STATEMENT OF SUBJECT MATTER AND APPELLATE JURISDICTION

I. District Court Jurisdiction

The District Court had subject matter jurisdiction pursuant to 28 USC § 1332(a)(1) because the amount in controversy exceeded the sum of $50,000.00 and the matter was between citizens of different states. Plaintiff-appellee, George Insurance Company ("George"), is a Massachusetts corporation with its principal place of business in Massachusetts. Defendant-appellant, Client ("Client"), was (at the time of the filing of this action) a Kentucky general partnership with its principal place of business in Kentucky.[1]

II. Court of Appeals Jurisdiction

[1] On January 1, 1995, Client was converted into a professional limited liability company, pursuant to Chapter 275 of the Kentucky Revised Statutes, and changed its name to "Client , PLC."

This Court has jurisdiction over the appeal pursuant to 28 USC §1291. This case was tried to a jury on December 13-15, 1994. At the close of the George case, Client moved for judgment as a matter of law and that motion was denied. (Conference TR at 185.) Judgment on the jury's answers to the District Court's interrogatories was entered on December 15, 1994. (R. 130 Judgment in a Civil Case.) On December 29, 1994, Client and intervening plaintiff-appellant, Johnson ("Johnson"), filed renewed motions for judgment as a matter of law, pursuant to Fed. R. Civ. P. 50(b), or alternatively, for a new trial, pursuant to Fed. R. Civ. P. 59, and also filed supporting memoranda. (R. 131, 132 and 133.[2]) These motions were denied by the District Court on April 10, 1995. (R. 136 Opinion and Order.) Each of Client and Johnson filed its Notice of Appeal in the District Court on May 9, 1995. (R. 137 Notice of Appeal [Client 138 Notice of Appeal [Johnson

[2] The Johnson Memorandum was incorporated in its motion.

STATEMENT IN SUPPORT OF ORAL ARGUMENT

This case is appropriate for oral argument because the issues are subtle and important, not only to this case, but to other contract interpretation cases in which Kentucky law will be applicable. Oral argument will assist the Court in clarifying the issues and answering questions that may not be fully addressed in the briefs.

STATEMENT OF ISSUES

This action was originally brought by George as an action to reform insurance policies[3] to add a professional liability exclusion endorsement which George asserted had been left out of the policies because of "mutual mistake." The jury returned a verdict in favor of George and Client and Johnson present the following issues on appeal.

1. Did George prove mutual mistake by clear and convincing evidence?

2. Is proof of actual agreement required before a contract is reformed because of mutual mistake or is proof only that a party "should have known" of the intent of the other sufficient to allow reformation?

3. Was the trial court's instruction regarding the exclusion "then in use" proper where it ignored the previous ruling of this Court and allowed (indeed required) the jury to find only the obvious -- that Client should have known that George intended that its policies be complete?

[3] Specifically, a general liability policy and an umbrella policy issued by George to Client for the policy period which included the date of the accident -- June 22, 1989.

STATEMENT OF THE CASE

II. NATURE OF CASE, COURSE OF PROCEEDINGS AND DISPOSITION

This case arose out of a construction accident which occurred on June 22, 1989, at the 12-Mile Bridge on the [redacted] in Campbell County, Kentucky. A bridge beam designed by an [redacted] subcontractor ([redacted] & [redacted]) failed during tensioning and collapsed, killing two workers and seriously injuring two others. ([redacted] at TR, Vol. III, at 18-23; Defendant's Trial Exhibits [redacted]-12, [redacted]-13, [redacted]-14, and [redacted]-15.)[4]

Wrongful death and personal injury actions were filed against the bridge contractor, the fabricator of the beam, the site engineer, [redacted] and [redacted], and were consolidated in the Campbell Circuit Court. ([redacted] at TR, Vol. III, at 23-24.) These consolidated actions were settled before trial and have been referred to throughout this litigation as the "[redacted] Claims."

[4] There was no evidence presented at the trial of this action that [redacted] had any responsibility for the design of the beam or the supervision of the construction.

[redacted] had obtained its professional liability insurance through [redacted] and its general liability insurance and its liability "umbrella" through [redacted] [redacted] promptly notified both carriers of the accident. ([redacted] at TR, Vol. III, at 25.) [redacted] undertook the defense of [redacted] and paid to the limits of its policy to settle the [redacted] Claims. [redacted] denied that its policies with [redacted] provided any coverage of the [redacted] Claims and [redacted] paid $504,000.00 in settlement and defense costs on the [redacted] Claims over and above the amount paid by [redacted][5]

[redacted] brought this action seeking to reform its policies to add a professional liability exclusion endorsement which [redacted] argued had been left out of its policies by "mutual mistake." [redacted] counterclaimed, alleging, among other things, that [redacted] had engaged in bad faith failure to settle and unfair claims settlement practices in violation of Kentucky Revised Statues (KRS) 304.12-235. (R.2 Answer and Counterclaim at 2-5.) [redacted] intervened to urge that the [redacted] policies provided primary coverage for the [redacted] Claims and that, consequently, [redacted] should have paid to the limits of its policies before [redacted] was required to pay any amounts. (R. 22, Memorandum, attached Intervening Complaint at Count I and II.)

The District Court granted [redacted] motion for summary judgment in 1993 in an opinion which failed to distinguish between professional liability and subcontractor liability and which held, essentially, that the mere existence of the [redacted] professional liability policy proved that [redacted] and [redacted] intended that professional liability (including liability for subcontractor mistakes) was to be excluded from the [redacted] policies and that both parties must

[5] [redacted] stipulated at trial that this amount was paid by [redacted] (Bench conference TR, Vol. III, at 28.)

necessarily have intended that the specific endorsement advocated by George was to be attached to the policies. (R. 78 Memorandum Opinion at 15-18.) This Court reversed the grant of summary judgment, in George v. Client Engineering Co., 33 F.3d 727 (6th Cir. 1994), and ruled that George was required to prove, by clear and convincing evidence, not only that Client knew or should have known that George intended to include a professional liability exclusion, but also that:

> . . . Client knew or should have known **the exact scope of that restriction** -- including that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence **by its subcontractors**, as well as liability for its own active professional negligence.

Id. at 731. (Emphasis supplied.) The case was sent back to the District Court and a jury trial on the issues was held December 12-14, 1994.

At the trial the District Court bifurcated the issue of reformation and the Client bad faith claims and tried the reformation issue first. Johnson made an appearance, but did not participate in the presentation of the case to the jury. (Bench conference at TR, Vol. I, at 3-8.)

The trial included the testimony of: (a) [redacted], the agent (with [redacted] in Lexington, Kentucky) who wrote the George policies, (b) [redacted], a former partner of Client who had been responsible for purchasing insurance for Client before the George policies were purchased, (c) [redacted], a partner of Client who was responsible for purchasing the George policies, (d) [redacted], a former employee of George who was responsible for some underwriting functions, (e) [redacted], the managing partner of Client and (f) [redacted], the George claims adjuster who was responsible for the [redacted] Claims and who provided the George formal denial of the claims.

At the close of the George case, the District Court denied the Client motion for judgment as a matter of law. (Conference at TR, Vol. II, at 185.) At the close of all the evidence in the case, the District Court refused a proffered instruction which paraphrased the language of the opinion of this Court and instead instructed the jury that:

> To reform the insurance contracts in question, the evidence must show that Client Engineering Company knew or should have known that the [George policies were] to contain the Architect's and Engineer's Professional Liability Exclusionary Endorsement **then in use** by George Insurance Company.

(Emphasis supplied.) (Jury Instructions at TR, Vol. III, at 137.) The jury returned a verdict in favor of George The renewed motions of Client and Johnson for judgment pursuant to Fed. R. Civ. P. 50(b) or, alternatively, for a new trial pursuant to Fed. R. Civ. P. 59 were denied. (R. 136 Opinion and Order.)

II. STATEMENT OF FACTS REGARDING George INSURANCE COVERAGE

Client applied to George for "comprehensive" coverage, including coverage of claims made against Client because of the negligence or alleged negligence of Client subcontractors (coverage sometimes known as "owners and contractors protective" or "independent contractor" coverage). (William Cowgill TR, Vol. I, at 124.) The insurance agent's handwritten insurance application, showing clearly that the independent contractor coverage was applied for, was introduced as Plaintiff's Exhibit 29-A. (William Cowgill TR, Vol. I, at 121.)

The relevant George policies, as written (i.e., without the exclusion), do provide the owners and contractors protective coverage. (TR, Vol. I, at 142.) The coverage is provided automatically, without the need for a separate endorsement. (

[redacted] TR, Vol. II, at 141.) The owners and contractors protective coverage provides insurance in the event the insured suffers a loss because of conduct of a subcontractor. ([redacted] TR, Vol. II, at 141.) The subcontractor coverage is not limited by any part of the policy other than the missing exclusion. ([redacted] TR, Vol. I, at 142.) Consequently, the George policies as written, without the exclusion, did provide coverage of Client for the claims arising out of the 12- Mile Bridge accident. ([redacted] TR, Vol. II, at 141.)[6]

Insurance certificates, issued by the agent to provide proof that Client was insured, show clearly that Client had the independent contractor coverage from George (Defendant's Trial Exhibits [redacted]-8 and [redacted]-9, [redacted] TR, Vol. II, at 9-10.)

The partners of Client who had responsibility for purchasing the George coverage were assured by their agent that they had coverage in the event they were sued because of a mistake by a subcontractor and were never told that the coverage was qualified in any way. [redacted] TR, Vol. II, at 103-104; [redacted] TR, Vol. III, at 14.)

Client purchased its first "comprehensive" general liability policy from George for the May 1987 to June 1988 policy period. The policy was renewed for the 1988-1989 and 1989-1990 policy periods. Not one of these policies referred to any professional liability exclusion, by reference to a policy number or otherwise. Not one of these policies had any type of professional liability exclusion attached. (See, Insurance Policies introduced as Defendant's Trial Exhibits [redacted]-1, [redacted]-2, and [redacted]-3.)

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[6] The District Court indicated at a bench conference that he would find, as a matter of law, that the George policy provided coverage of the [redacted] Claims if the jury found that the contract should not be reformed. (Bench Conference TR, Vol. III, at 70.)

[redacted] also purchased its first [redacted] umbrella lability policy (called "commercial catastrophe" policy) for the same May 1987 to June 1988 policy period and renewed the policy for the 1988-1989 and 1989-1990 policy periods. The first of these policies had professional liability exclusion form 221-4220 attached to the policy. The first renewal of this policy had a different professional liability exclusion (form 471-0009) attached to the policy. The exclusion attached to the first umbrella policy does not clearly eliminate coverage of "professional claims" brought because of subcontractor negligence. The exclusion attached to the first renewal of the [redacted] umbrella (which mirrors the CG 22431185 exclusion advocated by [redacted] for the general liability policy) does exclude coverage of claims brought as a result of professional services performed "by you or for you." It is this "by you or for you" language, found in the exclusion attached to the second [redacted] umbrella policy, **but not the first policy and not the last policy**, which [redacted] contends eliminates the coverage of claims brought because of subcontractor negligence. ([redacted] TR, Vol. III, at 86-87.) The renewal policy for the period in which the 12-Mile Bridge accident occurred (June 1989) referred to "form 471-0009," but did not either describe or attach the exclusion. See, Insurance Policies introduced as Defendant's Trial Exhibits [redacted]-4, [redacted]-5, and [redacted]-6.)

[redacted] applied for subcontractor coverage, it received that coverage from [redacted] and it relied upon that coverage from [redacted] Yet, the professional liability exclusion which [redacted] seeks to attach (retroactively) to the policies completely eliminates the subcontractor coverage.[7] Neither of the [redacted] employees who testified could give even one example of a

[7] Not surprisingly, [redacted] seeks to reform the policies to add the exclusion with the "by you or for you" limitation, even though there is no proof that any officer or employee of [redacted] ever saw that language.

claim against [redacted] because of subcontractor negligence which would be covered by [redacted] if the professional liability exclusion were attached. ([redacted] TR, Vol.2, at 143-144; [redacted] TR, Vol.3, at 76-82.) Mr. [redacted] did pose an example of a subcontractor employee who dropped a hammer off the bridge on a car and suggested initially that claims against [redacted] because of that conduct of its subcontractor would be "general liability" claims covered by the [redacted] policy. However, when examined about the liability theories which might be used by a plaintiff in such a circumstance, Mr. [redacted] had to admit that all of the theories sounded like "professional liability" theories -- which would take the claims, in Mr. [redacted]' view, outside of the coverage of the [redacted] policy. Counsel for [redacted] and Mr. [redacted] had the following exchange which highlights the difficulty of the [redacted] position in this case:

> Q. It is true, is it not, Mr. [redacted], that the purpose of protective liability insurance is to protect insureds in the event there is a claim that they should have supervised a sub and they didn't?
>
> A. Yes, that is true --
>
> Q. All right.
>
> A. -- for general liability purposes.
>
> Q. Okay. But supervision is professional; isn't it?
>
> A. I see what you are saying. Okay.
>
> Q. You see the difficulty, don't you Mr. [redacted]?
> A. Yes, sir.

([redacted] TR, Vol.3, at 85.)

III. STATEMENT OF [redacted] POSITION ON APPEAL

The [redacted] right to reimbursement from [redacted] for purposes of this Appeal is derivative of the rights of [redacted] and, consequently, the interests of [redacted] and [redacted] in this appeal are the same. At the opening of the trial, counsel for [redacted] stated its position that the recent Kentucky Supreme Court decision in Zurich American Insurance Company v. Haile, Ky., 882 S.W.2d 681 (1994), required it only to intervene, but not to actively prosecute the action. (Conference at TR, Vol. I, at 4.)[8] Counsel for [redacted] went on to say that [redacted] would be bound by any decision regarding reformation regardless of its participation or lack of it at trial. (Conference at TR, Vol. I, at 4.) Counsel for [redacted] also offered certain stipulations regarding the [redacted] policy and the amount paid by [redacted] in connection with the [redacted] Claims (R. 111 Offer of Stipulation of Fact.) to which counsel for [redacted] and [redacted] agreed. (Conference at TR, Vol. I, at 4.)

[redacted] joins in this Appeal on the same terms and for the same purposes. Should the judgment of the District Court be reversed and [redacted] denied reformation of its policies, counsel for [redacted] has acknowledged that the issue of whether the [redacted] coverage is "primary" is a question for the District Court, without a jury. (Conference at TR, Vol. I, at 6.)

Counsel for [redacted] will present Appellants' case during oral argument.

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[8] The Court in Zurich held that:

> With workers' compensation statutory subrogation, as with contractual subrogation, the insurer's right is a right to reimbursement, strictly derivative, with no right to maintain the action independently so long as the insured is pursuing the claim.

Id. at 685 (emphasis supplied). The Court explained that the proper role for Zurich was to notify the Court of its claim for reimbursement by filing an intervening complaint.

SUMMARY OF ARGUMENT

I. George DID NOT PROVE MUTUAL MISTAKE

This should have been an easy case. Client applied for and received insurance coverage from George for claims made because of subcontractor conduct. There was no proof of mutual mistake; no proof that Client knew that the unattached exclusion would eliminate the subcontractor coverage. Kentucky law is that exclusions are to be narrowly interpreted and all doubts resolved in favor of coverage. St. Paul Fire & Marine v. Powell-Walton-Milward, Ky., 870 S.W.2d 223 (1994). So what happened?

Among the reasons for the errors in this case is the fact that George confused the issue by failing to join the issue. In many ways, the George and Client theories of this case were like two ships passing in the night. Even after the ruling of this Court in the first appeal, George continued to assert that because Client had a professional liability policy to cover *its own acts* of professional negligence, Client must *necessarily* have known that its George policies did not provide coverage for Client in the event Client was sued because of alleged professional negligence of *its subcontractors*. According to this view, no proof other than the existence of a separate "professional liability" policy was necessary for George to win on the reformation issue.

On the other hand, Client has conceded (in its brief to the Sixth Circuit in the earlier appeal) that if the term **"professional liability"** is so clear and obvious as to cover claims made because of alleged subcontractor negligence, then Client must lose this case. Client asserts instead that the term is not so clear as claimed by George and Client asserts that it

believed that the George policy did provide coverage for any claims brought because of the alleged negligence of subcontractors. *Counsel for* Client *has consistently contended that the knowledge of* Client *regarding its subcontractor coverage is the only relevant inquiry in this action.*

This fundamental issue has been resolved, properly so, by the Sixth Circuit, consistently with the Client view. The Court of Appeals ruled that George was required to prove, by clear and convincing evidence, not only that Client knew or should have known that George intended to include a professional liability exclusion, but also that:

> . . . Client knew or should have known the exact scope of that restriction -- including that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence by its subcontractors, as well as liability for its own active professional negligence.

George v. Client [redacted] (Emphasis supplied.) George did not prove that "Client knew or should have known the exact scope of that restriction."

George continues to fight a battle it lost long ago. It continues to argue that the existence of the professional liability coverage is dispositive.

There was no proof that Client partners or employees actually knew "that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence by its subcontractors." In fact, the testimony of Mr. [redacted] and Mr. [redacted] was to the contrary. The very best that can be said of the George case, consequently, is that, because of certain inferences Client could have made, Client "should have known" about the exclusion and its effect on claims made because of subcontractor negligence.

The George case boils down to the inferences to be drawn from the following facts and circumstances: (a) Client did purchase a professional liability policy from a different insurer and knew that the George policy did not cover Client own professional liability, (b) the insurance premium for the professional liability policy was substantially larger than the premium charged for the George policies, and (c) other policies, including the [redacted] Casualty general liability policy (in effect prior to the purchase of the first George policies) and the George umbrella policy for the year prior to the year of the accident, had the professional liability exclusion advocated by George (See, George closing argument at TR, Vol. III, at 112-131.) None of these facts allow a judgment that Client should have known that subcontractor coverage, provided by the policy as written, was to be compromised.

The analysis of the claim for reformation of the relevant umbrella policy is only slightly different. That policy did refer to a professional liability policy form number, but it did not either describe or attach the form. This reference was not sufficient, under Kentucky law, to put Client on notice that the subcontractor coverage provided by the umbrella policy was to be compromised. The case of Twin City Fire Ins. Co. v. Terry, Ky., 472 S.W.2d 248 (1971), is directly on point. The court there held that a reference, by form number, to an unattached policy exclusion was not sufficient to make the exclusion a part of the policy.

There was no direct evidence that Client knew or should have known of the George intent to attach the exclusion and none of the circumstantial evidence allows the drawing of inferences which establish mutual mistake "clearly and convincingly." The motions of Client and Johnson for judgment as a matter of law should have been granted.

II. PROOF OF ACTUAL AGREEMENT IS REQUIRED;

THE "SHOULD HAVE KNOWN" STANDARD DOES NOT APPLY:

An additional contribution to the errors in this case was made by the "should have known" standard, which was used by the jury and the District Court to evaluate the George proof. At the close of all the evidence in the case, the District Court instructed the jury that:

> To reform the insurance contracts in question, the evidence must show that Client Engineering Company knew **or should have known** that the [George policies were] to contain the Architect's and Engineer's Professional Liability Exclusionary Endorsement then in use by George Insurance Company.

(Emphasis supplied.) (Jury Instructions TR, Vol. III, at 137.)

The language of the instruction allowing the jury to find that George could establish mutual mistake on the basis of what Client "should have known" is taken from this Court's decision in the earlier appeal, but is clearly an incorrect statement of the Kentucky law on mutual mistake. The Sixth Circuit's statements that George can prevail on a showing that Client "should have known" of the effect of the exclusion should be taken as mere dicta. The statement was not necessary for resolution of the appeal, and, as discussed in more detail below, the statement is not consistent with Kentucky law, which requires clear and convincing proof of actual agreement, Campbellsville Lumber Co. v. Winfrey, Ky., 303 S.W.2d 284 (1957), or the unilateral mistake of one party and fraud on the part of the other, Grigsby v. Mountain Valley Insurance Agency, Ky., 795 S.W.2d 372 (1990). There was no proof in this case that Client actually agreed to an exclusion which would adversely affect coverage of subcontractor claims and there was no allegation (and no proof) that Client was guilty of fraud in connection with the issuance of the policies.

If either the jury or the District Court had used the proper standard, i.e., proof of actual agreement, the verdict would have been in favor of Client

III. THE INSTRUCTION REGARDING THE EXCLUSION "THEN IN USE" WAS CLEARLY IMPROPER:

The instruction quoted above had another fatal flaw. With its other instructions, the Court instructed the jury that:

> To reform the insurance contracts in question, the evidence must show that [redacted] Engineering Company knew or should have known that the [[redacted] policies were] to contain the Architect's and Engineer's Professional Liability Exclusionary Endorsement **then in use** by [redacted] Insurance Company.

(Emphasis supplied.) (Jury Instructions TR, Vol. III, at 137.) The plain meaning of this instruction allowed (indeed required) the jury to find the obvious -- that [redacted] should have known that [redacted] intended to attach all the endorsements, "then in use," including the professional liability exclusion endorsement. Of course, [redacted] should have known that [redacted] intended that its policies be complete. Every insured everywhere should at least suspect that the insurer intends to deliver a correct, complete policy, i.e., a policy with all the parts "then in use." If the analysis stops here, the insurance company will win every missing endorsement case. The analysis does not stop there, however, and the question which should have been decided was whether [redacted] actually agreed to the attachment of an endorsement which "would eliminate coverage for [redacted] vicarious liability for acts of professional negligence by its subcontractors."

ARGUMENT

I. George DID NOT PROVE MUTUAL MISTAKE

A. Standard of Review:

The Court's standard of review on an appeal of a decision on a motion for judgment as a matter of law was discussed in Phelps v. Yale Security, 986 F.2d 1020 (6th Cir. 1993). This Court there held that:

> This court's standard of review of a judgment notwithstanding the verdict is identical to the standard used by the district court. Marsh v. Arn, 937 F.2d 1056, 1060 (6th Cir.1991). We do not weigh the evidence, evaluate the credibility of the witnesses, or substitute our judgment for that of the jury. Schrand v. Federal Pac. Elec. Co., 851 F.2d 152, 154-55 (6th Cir.1988). Instead, we must view the evidence in the light most favorable to the party against whom the motion is made, and give that party the benefit of all reasonable inferences. Id. The motion should be granted, and we should affirm if reasonable minds could not come to a conclusion other than one in favor of the movant. Id.

Id. at 1023.

However, this Court's standard of review must be informed by the Kentucky law of insurance contracts, which (as discussed below) provides that exclusions are to be strictly construed and all reasonable inferences are to be drawn to favor coverage -- in this case in favor of Client St. Paul Fire & Marine v. Powell-Walton-Milward, Ky., 870 S.W.2d 223 (1994). Moreover, the burden on George in the present case is much greater than that imposed on the usual plaintiff. George had to prove, by clear and convincing evidence, that Client actually agreed to the inclusion of the missing endorsement. Campbellsville Lumber Co. v. Winfrey, Ky., 303 S.W.2d 284 (1957). This standard should also inform this Court's standard of review.[9]

[9] There is some question about whether this reformation case should have been

B. Conflicts Between Reasonable Inferences Are to Be Resolved in Favor of Coverage:

Even if George needed only to prove that Client "should have known" of the effect of the exclusion, such proof still needed to be clear and convincing. The only direct evidence was that Client understood that its George policy provided subcontractor coverage. The only "evidence" supporting the George position in the case is circumstantial; the evidence consists of inferences which George believes can be drawn from the evidence. However, under Kentucky law all reasonable inferences favoring coverage must be adopted and all the most reasonable inferences available in this case point to the conclusion that Client had the reasonable expectation that claims made because of subcontractor coverage would be covered by the George policies.

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tried to the jury. This issue was briefed before trial, but neither party cited this Court's decision in Nat Harrison Assoc., Inc. v. Louisville Gas & Elec. Co., 512 F.2d 511 (6th. Cir.), cert. denied, 95 S. Ct 1992 (1975). The issue there had been tried to a jury without objection from either party, but the Sixth Circuit noted, in footnote 2, that contract reformation is "equitable in nature and hence triable to the court." Id. at 512.

A long line of Kentucky cases, ending with St. Paul Fire & Marine v. Powell-Walton-Milward, Ky., 870 S.W.2d 223 (1994), have addressed the issue of the drawing of inferences about coverage. The facts addressed in St. Paul Fire & Marine v. Powell-Walton-Milward are very like those presented by the George argument. The Kentucky Supreme Court, on a request for certification from the United States Court of Appeals for the Sixth Circuit, was asked to interpret conflicting provisions in a professional liability policy provided by St. Paul to Powell-Walton-Milward (PWM). An exclusion, clear on its face, was in conflict with or susceptible of two meanings when considered in connection with other parts of the contract. The relevant provisions could be interpreted by reasonable minds in at least two ways, one of which provided coverage of the claims made against PWM, one of which excluded the claims from coverage.[10] In resolving the conflict in favor of coverage the court there held:

> Any limitation on coverage or an exclusion in a policy must be clearly stated in order to apprise the insured of such limitations. Stated otherwise, not only is the exclusion to be carefully expressed, but, as in this case, the operative terms clearly defined.[11]
>
> . . . . As to the manner of construction of insurance policies, Kentucky law remains clear that exclusions are to be narrowly interpreted and all questions resolved in favor of the insured. Eyler v. Nationwide Mut. Fire Ins. Co., Ky., 824 S.W.2d 855 (1992).
>
> A policy of insurance is to be construed liberally in favor of the insured and if, from the language, there is doubt or uncertainty as to its meaning, and it is susceptible to two interpretations, one favorable to the insured and the other

[10] In fact, two different Judges in the United States District Court for the Eastern District of Kentucky interpreted the provisions in two different ways, one providing the coverage, one excluding it.

[11] The George policies did not define the terms "professional" or "profession liability".

favorable to the insurer, the former will be adopted. Koch v. Ocean Accident & Guar. Corp., 313 Ky. 220, 230 S.W.2d 893 (1950).

Id. at 226-227. (Emphasis supplied.)

The circumstances favoring coverage are much stronger in this case than those presented in St. Paul Fire & Marine v. Powell-Walton-Milward. In that case the insured was an insurance agency, a professional in the business of insurance, capable of understanding the insurer's interpretation of conflicting policy provisions. In this case, the insured is not in the business of insurance, and George argues that the insured not only had to guess about the existence of the exclusion (because it was not a part of the policies), it should have guessed about the scope of the exclusion.

C. Allowable Inferences Do Not Establish that Client "Should Have Known":

The uncontradicted testimony was that Client expected to be covered under the George policies for claims brought because of subcontractor negligence. The policies did provide coverage of at least some claims brought because of subcontractor negligence -- because the owners and contractors protective coverage was provided. No evidence was produced which can be reasonably be said to have clearly and convincingly qualified the Client expectation that all claims brought because of subcontractor claims were covered by the George policies. Yet, the George underwriter and claims representative (Mrs. [redacted] and Mr. [redacted] both admitted on cross examination that the professional liability exclusion eliminated the subcontractor coverage; neither could think of a type of claim brought because of subcontractor conduct that would not be eliminated by the missing exclusion. ([redacted] at TR, Vol. II,

at 143-144; [redacted] at TR, Vol. III, at 76-82.) Consequently, the George argument is that Client should have inferred that George intended, through an unattached, unknown exclusion, to exclude coverage which was applied for and provided by the policy. No such inference can be clear and convincing and, consequently, no such inference should be drawn. Nevertheless, each of the inferences urged by George is discussed below.

Inferences to be Drawn from Professional Liability Policy

The partners of Client knew they had purchased a professional liability insurance policy (from Johnson Insurance Company) covering their own professional negligence and knew the George policy did not provide such coverage. On the other hand, they were told, in general, unqualified terms, that the George policies did provide coverage in the event Client was sued because of subcontractor negligence. The inference actually drawn from these facts was that the professional liability policy provided coverage for the errors and omissions of Client partners and employees, but that the George policy provided coverage of claims, including "professional" claims, brought because of subcontractor negligence. This inference was and is reasonable and, in fact, is the only reasonable interpretation of the information which was available to the partners of Client Because the Client interpretation of its policies was reasonable, Kentucky law requires the adoption of that interpretation.

Inferences to be Drawn from the Differences in Premiums

George also made the argument that, since the professional liability policy was several times more expensive than the general liability policy, Client "should have known" or inferred "that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence by its subcontractors." The more obvious inference is that the

professional liability policy provided coverage for errors and omissions of [redacted] partners and employees, that this risk was relatively great, and that this risk was not covered by the general liability policy. The inference that subcontractor coverage was to be eliminated is in obvious conflict with the subcontractor coverage actually provided and, consequently, such an inference is not only not reasonable, it is improper under St. Paul Fire & Marine v. Powell-Walton-Milward, supra.

There was no evidence that anyone ever explained the calculation of premiums to any partner of [redacted] Moreover, Mrs. [redacted] testified that, in any event, the premium to be charged for coverage of subcontractor liability would be small (because, while the loss might be high in respect to any particular incident, the risk of loss was relatively low). ([redacted] TR, Vol. II, at 156.) There was, in other words, no reason for [redacted] to draw any conclusions about the subcontractor liability coverage from the relative size of the premiums charged with respect to the different policies.

Inferences to be Drawn from the Existence of Exclusions in Other Policies

Finally, [redacted] made the argument that, because of the existence of the exclusion in other policies, [redacted] "should have known" or inferred that the exclusion was to be attached to the [redacted] policies and "that the rider would eliminate coverage for [redacted] vicarious liability for acts of professional negligence by its subcontractors."

The CG22431185 exclusion was attached to the previous policy obtained by [redacted] from [redacted] Casualty Company, in a policy which was approximately 60 pages long and which contained a copy of both versions of the professional liability exclusion. ([redacted] at TR, Vol. I, at 129, and at TR, Vol. II, at 39.) However, no one testified that

[redacted] should have reviewed the [redacted] Casualty policy or that they were advised to review it. In fact, Mr. [redacted] was confident of the obvious -- that he did not suggest to the partners of [redacted] that they review policies from other insurers in order to determine the scope of the coverage of the [redacted] policies.[12] ([redacted] at TR, Vol. II, at 40.)

An exclusion (with a different form number, but with the same substance as the CG22431185 form) was also attached to the [redacted] umbrella policy for the year prior to the year of the accident. Here again, however, the testimony was that no one told [redacted] that it should review its umbrella policies in order to determine what its general liability policies included. If anything, one might conclude that [redacted] should have reviewed the umbrella policy for the first year in which it was obtained. Even if [redacted] had done that, and if [redacted] had reasoned from that to draw conclusions about its general liability policy, [redacted] would not have known that the exclusion was broad enough to exclude subcontractor claims (because the exclusion attached to the first umbrella did not have the "or for you" language).

Drawing the inference suggested by [redacted] has the effect of imposing a duty on [redacted] not only to read and understand other insurance policies, but also the virtually impossible duty to read and understand the right, or most nearly analogous, policy and, and, from that policy, to read and understand the correct exclusion. The imposition of such a duty is not only unreasonable, it is not allowed by Kentucky law. The decision of the Kentucky

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[12] In 1986, just prior to the purchase of the first [redacted] policies, 90% of the existing partnership interests of [redacted] were transferred from retiring partners to employees of [redacted] and [redacted] came under new management. The new partners were not responsible for the purchase of the policies in existence prior to the purchase of the [redacted] policies. ([redacted] at TR, Vol. II, at 66-67; [redacted] at TR, Vol. II, at 73-75.)

Supreme Court in Grigsby v. Mountain Valley Insurance Agency, Ky., 795 S.W.2d 372 (1990), is illustrative.

Grigsby involved a claim against an insurance agent for failure to provide "bailed goods" coverage in a commercial fire insurance policy. The agent defended, in part, by contending that the insured had a duty to read its policy and, if it had read the policy, the insured would have known that the bailed goods coverage was not provided. The Court rejected this argument, holding:

> Due to the highly technical nature of fire insurance policies, an insured may not be held contributorily negligent for the failure to read and understand his or her coverage. [P]olicies of fire insurance are rarely examined by the insured, and even where examined are not always enlightening to him, due to the technical and complicated language in which the contract is usually couched. Another practical factor considered is that the applicant usually tells the insurer's agent of his coverage necessities and relies on the agent for a policy in accordance therewith. For these reasons, most courts do not demand the same degree of vigilance and critical examination of fire insurance policies as would be expected of some other instruments. 43 Am.Jur.2d Sec. 373. We will not impose a duty upon the insured to become well versed in the technical language contained in fire insurance policies. That part of the trial court's conclusions to the contrary is legally erroneous. . . .
>
> In other words, the insured's failure to read and comprehend the policy has no legal effect: it may not serve as a sword for the insured nor as a shield for the agency. This is true whether the underlying claim is for contract reformation or recovery based upon negligence of the agency.

Id. at 373-374.

The policies offered into evidence in this case make clear that liability policies are no less "technical" than fire policies and, where Kentucky courts are unwilling to impose a duty on an insured to read and comprehend the policy which is the correct policy, the jury should not be allowed to impose a duty to read other unrelated or only marginally related policies.

D. George did not prove mutual mistake with regard to the umbrella policy:

In the main, since the endorsement was not attached to the relevant George umbrella policy, the analysis of the "mutual mistake" is the same for the umbrella policy as it is for the general liability policy. However, the umbrella policy did refer to, without explaining, form number "471-0009" and George urged that KRS 304.14-240 and the doctrine of incorporation by reference applied to require a finding that the exclusion was a part of the policy.

The statute relied upon by George provides as follows:

> 304.14-240 Renewal of policy.
>
> Any insurance policy terminating by its terms at a specified expiration date and not otherwise renewable, may be renewed or extended at the option of the insurer, upon a currently authorized policy form and at the premium rate then required therefor, for a specific additional period or periods by a certificate or by indorsement of the policy, and without requiring the issuance of a new policy.

The George view is, apparently, that the effect of this statute is to incorporate into the terms of the 1989-1990 umbrella policy all of the terms which may have existed in the prior George umbrella policy. This interpretation is not justified. The plain meaning of the statute is that a policy may be renewed by the issuance of "a certificate or by indorsement of the [renewed] policy", in other words, by some clear indication that none of the terms of the policy changed and that the insured should look entirely to the policy for the prior year for a complete understanding of the policy provisions. That is not the approach George took with respect to the 1989-1990 umbrella policy. No "certificate" or "indorsement" of the prior policy was issued.

No Kentucky court has yet interpreted this statute, which was adopted in 1970, but Kentucky's highest court has, after the adoption of the statute, determined that there is no

incorporation by reference of exclusions in insurance policies in Kentucky. Twin City Fire Ins. Co. v. Terry, Ky., 472 S.W.2d 248 (1971).

The issue presented in Twin City was very like that presented by the 1989-1990 George umbrella. The insured there proved that he had not received the part of the policy ("Form 4024") which required suits on the policy to be filed within one year of the loss. The part of the policy which was delivered contained this reference:

> 'This Declarations page, with 'POLICY PROVISIONS--PART 1,' Form 4024, and endorsements, if any, issued to form a part thereof, completes the below numbered STANDARD FIRE INSURANCE Policy.'

Like form "471-0009" in the George umbrella, the form 4024 was referred to, but not described.

The Court in Twin City relied upon KRS 304.14-180[13], also adopted in 1970, and a substantial body of Kentucky case law, and held that the reference to "form 4024" was not sufficient to bring the terms of form 4024 into the policy:

> It seems plain that the legislative policy in this jurisdiction, as interpreted in previous decisions by this court, requires that all terms of an insurance contract be 'plainly expressed' in the policy itself. This would appear to foreclose the possibility of incorporation by reference as related to insurance policies. For these reasons the court is not persuaded to follow the cases from foreign jurisdictions which are cited by the company. It is not discernible from those cases whether there were statutory provisions comparable to Kentucky's. But if such incorporation were permissible, the meager statements in the form delivered to the insured were insufficient to put him on notice or inquiry.

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[13]304.14-180 Must contain entire contract -- Exception concerning additional benefits.

> (1) No agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy.
>
> (2) No insurer or its representative shall make any insurance contract or agreement relative thereto other than as is plainly expressed in the policy. . . .

Id. at 250. (Emphasis supplied.) Twin City has not been overruled or distinguished and nothing in the case or in KRS 304.14-180 suggest that the rule -- that exclusions must be "plainly expressed" -- is not applicable to policy renewals. The meager reference to form 471-0009 in the George umbrella was not sufficient to put Client on notice or inquiry that the policy excluded claims based on subcontractor negligence.[14]

The reference to "form 471-0009" has no effect and, consequently, the analysis of the umbrella must be the same as that for the general liability policy and the conclusion is the same -- allowable inferences from the circumstantial evidence do not establish, clearly and convincingly, that "Client knew or should have known the exact scope of that restriction."

II. PROOF OF ACTUAL AGREEMENT IS REQUIRED; THE "SHOULD HAVE KNOWN" STANDARD DOES NOT APPLY:

A. Standard of Review:

This question of law should be reviewed *de novo*. Loudermill v. Cleveland Bd. of Educ., 844 F.2d 304 (6th Cir. 1988); United States v. Brown, 988 F.2d 658 (6th Cir. 1993).

B. Argument:

In its opinion on the first appeal in this case, this Court suggested that George could prevail in this case on proof that Client "should have known" about the broad scope of the

[14] But for an old case holding that the predecessor of KRS 304.14-180 does not change the law of mutual mistake, this case would be resolved merely by reference to the statute --which clearly sets forth the public policy in this state that exclusions of coverage must be clearly expressed in a writing which is made a part of the policy. See, Westchester Fire Ins. Co. v. Wilson, 220 Ky. 142, 294 S.W. 1059 (1927).

exclusion intended by George [redacted] v. Client [redacted]. The District Court incorporated this dicta into its jury instructions and relied upon it in its decision to deny the Client and Johnson motions for judgment as a matter of law. (R 136 Opinion and Order at 7.) However, that dicta is an inaccurate statement about Kentucky law, which requires clear and convincing proof of actual agreement, Campbellsville Lumber Co. v. Winfrey, Ky., 303 S.W.2d 284 (1957), or of the unilateral mistake of one party and fraud on the part of the other, Grigsby v. Mountain Valley Insurance Agency, Ky., 795 S.W.2d 372 (1990). Neither Campbellsville Lumber nor Grigsby has been overruled or distinguished.

This part of the Sixth Circuit's decision can and should be viewed only as dicta. It was not necessary to resolution of the appeal (which involved only the question of whether there were genuine issues of material fact on the issue of the intent of the parties) and was not briefed by the parties. Consequently, the statement that a contract should be reformed on the basis of mutual mistake where one party "should have known" of the intentions of the other cannot be taken as the law of the case or as binding precedent. See, Schwabenbauer v. Bd. of Educ. of City of Olean, 777 F.2d 837 (2nd Cir. 1985) and Great Lakes Dredge & Dock Co. v. Tanker, 957 F.2d 1575 (11th Cir. 1992).

In its discussion of the Kentucky law on mutual mistake, the Sixth Circuit cited Deskins v. Leslie, Ky., 387 S.W.2d 596 (1965), Nat Harrison Assoc., Inc. v. Louisville Gas & Elec. Co., 512 F.2d 511 (6th. Cir.), cert. denied, 95 S. Ct 1992 (1975) and Campbellsville Lumber. George v. Client [redacted] Of these cases, only Nat Harrison has any mention of what a party "should have known" and that case was not a

mutual mistake case.[15] The plaintiff there (Harrison) alleged unilateral mistake in submitting a bid for construction work "accompanied by fraud or inequitable conduct on the part of Louisville [the defendant] in accepting the bid, when it knew or should have known that a material mistake had been made in the bid." Id. at 513. Nat Harrison, consequently, is clearly not applicable to this case. George has not alleged unilateral mistake "accompanied by fraud or inequitable conduct."

The Sixth Circuit, in a circumstance in which the distinction did not matter in the outcome of the appeal, failed to distinguish between those cases dealing with reformation because of mutual mistake and reformation of contracts because of the unilateral mistake of one party and fraud or inequitable conduct on the part of the other. A moment's reflection is all that is necessary to know that the law is not and cannot be that written agreements may be reformed upon a mere showing that one party was mistaken and the other party should have known of the mistake. In the insurance context, especially where the insurer is seeking reformation, a "should have known" standard is directly contrary to the often stated rule that insurance contracts will be construed against the insurer and the public policy in Kentucky that "[n]o agreement in conflict with, modifying, or extending any contract of insurance shall be valid unless in writing and made a part of the policy." KRS 304.14-180(1). Moreover, the insurer would not be advocating a "should have known" rule were the insured seeking to reform the policy. One can hardly imagine the insurance industry agreeing that a policy can be reformed on a showing that the insurer "should have known" what the insured intended when the insurance was purchased. It is

[15] Neither George nor Client cited Nat Harrison to the Court in the first appeal.

not a stretch to conclude that insurers "should know" that insureds do not intend that their policies have any exclusions; but, this should not be sufficient to nullify clearly stated exclusions. The dicta in the earlier opinion in this case, that a contract may be reformed on the basis of what a party "should have known," is a radical departure from existing contract law and, in the insurance context, puts insureds and insurers at considerable risk.

Absent a showing of fraud on the part of [redacted] Campbellsville Lumber clearly requires proof of [redacted] actual agreement on the terms of the missing exclusion. The commentators are in agreement on this point. See, for example, 13A Appleman, Ins. L. & P., §7608 Reformation -- Limitations on Power to Grant (1992)(Pocket Part) ("Reformation must be consistent with complete mutual understanding of essential terms of bargain.") The drafters of the Restatement also make clear the distinction between reformation because of mutual mistake and reformation because of unilateral mistake and fraud. Contrast, Rest. 2d Contracts §155 ("When Mistake of Both Parties as to Written Expression Justifies Reformation") with §166 ("When Misrepresentation as to a Writing Justifies Reformation").

Whether the Sixth Circuit was incorrect in suggesting a "should have known" standard is now a moot point. [redacted] has conceded, as it must, that Kentucky law (like the law in most jurisdictions) requires clear and convincing proof of actual agreement between the parties before a contract may be reformed because of mutual mistake. For example, on page 3 of its Response to the Motions for New Trial (R. 134 Response at 3) [redacted] stated that the issue presented to the jury was "the determination of what the agreement was to have been." Further, on page 12 of its Response (R. 134 Response at 12), [redacted] discussed the leading Kentucky case on the matter:

> Campbellsville Lumber Co. v. Winfrey, 303 S.W.2d 284 (Ky. 1957) requires simply there be evidence that the actual agreement of the parties was different from that expressed in the writing and that this evidence be clear and convincing. . . . . The fact finder's responsibility is to determine what the agreement was to have been . . . .

Finally, on page 13 of its Response (R. 134 Response at 13), George stated that the jury's charge "was to find what the parties' agreement actually was . . . ."[16]

There was no proof that "Client knew . . . the exact scope of that restriction -- including that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence by its subcontractors" and, consequently, judgment should be entered denying reformation of the policies.

III. THE INSTRUCTION REGARDING THE EXCLUSION "THEN IN USE" WAS CLEARLY IMPROPER:

A. Standard of Review:

Jury instructions are to be reviewed as a whole to determine whether they adequately inform the jury of the relevant considerations and provide a basis in law for aiding the jury in reaching its decision. A judgment can be reversed if the instructions, viewed as a whole, were confusing, misleading, or prejudicial. Black v. Ryder/P.I.E. Nationwide, 970 F.2d 1461(6th Cir. 1992).

B. Argument:

George has argued, in essence, that: (a) the evidence allowed the jury to find that the parties actually agreed "that the rider would eliminate coverage for Client vicarious liability for acts of professional negligence by its subcontractors," and (b) the instructions allowed the jury to make that finding. Neither assertion is correct.

[16] Unfortunately, the jury was not charged with that duty.

The instruction quoted above had another fatal flaw. With its other instructions, the Court instructed the jury that:

> To reform the insurance contracts in question, the evidence must show that [redacted] Engineering Company knew or should have known that the [[redacted] policies were] to contain the Architect's and Engineer's Professional Liability Exclusionary Endorsement **then in use** by [redacted] Insurance Company.

(Emphasis supplied.) (Jury Instructions TR, Vol. III, at 137.) The plain meaning of this instruction allowed (indeed required) the jury to find the obvious -- that [redacted] should have known that [redacted] intended to attach all the endorsements, "then in use," including the professional liability exclusion endorsement. Of course, [redacted] should have known that [redacted] intended that its policies be complete. Every insured everywhere should at least suspect that the insurer intends to deliver a correct, complete policy, i.e., a policy with all the parts "then in use." If the analysis stops here, the insurance company will win every missing endorsement case. The analysis does not stop there, however, and the question which should have been decided was whether [redacted] actually agreed to the attachment of an endorsement which "would eliminate coverage for [redacted] vicarious liability for acts of professional negligence by its subcontractors."

CONCLUSION

The Court should enter judgment as a matter of law denying reformation of the [redacted] policies, awarding [redacted] damages for the losses incurred by [redacted] as the result of [redacted] failure to defend and indemnify [redacted] from the claims asserted because of the 12-Mile Bridge accident and awarding interest on the liquidated (and stipulated) amount. No

reasonable person fact finder can conclude that George carrier its burden of proof to show, clearly and convincingly, that Client agreed to the exclusion which eliminated the subcontractor coverage Client applied for, received and relied upon. The jury decided as it did, more likely than not, because it was not provided with the proper standards for review of the George evidence; the instructions given to the jury were not an accurate statement of the law of mutual mistake.

Respectfully submitted,

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ATTORNEY FOR Client

ATTORNEYS FOR INTERVENING PLAINTIFF - APPELLANT, Johnson INSURANCE COMPANY OF

CERTIFICATE OF SERVICE

This is to certify that two copies of this Appellants' Joint Brief has been delivered this 21st day of August, 1995, via regular mail, postage pre-paid, to [redacted]

[redacted]

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D. Duane Cook

[redacted]

ADDENDUM A - DESIGNATION OF JOINT APPENDIX CONTENTS

Appellants, pusuant to Sixth Circuit Rule 11(b), designate the following to be included in the joint appendix:

Description:	Docket Date:	Record Entry No.
District Court Docket Sheet		
Transcript of Trial		
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Proposed Joint Jury Instructions	12/12/94	112
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Exhibit List (Defendant)	12/14/94	123
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Judgment in a Civil Case	12/15/94	130
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