential damages.\textsuperscript{147} The court rejected the Plaintiff’s claim that such limitation of liability caused the express warranty to fail of its essential purpose, finding that such a description is limited to a situation where a limitation of liability would reduce the remedies to the repair or replacement of a product which could not fully correct the alleged defect.\textsuperscript{148} The court next reviewed the language of the limitation of liability to find that this term of the sales contract was not unconscionable.\textsuperscript{149} The court’s consideration of this question observed that the Plaintiff’s complaint did not allege personal injury, but rather implicated

\textsuperscript{138} KY. REV. STAT. ANN. § 355.2-316(2) (Banks-Baldwin 2002).
\textsuperscript{139} Gooch, 40 F. Supp. 2d at 868 (citing KY. REV. STAT. ANN. § 355.1-201(10) (Banks-Baldwin 2002). The court stated “[a] term or clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it.” Id.
\textsuperscript{140} KY. REV. STAT. ANN. § 355.1-201(10) (Banks-Baldwin 2002).
\textsuperscript{141} Gooch, 40 F. Supp. 2d at 869.
\textsuperscript{142} Id. at 874-76.
\textsuperscript{143} Id. at 869.
\textsuperscript{144} Id.
\textsuperscript{145} Id. at 870.
\textsuperscript{146} KY. REV. STAT. ANN. § 355.2-719 (Banks-Baldwin 2002).
\textsuperscript{147} Gooch, 40 F. Supp. 2d at 870, 872.
\textsuperscript{148} Id. at 870. See generally Rudd Constr. Equip. Co. v. Clark Equip. Co., 735 F.2d 974, 982 (6th Cir. 1984) (pointing out that the hydraulic hose was only defective part of a tractor shovel, but the hose caused the destruction of the entire tractor, so the limited remedy of repair or replacement of defective parts failed of its essential purpose).
\textsuperscript{149} Gooch, 40 F. Supp. 2d at 872. See also KY. REV. STAT. ANN. § 355.2-719(3) (Banks-Baldwin 2002).
commercial laws. The court's highly factual consideration of this question found the terms of the limitation of liability were not unconscionable, observing the high level of sophistication of the Plaintiff farmer, the appropriateness of shifting the risk of loss to the consumer under the circumstances, and the lack of unfair surprise given the Plaintiff's actual knowledge of the provisions of the warranty prior to his purchase.

The district court went on to reject the Plaintiff's claims in court under the theory that the Kentucky Supreme Court would apply the economic loss doctrine to bar claims in negligence and strict liability for a claim which primarily related to a breach of warranty in a sales contract. In making this finding, the court reiterated its ruling that the Plaintiff's claims in truth constitute claims for consequential damages to the crops resulting from the failure of the product.

The Kentucky Court of Appeals has itself provided guidance on the effective disclaimer and limitation of warranties and the creation of express warranties. In *Middletown Engineering Co. v. Climate Conditioning Co.*, the court held that a disclaimer of warranties of merchantability and of express warranties, along with a disclaimer of liability for consequential and incidental damages did not materially alter the terms of an offer for contract of sale such that the disclaimer could not become part of the contract. The court found the seller's disclaimer did not materially alter the offer and, thus, did not violate K.R.S. § 355.2-207(2)(b). The court also found the disclaimer to be an effective bar to the purchaser's claims for incidental damages, and further held that the warranty did not thereby fail of its essential purpose under K.R.S. § 355.2-719(2).

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150 Gooch, 40 F. Supp. 2d at 871.
151 Id. at 872.
152 Id. at 876.
153 Id. at 875.
154 See infra notes 155-57 and accompanying text.
156 Middletown Eng'g, 810 S.W.2d at 59. Ky. Rev. Stat. Ann. § 355.2-207(2) provides:

The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless: (a) The offer expressly limits acceptance to the terms of the offer; (b) They materially alter it; or (c) Notification of objection to them has already been given or is given within a reasonable time after notice of them is received.

157 Middletown Eng'g, 810 S.W.2d at 59 (citing Ford Motor Co. v. Mayes, 575 S.W.2d 480, 484 (Ky. Ct. App. 1978)). The court in *Mayes* approved the analysis made in Beal v. General Motors Corp., 354 F. Supp. 423, 426 (D. Del. 1973) which stated:
F. Limitations, Jurisdiction and Venue

In *Barnes v. Community Trust Bank*, the Kentucky Court of Appeals dealt with whether motor vehicle sales are governed by the UCC.\(^{158}\) Plaintiff, Community Trust Bank (CTB), financed defendant’s purchase of a Toyota truck.\(^{159}\) Plaintiff repossessed and sold the truck, but a deficiency on the loan remained.\(^{160}\) Plaintiff then filed an action to recover this deficiency five and one half years after the truck was sold.\(^{161}\)

On appeal from a trial court ruling granting plaintiff’s summary judgment, defendant argued that U.C.C. § 2-725 (K.R.S. § 355.2-725) barred plaintiff’s action because it was filed outside the four-year statute of limitations.\(^{162}\) Plaintiff argued that motor vehicles should not be included in the definition of “goods” and cited the definition provided in K.R.S. § 371.210.\(^{163}\)

The court concluded that K.R.S. § 371.210 was not applicable because it is part of the Kentucky Retail Installment Sales Act.\(^{164}\) This Act does not apply to motor vehicles because there is a separate act that does \(^{165}\) – the Kentucky Motor Vehicle Retail Installment Sales Act.\(^{166}\) Furthermore, because neither of the discussed acts provide a remedy for an aggrieved seller, the remedies for breach of contract regarding goods are found in K.R.S. §§ 355.2-703 – 355.2-709 (U.C.C. §§ 2-207 – 2-709).\(^{167}\)

The purpose of an exclusive remedy of replacement or repair of defective parts, whose presence constitute a breach of an express warranty, is to give the seller an opportunity to make the goods conforming while limiting the risks to which he is subject by excluding direct and consequential damages that might otherwise arise. From the point of view of the buyer the purpose of the exclusive remedy is to give him goods that conform to the contract within a reasonable time after a defective part is discovered. . . . The limited, exclusive remedy fails of its purpose and is thus avoided under [UCC] § 2-719(2), whenever the warrantor fails to correct the defect within a reasonable period.

See also supra note 89 for text of KY. REV. STAT. ANN. § 355.2-719(2) (Banks-Baldwin 2002).


\(^{159}\) Id.

\(^{160}\) Id.

\(^{161}\) Id.

\(^{162}\) Id.

\(^{163}\) Id.

\(^{164}\) Barnes, 121 S.W.3d at 521-22.

\(^{165}\) Id. at 522.

\(^{166}\) KY. REV. STAT. ANN. §§ 190.090 – 190.250 (Banks-Baldwin 2001).

\(^{167}\) Barnes, 121 S.W.3d at 522.
The court cited the definition of "goods" in K.R.S. § 355.2-105 and determined that a Toyota truck falls within this definition because it is a "thing which is movable at the time of identification to the contract for sale . . . ." In reaching this conclusion, the court rejected the proposition that the cause of action arose from breach of the security agreement, and was therefore governed by the statute of limitations provided for under Article 9 of the UCC.

In Hayden v. CMH Homes, Inc., the Kentucky Court of Appeals reviewed the decision of a trial court dismissing a breach of contract action for lack of jurisdiction and venue. The plaintiffs, Harold and Anna Hayden, entered into a contract with defendant CMH Homes (CMH) for the purchase of a mobile home. Though plaintiffs were from Kentucky, the contract was executed in Tennessee and included a "Controlling Law and Place of Suit" clause. The clause provided that "any dispute" arising from the contract would be controlled by Tennessee law and such a proceeding would take place in the county where CMH’s principal offices were located – in this case, Blount County, Tennessee. The trial court enforced this provision and dismissed the Haydens’ action for lack of jurisdiction and venue.

On appeal, the court concluded that the forum-selection clause was valid and enforceable for several reasons. First, plaintiffs failed to show that it was unreasonable. Second, because the UCC applied, it was immaterial that an officer of CMH never signed the contract. K.R.S. § 355.2-201 provides that only the party against whom enforcement is sought (in this case, the Haydens) must sign the contract. Third, the court rejected plaintiffs’ claim of inconvenience of litigating in Tennessee because plaintiffs went to Tennessee to purchase the mobile home.

168 Id.
169 Id. at 524.
170 Id.
172 Id.
173 Id.
174 Id. at *2.
175 Id.
176 Id.
177 See infra notes 178-81 and accompanying text.
178 Hayden, 2003 WL 1228084, at *3.
179 Id. at *4.
180 KY. REV. STAT. ANN. § 355.2-201 (Banks-Baldwin 2002).
In *Sallee v. Fort Knox National Bank, N.A.*, the Sixth Circuit Court of Appeals considered the claims of a bankruptcy debtor against the bank who had financed the purchase of a business, where the bank had previously made loans to the seller of the business. The court first made the determination that the relationship between these parties, as mortgagor and mortgagee, was not a fiduciary one.

The court's analysis of the Plaintiff's fraud claims relied upon the elements for that tort set forth by the Kentucky Court of Appeals in *McGuffin v. Smith*. The court's highly detailed discussion of the fraud claim is most significant for its holding concerning a fraud plaintiff's election of remedies. The court restated Kentucky law on this subject, which it interpreted as requiring that:

one claiming to have been defrauded into making a contract has an option either to disaffirm the contract and seek its rescission or to affirm the contract and seek his remedy by an action for damages; he may not follow inconsistent remedies. He has but one election, and if he affirms the contract, his election is irrevocable and he condones the fraud.

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182 *Sallee v. Fort Knox Nat'l Bank, N.A.*, 286 F.3d 878, 884, 886 (6th Cir. 2002).
183 *Id.* at 894.
184 *Id.* at 895-96. See *McGuffin v. Smith*, 286 S.W. 884, 886 (1926). The *McGuffin* court stated:

[T]he general rule is that to constitute actionable 'fraud' it must appear: (1) that defendant made a material representation; (2) that it was false; (3) that when he made it he knew that it was false, or made it recklessly, without any knowledge of its truth, and as a positive assertion; (4) that he made it with the intention that it should be acted upon by plaintiff; (5) that plaintiff acted in reliance upon it; and (6) that he thereby suffered injury.

*Id.*

185 *Sallee*, 286 F.3d at 895-904.
186 See *infra* note 187 and accompanying text.

187 *Sallee*, 286 F.3d at 900 (citing Moore, Owen, Thomas & Co. v. Coffey, 992 F.2d 1439, 1445 (6th Cir. 1993) (quoting Hampton v. Suter, 330 S.W.2d 402, 406 (Ky. 1959))).
This critical limitation of remedies should be noted by the practitioner for its clear import upon a fraud claimant’s rights and the obvious potential effects upon the calculation of damages.

In *Bowling Green Municipal Utilities v. Thomasson Lumber Co.*, the United States District Court for the Western District of Kentucky made a similar prediction to that of the court in *Gooch*. The *Bowling Green* court held that the economic loss doctrine precluded the purchaser Municipal Company from recovering under a tort theory against the sellers for damages to the goods sold. The court held that the purchaser was not entitled to recover the claimed compensatory damages to pay for the tracking and replacement of defective utility poles. However, the court came to a different conclusion with respect to damages to other utility poles, which were not purchased from the seller, resulting from the defects in the poles that were purchased from the seller. The court determined that damage to “other” property was not barred by the economic loss doctrine.

**IV. ANALYSIS CREATION, PERFECTION, AND PRIORITY OF SECURITY INTERESTS AND LIENS**

This section of the Article will deal primarily with secured transactions and the priority of security interest and liens under Revised Article 9 of the Kentucky Commercial Code. Effective July 1, 2001, Kentucky adopted Revised Article 9 of the UCC, which has since been adopted by every other state. By the date of this publication, countless articles and presentations regarding Revised Article 9 will have been published, presented, and thoroughly discussed. Thus, while this section of the Article concerns commercial law regarding security interests, a comprehensive review of Kentucky’s Revised Article 9 will not be the attempt here.

With that said, some of the more interesting changes in Kentucky commercial law have changed not as a result of published case law, but rather as a result of the adoption of Revised Article 9. Therefore some of the revisions of Article 9 will be addressed and analyzed. Further, several Kentucky and Federal

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189 See *supra* notes 132-37, 139, 141-45 & 147-53 and accompanying text.
191 *Id.*
192 *Id.* at 139.
193 *Id.*
cases affecting Kentucky commercial law will be addressed and reviewed as well.

A. Security Interests and Equine Liens – The Race is On

One area of Kentucky commercial law that has changed by the adoption of Revised Article 9 is the law of priority with regard to security interests and statutory liens in the equine industry.196 While no significant case has been published in Kentucky in over ten years affecting the laws of security interest or liens in equine interests, Kentucky’s version of Revised Article 9, unlike some other states, specifically added equine interests to its definition of farm products.197 The effect of including equine interests to the definition of “farm products” is to make liens on horses and horse interests subject to the rules of priority and perfection of Kentucky’s Revised Article 9.

The Kentucky Revised Statutes provide several types of lien rights that can protect equine interests: K.R.S. § 376.400 provides that a livery stable owner has a lien on horses and other livestock for the cost of services rendered;198 K.R.S. § 376.420 allows for a lien for stud fees and costs against the offspring of a “stallion, jack, or bull;”199 and K.R.S. § 376.470 provides veterinarians a lien right against the animal for the costs of professional services rendered.200

196 See infra notes 196-208 and accompanying text.
197 KY. REV. STAT. ANN. § 355.9-102(1)(ah) (Banks-Baldwin 2002).
198 KY. REV. STAT. ANN. § 376.400 (Banks-Baldwin 2003). See also Fitch v. Steagall & Young, 77 Ky. (14 Bush) 230 (1878) (enforcing a livery stable owner’s lien on two horses).
199 KY. REV. STAT. ANN. § 376.420 (Banks-Baldwin 2003) provides:

(1) Any licensed keeper of a stallion, jack, or bull shall have a lien for the payment of the service fee upon the get of the stallion, jack, or bull, for one (1) year after the birth of the progeny. However, a lien created pursuant to K.R.S. § 376.400 shall take priority over a lien created pursuant to this subsection.

(2) This lien may be enforced by action as in cases of other liens, or by warrant as permitted in the case of the enforcement of the lien of the keeper of a livery stable or an agister.

200 Id. § 376.470 provides:

(1) Any licensed veterinarian who performs professional services for an animal, by contract with, or by the written consent of, the owner or authorized agent shall have a lien on the animal to secure the cost of the service provided.

(2) The priority among veterinarian’s liens filed under this section shall be according to the first lien filed.
Prior to 1996, it was unclear which lien would prevail as between a K.R.S. § 376.400 (livery stable) lien or a K.R.S. § 376.420 (breeders’) lien where the stallion or bull received both services concurrently.\(^{201}\) As of July 15, 1996, the legislature made it perfectly clear that a livery stable lien trumps a breeder’s lien.\(^{202}\)

Now, with the adoption of Revised Article 9 which includes equine interests in the newly broadened definition of “farm products,” the question arises as to perfection of the equine lien interests. Further, the definition of “secured party” has been broadened to include the holder of an agricultural lien\(^{203}\) and “collateral” is defined to include property subject to an agricultural lien.\(^{204}\)

K.R.S. § 355.9-322 provides that the priority of conflicting security interests or agriculture liens is a horse race—first to perfect wins.\(^{205}\) Security interests in agricultural liens can be perfected by possession\(^{206}\) or by filing a financing statement.\(^{207}\) Thus, while a lien holder under K.R.S. § 376.400, or § 376.420 may be perfected while he or she retains possession of the horse, this party will need to file a financing statement with the Secretary of State’s office in order to remain perfected in the event that possession is surrendered. Even more notable, a veterinarian lien holder under K.R.S. § 376.470 will need to perfect his or her interest two times for maximum protection: first by filing a lien with the county clerk where the horse is located pursuant to K.R.S. § 376.475\(^{208}\) and second by filing a financing statement with the Secretary of State.\(^{209}\)

B. Security Interests in Mobile Homes – On the Road Again?

Creditors within Kentucky and without have long struggled to establish and perfect security interests in mobile or manufactured homes.\(^{210}\) Kentucky’s adoption of Revised Article 9\(^{211}\) and the addition of K.R.S. § 186A.297\(^{212}\) have created some potential missteps for creditors with regard to security interests in manufactured homes. Kentucky’s Revised Article 9 now supplies both a

\(^{201}\) The only case dealing with both sections is Benjamin v. Goff, 236 S.W.2d 905 (Ky. 1951).
\(^{202}\) See KY. REV. STAT. ANN. §§ 376.400, 376.420 (Banks-Baldwin 2003).
\(^{203}\) KY. REV. STAT. ANN. § 355.9-102(1)(bt) (Banks-Baldwin 2002).
\(^{204}\) Id. § 355.9-102(1)(f).
\(^{205}\) Id. § 355.9-322.
\(^{206}\) Id. § 355.9-313.
\(^{207}\) Id. § 355.9-310.
\(^{208}\) KY. REV. STAT. ANN. § 355.9-102(1)(f).
\(^{209}\) KY. REV. STAT. ANN. § 376.475 (Banks-Baldwin 2003).
\(^{212}\) KY. REV. STAT. ANN. § 186A.297 (Banks-Baldwin 2001) (effective July 14, 2000).
definition of "manufactured-home" and rules of perfection and priority of security interests in "manufactured-home transactions."

The problem then and now with securing and perfecting an interest in a manufactured home, is that as collateral, a manufactured home can be categorized in several different ways throughout its tenure as collateral. A manufactured home can be encumbered or secured by a creditor or creditors in a variety of ways: it can be inventory, subject to a security interest perfected by a UCC filing; it can be a registered vehicle subject to a security interest noted on its certificate of title; and finally, it could be real property subject to a mortgage or other real property encumbrances.

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213 See KY. REV. STAT. ANN. § 355.9-102(1)(ba) (Banks-Baldwin 2002). This section defines a manufactured home as follows:

"Manufactured home" means a structure, transportable in one (1) or more sections, which, in the traveling mode, is eight (8) body feet or more in width or forty (40) body feet or more in length, or, when erected on site, is three hundred twenty (320) or more square feet, and which is built on a permanent chassis and designed to be used as a dwelling with or without a permanent foundation when connected to the required utilities, and includes the plumbing, heating, air-conditioning, and electrical systems contained therein. The term includes any structure that meets all of the requirements of this paragraph except the size requirements and with respect to which the manufacturer voluntarily files a certification required by the United States Secretary of Housing and Urban Development and complies with the standards established under Title 42 of the United States Code.

214 Id. § 355.9-102(1)(bb) defines manufactured home transaction as follows:

"Manufactured-home transaction" means a secured transaction:

1. That creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory; or

2. In which a manufactured home, other than a manufactured home held as inventory, is the primary collateral.

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215 See infra notes 215-18 and accompanying text.
216 KY. REV. STAT. ANN. § 355.9-102(1)(av) (Banks-Baldwin 2002).
217 Id. §§ 355.9-310 – 355.9-312. See also id. §§ 355.9-501 – 355.9-527.
218 KY. REV. STAT. ANN. § 186A.190 (Banks-Baldwin 2001).
219 See Hiers v. Bank One, West Virginia, Williamson, N.A., 946 S.W.2d 196 (Ky. Ct. App. 1996) (treating a lessee/mortgagor's manufactured home as a part of real property, allowing mortgagee's
1. Manufactured Homes as Inventory

Manufactured home dealers maintain a large inventory of manufactured homes prior to any home having been issued a certificate of title.\(^{220}\) Filing a financing statement is the typical method of perfecting a purchase money security interest in manufactured homes as inventory.\(^{221}\) Unlike an automobile dealer, a manufactured home dealer will more likely desire a perfected security interest in its inventory after the expiration of the initial term of the financing statement (five years),\(^{222}\) as manufactured homes are more likely to still be inventory than are cars after five years.\(^{223}\)

2. Manufactured Homes as Registered Vehicles

Kentucky, like most other states, originally enacted its Motor Vehicle Certificate of Title Act to deter sales of stolen motor vehicles.\(^{224}\) Today, Kentucky’s Motor Vehicle Registration Act operates primarily as a means to perfect security interests in titled vehicles.\(^{225}\) Kentucky’s certificate of title statute provides that the only way to perfect a security interest in the goods covered by a certificate of title is by notation on the certificate of title.\(^{226}\) Further, K.R.S. § 355.9-311(1)(b) and K.R.S. § 355.9-334(5)(d) dictate deference to K.R.S. Chapter 186A, the Kentucky certificate of title statute, in establishing a method of perfecting a security interest in a manufactured home.\(^{227}\) K.R.S. § 186A.070 states that any state resident owner of a mobile home must obtain a certificate of title.\(^{228}\) Moreover, K.R.S. 186A.190(1) expressly provides that “the perfection and discharge of a security interest in any property for which has been issued a Kentucky certificate of title shall be by notation on the certificate of title” in accordance with the requirements of K.R.S. Chapter 186A.\(^{229}\)


\(^{221}\) KY. REV. STAT. ANN. § 355.9-311(4) (Banks-Baldwin 2002).

\(^{222}\) Id. § 355.9-515(1).

\(^{223}\) Koontz, supra note 219, at 1840-41.

\(^{224}\) See 7A AM. JUR. 2D Automobiles and Highway Traffic § 29 (2003).


\(^{226}\) KY. REV. STAT. ANN. § 186A.190 (Banks-Baldwin 2001).

\(^{227}\) Revised Article 9 of the Uniform Commercial Code provides same. See U.C.C. §§ 9-311(a)(2) – 9-334(e)(4) (2002).

\(^{228}\) KY. REV. STAT. ANN. § 186A.070 (Banks-Baldwin 2001).

\(^{229}\) Id. § 186A.190.
Fortunately, Revised Article 9 uses the same definition of "manufactured home" as K.R.S. Chapter 186A, making it perfectly clear that the "manufactured home transaction" priority rule in section 355.9-334 allows for a security interest perfected pursuant to a certificate of title statute to have priority over a real estate encumbrance. While certificate of title statutes typically control the perfection of security interests on titled manufactured homes, lenders and attorneys should be on notice that statutory liens of other states may affect the priority of an interest properly perfected under Kentucky law.

3. Manufactured Homes as Real Property

On July 14, 2000, K.R.S. § 186A.297 became effective, providing that a manufactured home may become real estate, thereby rendering a certificate of title irrelevant. Consistently, Revised Article 9, which was adopted a year

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"Manufactured home" means a structure, transportable in one (1) or more sections, which:
(a) Is eight (8) body feet or more in width and forty (40) body feet or more in length when in the traveling mode;
(b) Has three hundred twenty (320) or more square feet when erected on site;
(c) Is built on a permanent chassis;
(d) Is designed to be used as a dwelling, with or without a permanent foundation, when connected to the required utilities;
(e) Includes plumbing, heating, air-conditioning, and electrical systems; and
(f) May be used as a place of residence, business, profession, or trade by the owner, lessee or their assigns, and may consist of one (1) or more units that can be attached or joined together to comprise an integral unit or condominium structure.


232 Indiana Code Section 16-41-27-29 provides that a mobile home park owner has a possessory lien against homes located in its community for unpaid lot rent. Further, Indiana Code Section 26-1-9.1-333 provides that the fore-mentioned possessory lien is superior to all other security interests in the manufactured home.


(1) When a manufactured home is or is to be permanently affixed to real estate, the owner may execute and file an affidavit of conversion to real estate with the county clerk
later, recognizes the extinction of certificates of title in K.R.S. § 355.9-303.\textsuperscript{234} K.R.S. § 355.9-303(2) clarifies when "goods" become and or cease to be covered by a certificate of title.\textsuperscript{235}

The "manufactured-home transaction," defined in K.R.S. § 355.9-102(1)(bb),\textsuperscript{236} provides the scope for when K.R.S. § 355.9-334(5)(d) will give of the county in which the real estate is located. The affidavit shall attest to the fact that the home has been or will be permanently affixed to the real estate and be accompanied by a surrender of the Kentucky certificate of title. The county clerk shall file the affidavit of conversion to real estate in the miscellaneous record book. (2) A county clerk shall not accept a surrender of a Kentucky certificate of title which displays an unreleased lien unless it is accompanied by a release of the lien. When the county clerk files the affidavit of conversion to real estate, the county clerk shall furnish a copy to the property valuation administrator for inclusion in the real property tax rolls of the county. A filing of an affidavit of conversion to real estate and a surrender of a Kentucky certificate of title shall be deemed a conversion of the property as an improvement to the real estate upon which it is located.

\textsuperscript{234} Ky. REV. STAT. ANN. § 355.9-303 (Banks-Baldwin 2002) provides:

(1) This section applies to goods covered by a certificate of title, even if there is no other relationship between the jurisdiction under whose certificate of title the goods are covered and the goods or the debtor.

(2) Goods become covered by a certificate of title when a valid application for the certificate of title and the applicable fee are delivered to the appropriate authority. Goods cease to be covered by a certificate of title at the earlier of the time the certificate of title ceases to be effective under the law of the issuing jurisdiction or the time the goods become covered subsequently by a certificate of title issued by another jurisdiction.

(3) The local law of the jurisdiction under whose certificate of title the goods are covered governs perfection, the effect of perfection or nonperfection, and the priority of a security interest in goods covered by a certificate of title from the time the goods become covered by the certificate of title until the goods cease to be covered by the certificate of title.

\textsuperscript{235} Id.

\textsuperscript{236} Id. § 355.9-102(1)(bb) provides: "'Manufactured-home transaction' means a secured transaction: (1) That creates a purchase-money security interest in a manufactured home, other than a manufactured home held as inventory, or (2) In which a manufactured home, other than a manufactured home held as inventory, is the primary collateral."
priority to a lien interest noted on the certificate of title against a real property encumbrance.\textsuperscript{237} K.R.S. § 355.9-334(5)(d) only covers secured transactions creating a purchase money security interest in the manufactured home, or those where the manufactured home serves as the primary collateral.\textsuperscript{238}

K.R.S. § 355.9-334(5)(d) removes the need for determining when a manufactured home has become a fixture.\textsuperscript{239} It does not matter whether the manufactured home is considered a "good" or a "fixture," because the only method for perfecting a security interest is through a certificate of title statute as provided in K.R.S. § 355.9-311(1)(b).\textsuperscript{240} When a manufactured home becomes affixed to real property and is considered a fixture, the creditor who has perfected a security interest in a manufactured home by notation on the certificate of title is protected against a creditor with a real estate interest or owner with a real property interest in the land.\textsuperscript{241}

4. **Watch Out For K.R.S. § 355.9-515!**

A confusing addition to Revised Article 9 is K.R.S. § 355.9-515. This provision seems to contradict K.R.S. § 355.9-311(1)(b), which provides that filing financing statements is useless against manufactured homes covered by certificate of title statutes.\textsuperscript{242} K.R.S. § 355.9-515(2) indicates that a proper method of perfecting an interest in connection with a "manufactured-home transaction"\textsuperscript{243} is through filing a financing statement.\textsuperscript{244} Further, K.R.S. §

\textsuperscript{237} See KY. REV. STAT. ANN. § 355.9-334(5)(d)1 (Banks-Baldwin 2002).
\textsuperscript{238} Id. § 355.9-334(5)(d)1.
\textsuperscript{239} Id. § 355.9-334(5)(d). See also Hiers v. Bank One, West Virginia, Williamson, N.A., 946 S.W.2d 196 (Ky. Ct. App. 1996). In Hiers, the trial court found, prior to the Revised Article 9 provisions, that a creditor who noted its security interest on the home's certificate of title had priority over a lease agreement granting an interest in the home. Id. at 196. It was argued that since the mobile home had become affixed to the land, it was no longer governed by the requirements of the K.R.S. Chapter 186A. Id. at 198. The court of appeals rejected the argument because the statute does not contain anything that suggests that the chapter's provisions or the certificate of title requirements no longer apply to a mobile home merely because it is permanently affixed to real property. Id.
\textsuperscript{240} KY. REV. STAT. ANN. § 355.9-334(5)(d)2 (Banks-Baldwin 2002).
\textsuperscript{241} Id. § 355.9-311(1)(b).
\textsuperscript{242} Id.
\textsuperscript{243} Id. § 355.9-102(1)(bb).
\textsuperscript{244} Id. § 355.9-515(2) provides:

Except as otherwise provided in subsections (5), (6), and (7) of this section, an initial financing statement filed in connection with a public-finance transaction or manufactured-home transaction is effective for a period of thirty (30) years after the date of filing if it indicates that it is filed in connection with a public-finance transaction or manufactured-home transaction.
355.9-515(2) provides that the filing period is extended to thirty years. Thus, Revised Article 9 creates a potential conflict between certificates of title and financing statements.

A reasonable, yet incorrect, inference drawn from K.R.S. § 355.9-515(2) is that filing a financing statement is the proper method for perfecting a security interest granted in a mobile home transaction – such an inference could be costly for an unwary practitioner. Financing statements are not effective to perfect security interests in goods subject to certificates of title. So while a practitioner might assume that Revised Article 9 permits manufactured home perfection through financing statements, K.R.S. § 355.9-515(2) is only applicable in situations when a certificate of title is not required.

C. Perfected Parties’ Right to Identifiable Proceeds: General Motors Acceptance Corporation v. Lincoln National Bank

With regard to security interests in identifiable proceeds, the Kentucky Supreme Court in General Motors Acceptance Corp. v. Lincoln National Bank announced a bright-line rule that comment 2(c) to section 9-306 of the old Article 9 of the UCC “does not apply when a bank seizes funds deposited in a customer’s account and applies the funds to payments of overdrafts or antecedent debts.”

K.R.S. 355.9-306 (old Article 9) provided that funds can be paid out of a debtor’s account to other parties free and clear of any claim a secured creditor had so long as the payments are made in the ordinary course of business. Thus, a bank may, pursuant to its loan documents and in accordance with Kentucky Statutes, upon default by the depositor, set-off against a general

Financing statements usually remain effective for five years. Id. § 355.9-515(1).

Id. § 355.9-515(2).


Id. § 355.9-515.

General Motors Acceptance Corp. v. Lincoln Nat'l Bank, 18 S.W.3d 337 (Ky. 2000).

Id. at 340.

U.C.C. § 9-306 cmt. 2(c) (amended 2000) 3B U.L.A. 35 (2002). This comment provides:

Where cash proceeds are covered into the debtor’s checking account and paid out in the operation of the debtor’s business, recipients of the funds of course take free of any claim which the secured party may have in them as proceeds. What has been said relates to payments and transfers in ordinary course. . . .

deposit account belonging to the depositor.\textsuperscript{252} This involves using the deposit account of the debtor to pay off the unpaid loans or overdrafts of the debtor.\textsuperscript{253} Kentucky’s adoption of Revised Article 9 replaced the provisions of K.R.S. § 355.9-306 with K.R.S. § 355.9-315.\textsuperscript{254} While there is no equivalent to comment 2(c) to U.C.C. § 9-306 in the official comments to U.C.C. § 9-315, there is nothing to indicate that the adoption of the Revised Article 9 would affect the common law “ordinary course” exception.\textsuperscript{255}

The court in \textit{General Motors Acceptance Corp.} held a bank liable to a secured creditor for conversion since the creditor’s security interest in identifiable proceeds of its collateral took priority over the bank’s right to apply those proceeds to payment of overdrafts.\textsuperscript{256} In this case, General Motors Acceptance Corporation (GMAC) provided floor plan financing to Donohue Ferrill Motor Company, Inc. (Donahue Ferrill), a Chevy dealership.\textsuperscript{257} GMAC took a security interest in Donohue Ferrill’s inventory and proceeds from inventory.\textsuperscript{258} A.G. Back, Jr., founder and former President of Donohue Ferrill, was chairman of the board of Lincoln National Bank (Lincoln) when he signed the security agreement in favor of GMAC.\textsuperscript{259} Late in 1991, Donahue Ferrill began struggling and consequently its account became overdrawn.\textsuperscript{260} Contrary to Lincoln’s standard procedures, Mr. Back personally handled all of Donahue Ferrill’s overdrafts.\textsuperscript{261} Eventually the business failed in December 1991 and Donohue Ferrill defaulted on its obligations to GMAC, leaving an unpaid debt of $308,088.22 after the liquidation of all of its assets.\textsuperscript{262}

Just prior to its default, Donohue Ferrill sold six trucks and deposited the proceeds in Lincoln, which in turn applied the proceeds to Donohue Ferrill overdrafts.\textsuperscript{263} GMAC sued Lincoln for conversion of the proceeds from the sale

\textsuperscript{253} \textit{General Motors Acceptance Corp.}, 18 S.W.3d at 340.
\textsuperscript{254} KY. REV. STAT. ANN. § 355.9-315 (Banks-Baldwin 2002).
\textsuperscript{255} U.C.C. § 9-315 cmts. 1-9 (2002).
\textsuperscript{256} \textit{General Motors Acceptance Corp.}, 18 S.W.3d at 339-40.
\textsuperscript{257} \textit{id.} at 337.
\textsuperscript{258} \textit{id.} at 338.
\textsuperscript{259} \textit{id.}
\textsuperscript{260} \textit{id.}
\textsuperscript{261} \textit{id.}
\textsuperscript{262} \textit{General Motors Acceptance Corp.}, 18 S.W.3d at 338.
\textsuperscript{263} \textit{id.}
of the trucks, citing the old K.R.S. § 355.9-306(2). Lincoln argued that it applied the monies to the overdrafts in the ordinary course of its business. The Kentucky Supreme Court reasoned that the payment by a bank of an overdraft is an unsecured loan. K.R.S. § 335.9-201 (under both old Article 9 and new Article 9) gives secured creditors priority over all other creditors in the collateral or proceeds from the collateral. Thus, Lincoln had no rights to money deposited by Donohue Ferrill, as GMAC’s perfected security interest extended to the proceeds from the sale of the collateral. Application of the ordinary course of business exception in cases where the bank is applying proceeds from secured collateral to its unsecured loans would allow banks to “leapfrog” secured creditors.

In a minor note, General Motors Acceptance Corp. may also provide a gentle warning to secured creditors concerning their knowledge of or “acquiescence” in allowing a bank to set-off against a general deposit of collateral proceeds. Lincoln argued that GMAC’s complaint should fail because it acquiesced in the bank’s possession and use of the proceeds. The Court did not accept Lincoln’s argument, however, it indicated that had stronger evidence been introduced, a more thorough examination of Lincoln’s claim would have been necessary. The court also noted that mere acquiescence is not enough to constitute estoppel.

D. The Trustee’s Strong Arm: In re Lynum

While federal bankruptcy law dictates what a trustee’s lien interests are, Kentucky commercial law dictates the priority of the lien. In Lynum, a

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264 Id. The old K.R.S. § 355.9-306(2) provided:

Except where this article otherwise provides, a security interest continues in collateral notwithstanding sale, exchange or other disposition thereof unless the disposition was authorized by the secured party in the security agreement or otherwise, and also continues in any identifiable proceeds including collections received by the debtor.

1996 Ky. Acts ch. 130, § 176, 526 (current version at KY. REV. STAT. ANN. § 355.9-315 (Banks-Baldwin 2002)).

265 General Motors Acceptance Corp., 18 S.W.3d at 338.

266 Id. at 339.

267 KY. REV. STAT. ANN. § 355.9-201(1) (Banks-Baldwin 2002).

268 General Motors Acceptance Corp., 18 S.W.3d at 339.

269 Id. at 340.

270 Id. at 338.

271 Id. at 340 (stating that the evidence of the bank’s acquiescence was “woefully inadequate”).

272 Id.

273 KY. REV. STAT. ANN. § 355.9-301 (Banks-Baldwin 2002).
trustee’s strong-arm ability to avoid an unperfected lien interest did not extend to
a subsequent lien holder’s perfected security interest.\footnote{274} Section 544 of the Bankruptcy Code provides that upon filing, the
bankruptcy trustee acquires the status of a hypothetical judicial lien creditor and
“may avoid” any lien or encumbrance on property of the debtor that is voidable
by such a creditor under \textit{applicable law} (meaning state law).\footnote{275} Under Kentucky
law, an unperfected security interest is subordinate to the rights of a subsequent
lien creditor.\footnote{276}

Lynum, the debtor, granted a security interest in a boat to the National City
Bank (NCB), which NCB failed to perfect.\footnote{277} Subsequently, Lynum granted a
security interest in the same boat to M&T Financing, Inc. (M&T) – which M&T
perfected by noting its security interest on the boat’s certificate of title.\footnote{278}

In the bankruptcy proceeding, NCB filed a Motion for Termination of
Automatic Stay and Abandonment in 1999.\footnote{279} The trustee filed an Objection to
the Motion on the next day.\footnote{280} NCB withdrew its motion, but M&T filed a
Motion for Relief and the Trustee objected their motion as well.\footnote{281} The trustee,
flexing his strong arm, contended that his interest was superior to M&T’s as a
hypothetical judgment lien creditor.\footnote{282} The court, however, disagreed, conceding
that the Trustee’s interest is superior to the unperfected security interest held
by NCB, but refused to declare M&T’s perfected security interest subordinate to the
rights of a subsequent judgment lien creditor.\footnote{283} The court relied on K.R.S.
§ 355.9-312(5)(a) (new § 355.9-322) which provides the rank of security interests
according to priority.\footnote{284} “Priority dates from the earlier of the time a filing
covering the collateral is first made or the security interest or agricultural lien is
first perfected, if there is no period thereafter when there is neither filing nor
perfection.”\footnote{285}

\begin{footnotes}
\footnotetext{274}{\textit{In re Lynum}, 246 B.R. 537, 539 (Bankr. W.D. Ky. 2000).}
\footnotetext{276}{Ky. REV. STAT. ANN. § 355.9-317(i)(b) (Banks-Baldwin 2002) (previously K.R.S. § 355.9-
301(b), to which the \textit{Lynum} court refers).}
\footnotetext{277}{\textit{Lynum}, 246 B.R. at 539.}
\footnotetext{278}{Id.}
\footnotetext{279}{Id.}
\footnotetext{280}{Id. at 538.}
\footnotetext{281}{Id.}
\footnotetext{282}{Id.}
\footnotetext{283}{\textit{Lynum}, 246 B.R. at 539.}
\footnotetext{284}{1996 Ky. Acts ch. 130, § 178, 527-28 (current version at Ky. REV. STAT. ANN. § 355.9-322
(Banks-Baldwin 2002)).}
\footnotetext{285}{Ky. REV. STAT. ANN. § 355.9-322 (Banks-Baldwin 2002).}
\end{footnotes}
E. Enforceability of Future Advance Clauses: Call Federal Credit Union v. Sweeney

In Call Federal Credit Union v. Sweeney, the defendant, Sweeney, financed the purchase of a motorcycle ($2,684.55) with the Call Federal Credit Union (CFCU) (then known as Phillip Morris Employees Federal Credit Union), granting CFCU a security interest in the motorcycle. The security agreement included a future advances clause providing that all past and future indebtedness was secured by the motorcycle. Sweeney later received a second loan from CFCU in the amount of $5,520.81. Subsequently, the motorcycle was destroyed in an accident. The insurance company issued a two-party check for $3,235.35 that Sweeney was able to cash. Upon receipt of the insurance funds, Sweeney used the funds to buy himself a new motorcycle.

In the Bankruptcy action that followed, CFCU filed an adversary proceeding seeking a ruling that the damages from Sweeney's conversion are not dischargeable in bankruptcy. In Kentucky, damages for conversion are determined by the fair market value of the converted property, not the balance owed under the contract. However, if the balance due on the debt is less than the fair market value of the property, the defendant only owes for the unpaid balance of the account — damages are limited because the creditor only has a security interest in the converted property and thus can only be injured to the extent of the debt secured by the collateral.

The problem presented in Sweeney was that due to the future advances clause in the original note and the cross-collateralization in both notes, Sweeney's motorcycle served as collateral for both notes, securing a total amount of $8,205.36. Thus, CFCU alleged that its recoverable damages equal the fair market value of the motorcycle, or $4,235, because this amount was less than the total balance due at $8,205.36. The Court disagreed and determined that the appropriate amount of damages was the balance owed to CFCU for the purchase of the first motorcycle, or the sum of $2,684.55, because the future advances clause in the first note was not enforceable.

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287 Id.
288 Id.
289 Id.
290 Id.
291 Id.
292 Sweeney, 264 B.R. at 873.
293 Id.
294 Id.
295 Id.
296 Id.
297 Id. at 874.
Future advance clauses are generally enforceable in Kentucky. In order for a future advance clause to be valid in a situation where “the original debt is a purchase money transaction,” the latter transaction must be of the same class as the prior transaction. In Sweeney, the first loan was a purchase money transaction and the second loan was a general unsecured loan. “There was no proof here that the Defendant could have reasonably contemplated . . . that the motorcycle would secure all future owed debt to the plaintiff.” Thus the two transactions lacked the essential nexus that would enable the future advance clause to connect the two loans.

The lesson to be learned is that any expectation of security for a loan should be stated in that loan and documented in a new security agreement, even if it is supposedly already secured.

299 Sweeney, 264 B.R. at 874.
300 Id.
301 Id. at 874-75.