COMMONWEALTH OF KENTUCKY
SUPREME COURT
CASE NO. 2007-SC-00246

AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE COMPANY — APPELLANT

v.

APPEAL FROM JEFFERSON CIRCUIT COURT
CASE NO. NO. 05-CI-00771
APPEAL FROM KENTUCKY COURT OF APPEALS
NO. 2006-CA-002510

HON. EDDY COLEMAN, JUDGE
PIKE CIRCUIT COURT, ET AL. — APPELLEE

THE ESTATE OF IDA SWORD McCOWN, by and through JAMES McCOWN, Executor — REAL-PARTY-IN-INTEREST

REPLY BRIEF OF APPELLANT, AMERICAN INTERNATIONAL SPECIALTY LINES INSURANCE COMPANY

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CERTIFICATE OF SERVICE

In accordance with CR 76.12(5), I hereby certify that a copy of this Brief was on this 17th day of July, 2007, served by First Class Mail, postage prepaid, upon Miller Kent Carter, Miller Kent Carter & Michael Lucas, PLLC, 131 Division Street, P.O. Box 852, Pikeville, KY 41502; Richard E. Circeo, Wilkes & McHugh, P.A., 2100 West End Ave., Suite 640, Nashville, TN 37203, Byron N. Miller, Kevin M. Murphy, Thompson, Miller & Simpson PLC, 600 West Main Street, Suite 500, Louisville, KY 40202; Hon. Eddy Coleman, Judge, Pike Circuit Court, 435 Hall of Justice, 172 Division Street, Pikeville, KY 41501; and Kentucky Court of Appeals, 360 Democrat Drive, Frankfort, KY 40601-8209.

Edward H. Stopher

INTRODUCTION

Nothing in the brief of the real party in interest/appellee, the Estate of Ida Sword McCown, sanctions the overturning of the long-standing rule in Kentucky prohibiting actions – direct, declaratory or otherwise – against insurers before judgment has been rendered against their insureds. McCown's argument hinges on the purported existence of an insolvency/bankruptcy exception to this rule. Appellant, American International Specialty Lines Insurance Company ("AISLIC"), established in its brief there is no such exception, which McCown failed to rebut. Indeed, Kentucky courts have repeatedly affirmed the rule prohibiting non-insureds from suing insurers before obtaining judgment, even when insolvent or bankrupt.

McCown's reliance on a non-existent insolvency/bankruptcy exception and other inapposite case law notwithstanding, McCown simply lacks standing at the present time to litigate coverage issues under a policy to which it is a stranger and the trial court lacks jurisdiction to entertain McCown's declaratory judgment action. To hold otherwise would drastically alter the landscape of insurance law, and invite the waste of judicial resources caused by a surge of litigation designed to determine coverage for a prospective judgment that the complaining party may never obtain.

ARGUMENT

I. McCown Has Failed to Establish the Trial Court Has Jurisdiction to Entertain Its Declaratory Judgment Action.

As set forth in AISLIC's appellant's brief, where a trial court acts without jurisdiction in entertaining an action, the defendant is entitled to a writ of prohibition. To argue the trial court has jurisdiction over its declaratory action, McCown erroneously contends an insolvency/bankruptcy exception exists to permit its direct action against

AISLIC. Additionally, McCown all but ignores Kentucky law on third-party beneficiary theory, which fails to grant McCown standing to prematurely litigate coverage under the AISLIC policy.

A. McCown Relies on a Non-Existent Insolvency/Bankruptcy Exception to the Rule That Prohibits the Present Action.

McCown continues to acknowledge that it would have no right to maintain its declaratory action if the Parkview defendants – and AISLIC's insureds – were not bankrupt, but that their bankruptcy provides an exception to the general rule that otherwise would prohibit McCown's action. (McCown's appellee's brief at 8 (referring to an "exception to the general rule in cases of insolvency or bankruptcy"), 12 (citing foreign cases for the proposition that "when the insured is bankrupt or insolvent," the injured party has standing to litigate the issue of coverage under a liability policy) and 13 (arguing Parkview's bankruptcy "creates an exception allowing Plaintiff to bring a declaratory action for determination of insurance coverage"). The only case McCown cites for this proposition is Harris v. Jackson, 192 S.W.3d 297 (Ky. 2006).

As shown in AISLIC's brief, Harris did not involve an insolvent or bankrupt insured, or even a plaintiff seeking a declaration of coverage for alleged damages before she obtained judgment against the insured. Rather, the Court permitted Jackson's claim to proceed despite failing to timely revive the action following the defendant's death because the insurer continued to defend when it knew of Harris' death. The Court held the insurer was estopped from obtaining a dismissal despite the lack of a valid defendant and the general rule that "the injured person cannot sue the negligent party's insurance carrier, except in cases of insolvency or bankruptcy." Id. at 302, 307 (expressing dicta).

Clearly, these facts are entirely distinguishable from our case and the Court's reference to the so-called insolvency/bankruptcy exception is dicta.

AISLIC also showed in its brief that the same dicta in other distinguishable cases emanated from New York Indem. Co. v. Ewen, 298 S.W. 182 (Ky. 1927), which *did* involve an insolvent insured. The Court in Ewen not only failed to allow the injured party from directly suing the insurer of the insolvent defendant, it affirmed the rule that "no direct cause of action against the insurance company [may be maintained] until she had obtained a judgment against the assured and establishing the latter's insolvency or bankruptcy . . . ." Id. at 185. McCown failed to address Ewen, which undermines its case.[1]

McCown also failed to address Padgett v. Long, 453 S.W.2d 272 (Ky. 1970), which essentially affirmed Ewen when the Court held it is improper for a plaintiff to sue the insurance company "before establishing and liquidating the claim" where the policy provides, similar to the AISLIC policy, that "[n]o action shall lie against the company until the amount of the insured's obligation to pay shall have been finally determined either by judgment against the insured . . . or by written agreement . . . ." Id. at 274, 276. See R. 117.

Unable to support the validity of its action against AISLIC with Kentucky law, McCown cites several foreign cases which also fail to support its position. In Truck Insurance Exchange v. Ashland Oil, Inc., 951 F.2d 787 (7th Cir. 1992), the insurer filed

[1] McCown also contends that its failure to timely file its post-petition claim in the bankruptcy court is irrelevant for this Court's determination. If an insolvency/bankruptcy exception exists, which it does not, McCown's inaction in the bankruptcy court is relevant because it shows McCown would not have needed to rely on such an exception to satisfy any judgment it may obtain against Parkview. Indeed, had McCown timely filed a post-petition claim, Parkview's $1 million self-insured retention would have been available to McCown had it obtained judgment against Parkview. Thus, even if an insolvency/bankruptcy exception applied, McCown should not be permitted to invoke it due to its laches in the bankruptcy proceeding.

the declaratory action, not the injured party. Here, McCown filed the present action, not AISLIC.

In Dial v. Marine Office of America, 743 N.E.2d 621 (Ill.App. 2001) and Howard v. Montgomery Mut. Ins. Co., 805 A.2d 1167 (Md.App. 2002), the courts held that injured parties could bring a declaratory action only where, among other things, the insurer has not provided a defense to its insured.[2] Here, AISLIC has not denied a defense to McCown.

B. The Excess Nature of AISLIC's Coverage Reinforces That McCown's Action Against AISLIC is Premature.

AISLIC pointed out in its brief that Parkview has a $1 million self-insured retention ("SIR") under its policy, which would have been available to satisfy any judgment against Parkview before AISLIC's policy was implicated. McCown erroneously claims the SIR is contained in three additional policies that AISLIC did not previously submit to the trial court or Court of Appeals. AISLIC *did* submit to both lower courts the only policy at issue – the Healthcare Professional and Healthcare General Liability claims made policy – which clearly identifies the $1 million SIR.[3] (R. 104).

The fact that AISLIC's policy is excess is indeed relevant because it highlights the rationale for prohibiting direct actions against insurers. Not only may a declaration of coverage be unnecessary because the injured party may never obtain a judgment against

[2] The court in Dial expressly limited the decision in Reagor v. Travelers Ins. Co., 415 N.E.2d 512 (Ill.App. 1980), another case McCown cited, to cases where the insurer has refused to defend the insured.

[3] The Declarations sheet of this policy, No. 612-55-47, identifies Hilltopper Holding Corp. as the First Named Insured and also provides coverage to the insureds listed in Schedule A, under which Parkview is listed. The other two policies list Centennial Healthcare Properties, LLC as the named insured and were mistakenly attached as part of Exhibit A to the original the motion to dismiss in the trial court. These policies do not apply to McCown's claims.

the insured, but even if the insurer obtains judgment, the amount might not reach the excess coverage. See Kentucky Hosp. Ass'n Trust v. Chicago Ins. Co., 978 S.W.2d 754, 756 (Ky.App. 1998) (insured must become legally obligated to pay before injured party may claim a right to insurance proceeds); Rhone-Poulenc, Inc. v. International Ins. Co., 71 F.3d 1299, 1302 (7th Cir. 1995) ("a suit against an excess carrier cannot proceed 'until the primary carriers' . . . have been determined by a court to be liable . . . .'"

Here, while McCown cites to a $20 million judgment in another nursing home liability case, McCown conspicuously fails to offer any evidence that its claim exceeds $1 million. Pursuant to the policy and Kentucky case law, McCown's declaratory action seeking coverage under the policy is premature until Parkview becomes legally obligated to pay more than $1 million. Because the prospect of these events occurring is questionable, it would be a waste of judicial resources to allow McCown's premature direct action to proceed.

C. McCown's Argument That It is a Third-Party Beneficiary of the AISLIC Policy is Contrary to Kentucky Law.

Despite acknowledging that McCown may assert a declaratory action against AISLIC only if an insolvency/bankruptcy exception exists, McCown then argues it is a third-party beneficiary of the policy and claims it has standing to litigate coverage under the policy. After reciting the general law in Kentucky regarding third-party beneficiary theory, McCown then cites two cases for the proposition that an injured party is a third-party beneficiary of a contract of liability insurance. Neither case is applicable.

First, in Home Indem. Co. v. St. Paul Fire & Marine Ins. Co., 585 S.W.2d 419 (Ky.App. 1979), an accident occurred involving a tractor-trailer and the issue was the proportion of coverage owed under policies issued by three insurers. The lease for the

tractor-trailer provided that insurance shall be maintained as required by federal Internal Commerce Commission regulations. The Court held that "[s]ince the ICC regulations were enacted for the benefit of the public, . . . the ICC insurance requirements . . . create a right in the plaintiffs . . . as third party beneficiaries of the insurance contract." Id. at 424.

The present case obviously does not involve leased tractor-trailers and ICC regulations. Rather, this case is on point with Brooks v. Clark County, 180 S.W.2d 300 (Ky. 1944) in which the Court rejected the plaintiff's argument that the automobile insurance policy procured by the County was taken out for the benefit of the public. The Court cited the language of the policy, which is substantially similar to the AISLIC insuring clause, that the insurer is obligated "to pay on behalf of the insured all sums which the insured shall become legally obligated to pay by reason of the liability imposed upon him by law for damages . . . ." Id. at 301. The Court then held "[w]ords could not more clearly express the intention of the parties that the contract of insurance was one of indemnity only" and permits a third party to seek benefits under it only after securing a judgment against or settling with the insured. Id. Thus, as in Brooks, McCown is not a third-party beneficiary of the AISLIC policy.

Second, Central Mut. Ins. Co. v. Pippen, 111 S.W.2d 425 (Ky. 1937) involved a lawsuit against the insurer *after* a judgment had been entered against the insured and execution was returned "no property found." Id. at 426. This case is consistent with AISLIC's argument and the other case law that a judgment against the insured is a prerequisite to a direct or declaratory action against the insurer.

II. AISLIC is Entitled to a Writ Even if the Trial Court Acted Within its Jurisdiction But Erroneously.

McCown faults AISLIC for not supporting its claimed right to a writ of the second class with an itemization of the type and amount of expenses AISLIC will incur if the declaratory judgment action proceeds. McCown erroneously states that AISLIC's discussion of the expense of defending the declaratory action relates to the great and irreparable injury requirement. Indeed, AISLIC contended it need not show great and irreparable injury because this case is one of the "certain special cases" where a "substantial miscarriage of justice will result" if the trial court is acting erroneously and "correction of the error is necessary and appropriate in the interest of orderly judicial administration." Grange Mut. Ins. Co. v. Trude, 151 S.W.3d 803, 808 (Ky. 2004). The Court held such special cases "tend to be limited to situations where the action for which the writ is sought would violate the law. . . . " Id.

AISLIC did not argue that a substantial miscarriage of justice will result if the trial court entertains the declaratory action solely because AISLIC will incur expense in defending it. Rather, the declaratory action violates clear Kentucky law that expressly prohibits such actions where the plaintiff has not yet obtained a judgment against the insured in the underlying tort action. Unlike most other defendants who argue litigation expense constitutes great and irreparable injury but still must answer and defend the action, AISLIC is not subject to being sued by the injured party prior to judgment against the insured. Allowing the trial court to entertain McCown's declaratory action would subvert the rule against such actions and amount to a substantial miscarriage of justice.[4]

[4] McCown also states AISLIC argued that allowing McCown's action to proceed would inject the issue of insurance into the underlying action, which would unduly prejudice it. AISLIC did not so argue in its appellant's brief.

CONCLUSION

For all the foregoing reasons and the reasons set forth in its appellant's brief, AISLIC respectfully requests the Court to reverse the Court of Appeals Order, and grant a writ of prohibition and/or mandamus to preclude the trial court from hearing the declaratory judgment action and require the trial court to dismiss such action against AISLIC.

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